

Get Ready To Report Your Bitcoins To IRS

By Robert W. Wood

In her annual report to Congress, U.S. Taxpayer Advocate Nina Olson said that the uses of digital currencies like Bitcoin were growing rapidly. In fact, she said that between July and December 2013, Bitcoin usage increased by over 75 percent — from about 1,700 transactions per hour to over 3,000. In the same period, the market value of Bitcoins in circulation rose from approximately \$1.1 billion to \$12.6 billion.

Olson was reporting nationally, and on a local level in California — perhaps especially in San Francisco and Silicon Valley — it has been become even more prevalent. She noted that the Internal Revenue Service has yet to issue specific guidance addressing the tax treatment or reporting requirements applicable to digital currency transactions. That left many unanswered questions that seem pretty basic, including these:

➤ When will receiving or using digital currency trigger gains and losses?

➤ When will these gains and losses be taxed as ordinary income or capital gains?

➤ What information reporting, withholding, backup withholding, and recordkeeping requirements apply to digital currency transactions?

Well, be careful what you wish for. In March, the IRS issued a bevy of questions and answers about digital currencies like Bitcoin. The biggest news is that it is considered property for tax purposes, which means that, among other things:

➤ Wages paid to employees using virtual currency are taxable must be reported on Form W-2 and are subject to federal income tax withholding and payroll taxes.

➤ Payments made to independent contractors using virtual currency are taxable, and payers must issue Form 1099.

➤ Gain or loss from the sale or exchange of virtual currency depends on whether the virtual currency is a capital asset in your hands.

➤ A payment made using virtual currency is subject to Form 1099 reporting just like any other payment made in property.

The complete IRS Notice 2014-21 includes these key points:

Q-1: How is virtual currency treated for federal tax purposes?

A-1: It is property.

Q-2: Is it currency for determining whether a transaction results in foreign currency gain or loss?

A-2: No, it is not currency that could generate foreign currency gain or loss.

Q-3: Must a taxpayer who receives virtual currency as payment for goods or services include its fair market value in income?

A-3: Yes, include the fair market value of the virtual currency. Measure it in U.S. dollars on the date the virtual currency was received.

Q-4: What is the basis of virtual currency received as payment for goods or services?

A-4: Your basis is the fair market value of the virtual currency in U.S. dollars as of the date of receipt.

Q-5: How is the fair market value of virtual currency determined?

A-5: Taxpayers are required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt. If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into U.S. dollars (or into another real currency which in turn can be converted into U.S. dollars) at the exchange rate, in a reasonable manner that is consistently applied.

Q-6: Do I have gain or loss on an exchange of virtual currency for other property?

A-6: Yes. If the fair market value of property received exceeds your adjusted basis of the virtual currency, you have taxable gain. You have a loss if the fair market value of the property received is less than the adjusted basis of the virtual currency.

Q-7: What type of gain or loss do I realize on the sale or exchange of virtual currency?

A-7: The character of the gain or loss depends on whether the virtual currency is a capital asset in your hands. A taxpayer generally realizes capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. For example, stocks, bonds, and other investment property are generally capital assets. A taxpayer generally realizes ordinary gain or loss on the sale or exchange of virtual currency that is not a capital asset in the hands of the taxpayer. Inventory and other property held mainly for sale to customers in a trade or business are examples of property that is not a capital asset.

Q-8: Does a taxpayer who “mines” virtual currency have income from mining?

A-8: Yes, when you successfully “mine” virtual currency, the fair market value is includible in your income.

Q-9: Is an individual who “mines” virtual currency as a trade or business subject to self-employment tax?

A-9: Yes.

Q-10: Does virtual currency received by an independent contractor for performing services constitute self-employment income?

A-10: Yes.

Q-11: Does virtual currency paid by an employer for services constitute wages?

A-11: Yes.

Q-12: Is a payment made using virtual currency subject to Form 1099 reporting?

A-12: A payment made using virtual currency is subject to information reporting just like other payments in property.

Q-13: If a person in business pays virtual currency worth \$600 or more to an independent contractor for services, is a Form 1099 required?

A-13: Generally, yes.

Q-14: Are payments made using virtual currency subject to backup withholding?

A-14: Yes, just like other payments made in property. Payors using virtual currency must solicit a taxpayer identification number (TIN) from the payee.

Q-15: Are there IRS information reporting requirements for a person who settles payments made in virtual currency on behalf of merchants that accept virtual currency from their customers?

A-15: Yes, if certain requirements are met.

Q-16: Will taxpayers be subject to penalties for having treated a virtual currency transaction in a manner that is inconsistent with this notice prior to March 25, 2014?

A-16: Yes, you can be penalized, but you can also ask for waivers.



Robert W. Wood is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including “Taxation of Damage Awards & Settlement Payments” (4th Ed. 2009 With 2012 Supplement www.taxinstitute.com), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.