THE FUTURE OF MONEY ISN'T FREE

Taxation of Crypto Virtual Currencies

cryp·to·cur·ren·cy

ˈkriptōˌkərənsē/

noun: crypto-currency

a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank.

Bitcoin may not be taking up space in your wallet, but you could be seeing it elsewhere. With the now burgeoning use of crypto currencies, the Internal Revenue Service (IRS) has initiated an extensive compliance program to regulate crypto reporting requirements.

The Service has determined that this is a vast area of non-compliance and will seek to audit those found to have unreported transactions on their tax returns. Following action similar to the foreign account initiative, the IRS will seek criminal charges against a taxpayer failing to report his/her activity.

Through their Criminal Investigation Division, the IRS has issued a "John Doe" summons to the Coinbase virtual currency exchange seeking taxpayer identities of all of its customers engaged in transactions of $20,000 or more. The summons requires that Coinbase, the world's most popular way to buy and sell the likes of bitcoin, ethereum, and litecoin, provide all transactional logs and correspondence from years 2013-2015 be turned over to the IRS.

Recently, the IRS issued notice 2014-21, which acknowledged virtual currencies as equivalent in value to real currency. Bitcoin is one example of a virtual currency. This currency can be traded between users and can be purchased or exchanged in US Dollars, Euros or any other government-issued traditional currency.

The IRS has taken the position that trading or exchanging goods and services in virtual currencies has tax consequences that may result in a tax liability. The Service has indicated that virtual currency has the characteristics of property, and not as a currency recognized by any government.

Therefore, if one trades in Bitcoin, for example, or uses it to purchase goods or services, if the Bitcoin has appreciated in value since it was acquired there may be a tax owed on the fair market value of the property or services received if the amount exchanged exceeds the taxpayer's adjusted basis of the Bitcoin.

If the Bitcoin is a capital asset in the hands of the taxpayer, then he/she will realize a capital gain or loss on the transaction. In essence, the Service will treat the Bitcoin exchange similarly to a stock or bond transaction. If the Bitcoin is held out for sale to others in the normal course of business, then the transaction would be considered ordinary income or loss and should be reported accordingly.

Bottom-line for users: The IRS is seeking greater compliance in this new area. There are potential risks and penalties if you are trading or utilizing these currencies. Reporting of the transactions is a requirement. Failure to accurately report can result in not just tax but interest and severe penalties.

For those taxpayers who did not understand the intricacies of cryptocurrency, it may not be too late to address the matter—your CPA can amend your returns or refer you to an experienced tax attorney. ⌘

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