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It has been over two years since the IRS came out with its initial position on the tax treatment of Bitcoin and other virtual currencies, but there has yet to be any follow-up on questions that this initial position has raised. The American Institute of Certified Public Accountants has written a letter to the IRS urging the Service to publish additional guidance to provide more certainty on these open issues.

IRS Notice 2014-21 stated that virtual currencies are to be treated as property, not as currency. This was potentially good news to Bitcoin investors, since it would allow them to pay the lower long-term capital gains tax rate on profits if they held the Bitcoin for over a year. On the other hand, this position was inconvenient for consumers and merchants who use and accept virtual currencies as a means of exchange, because each transaction, no matter how small, must be reported in order to determine the amount of gain or loss every time a consumer uses the virtual currency as a means of exchange, and every time the merchant converts the virtual currency received in a transaction into U.S. currency.

In the two years since the IRS published Notice 2014-21, this classification of virtual currencies as property rather than a currency, many other questions have been raised, but have not been addressed. The letter from the AICPA sets them out:

(1) Determining Fair Market Value of the Virtual Currency: The IRS should publish guidance on whether a taxpayer can use any published exchange rate to determine the fair market value of virtual currencies, and whether the taxpayer must use the same published exchange rate for all other transactions. The letter notes that there
are a wide variance in the fair market value of Bitcoin on four Bitcoin published rates (Google, Bitcoin exchange rate, Bitstamp, CEX and Winkdex), citing an example selected at the same time, reflecting a range of value from a low of $227.84 to a high of $231.14.

(2) Expenses of Obtaining Virtual Currencies: Are the expenses to mine virtual currencies currently deductible, or are they to be added to the basis of the mined currency? This would normally be an easy call – costs would normally be added to the basis of the property that is manufactured – but the 2014 guidance intimates that this might not be the case.

(3) Tracking Basis of Virtual Currency: Because virtual currencies are treated as property, the taxpayer must track the cost of purchasing each unit acquired, in order to determine the taxable gain when it is sold (including every time a consumer uses it to purchase goods and services). The AICPA letter says that tracking the basis for virtual currency is virtually impossible when it is used in everyday commerce, and asked for the IRS to consider alternative means to determine basis.

(4) General Transaction Rules Applicable to Property: The AICPA letter asks whether the general tax rules applicable to property (rather than currencies) would apply to virtual currencies. For example, the letter asks whether a taxpayer would be able to take advantage of the tax free like-kind exchange rules of section 1031 if one type of virtual currency is exchanged for a different type of virtual currency (for example, a Bitcoin for Ethereum exchange).

(5) Character of Virtual Currencies Held By Merchants: How should virtual currencies that are accepted by a merchant be classified for tax purposes – as a capital asset or as an ordinary income asset?

(6) Charitable Contributions: Does a contribution of virtual currencies to a charitable organization require a formal appraisal? The general rule is that if a taxpayer donates property worth more than $5,000 to a charitable organization, the taxpayer must obtain a formal appraisal to support the amount to be deducted as a charitable contribution. There is an exception, where an appraisal is not needed for the donation of securities that are traded on a published exchange. The letter asks whether the donation of virtual currency should be subject to the same exception, since they are traded on published exchanges.

(7) Is Virtual Currency a Commodity: If virtual currencies are treated as a commodity, would it be subject to the mark-to-market rules for commodity traders?

(8) How About a De Minimus Exception For Small Transactions: The letter asks the IRS for an exception to the rule requiring a taxpayer to report each virtual currency transaction as a taxable sale of property when used to make small consumer purchases.

(9) Retirement Accounts: Can virtual currencies be held as an investment in a qualified retirement plan (like a 401(k) plan)? The rules for eligible investments in such plans limit the types of property than can be held in a qualified retirement plan.
Foreign Reporting Requirements: Are virtual currencies subject to Foreign Bank Account Reports (FBAR) and/or Foreign Bank Account Tax Compliance Act (FATCA) reporting?

As these issues get worked out, others are likely to arise. Until they are addressed by the IRS, the uncertainty will likely inhibit the growth of virtual currencies in the U.S. economy.

To see a copy of the AICPA letter to the IRS, please click here.

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