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STRUCK IT RICH WITH BITCOIN? DON'T FORGET TO TELL (AND PAY) UNCLE SAM

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Earlier this year as I was planning my April 2017 wedding and watching my savings trickle away, my sister (and trusty maid of honor) told me to buy some Bitcoins - a convertible electronic currency often used to buy and sell illegal drugs or requested by computer hackers as ransom in exchange for the release of confidential business data, but with growing acceptance for legal transactions. As I was spending frantically on videographers and gowns, etc., I found it hard to justify shelling out an extra \$2,000 for this cryptic internet currency that I barely understood at the time. Flash forward about 8 months. That \$2,000 Bitcoin my sister told me to buy is now worth over \$14,000. Yes. That is correct. Bitcoin has increased almost 7-fold in less than a year (and even more if you were lucky enough to buy Bitcoin in 2011 when it was going for less than \$20 per Bitcoin). As a tax attorney, I immediately began to think of the tax consequences of this investment and what the IRS was doing about it.

It turns out the IRS did think about this in 2014 but has not provided any additional guidance since. In Notice 2014-21, the IRS stated that Bitcoins are treated like property. For individual investors, this generally means that the increase in value from the purchase date to the sale date will result in capital gains tax. For employers that pay employees or independent contractors in Bitcoin, these payments are subject to information reporting and the virtual currency must be reported in U.S. Dollars. These reporting requirements can cause an additional layer of book-keeping confusion as the value of Bitcoin are changing, quite drastically, day-to-day. Also, payments to non-compliant taxpayers made using Bitcoin may be subject to backup withholding to the same extent as other payments made in property. Moreover, if one uses Bitcoin to pay for goods or services, the user will have a tax to pay for the increase in value of the Bitcoin as if the user sold the Bitcoin for cash.

Still think that you can sneak by without the IRS discovering your new-found fortunes? In 2016, a judge in the Northern California District Court approved a John Doe summons requiring Coinbase, a Bitcoin wallet service, to hand over records of all transactions (including nearly 500,000 accountholders) that took place from 2013 to 2015. Coinbase appealed and, on November 29, 2017, the court narrowed the scope of the summons to approximately 14,335 users (accounting for nearly 9 million transactions). Although the IRS's initial request was shrunken, this ruling is still viewed as a victory for the IRS and a warning to taxpayers – report and pay or you may be liable for significant penalties. Further, as of the date of publication, despite speculation, the IRS has not published any tax amnesty for taxpayers who fail to report income with respect to Bitcoins.



E-ALERT

Various tax issues can arise when individuals invest in Bitcoins and when businesses use Bitcoins in daily activities. Contact [Stephanie Searles](mailto:ssearles@dilworthlaw.com) at ssearles@dilworthlaw.com if you have any questions regarding the tax consequences related to Bitcoin transactions or any other tax concerns.