

WHAT GOES UP, MUST . . . GET TAXED? TAX ISSUES WITH VIRTUAL CURRENCY

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Bitcoin, and other virtual currencies, had a heck of a year in 2017. Bitcoin started the year trading at about \$1,000 per coin; by year's end, its value had skyrocketed to about \$14,000. Ethereum jumped from less than \$10 to over \$700. Monero's price similarly went from about \$11 in January to about \$350 on December 31.

While many people enjoyed watching the value of their cryptocurrency holdings grow at such an astounding rate, relatively few concerned themselves with the federal income tax implications of the price increases. Depending upon what each individual did with his or her cryptocurrency holdings during 2017, many people might find themselves in for a rude awakening when tax time rolls around this coming April.

IRS Notice 2014-21

In 2014, the IRS issued guidance ([Notice 2014-21](#)) in which the Service attempted to answer some questions about the taxation of Bitcoin and what the IRS referred to as other "convertible virtual currency," i.e., "irtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency."

Notice 2014-21 consisted of a 6-page document which posed, and answered, 16 questions concerning the tax treatment of virtual currency. Most people have found this notice to be, to put it nicely, inadequate.

Since issuing Notice 2014-21, the IRS has had nothing more to say on the subject. On June 10, 2016, the American Institute of Certified Public Accountants sent the IRS a letter requesting (more like begging) the IRS "to release additional, much needed, guidance on virtual currency." The IRS's response? **Silence.**

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Why is this an issue?

The IRS's non-guidance poses real problems for those who engaged in cryptocurrency transactions during 2017. The situation is relatively straightforward for many taxpayers who sold virtual currency during the year and received cash. Most of those taxpayers (there may be exceptions) will have to determine the price at which they acquired the virtual currency they subsequently sold and compare that to the price they received when they sold it; the difference (assuming the sales price was higher than the acquisition price, which, for cryptocurrency sold in 2017 will almost certainly be the case), will represent a capital gain, which the taxpayer should report on his or her income tax return.

But what if the taxpayer did not sell his or her virtual currency for cash, but instead traded or exchanged it for a different virtual currency (e.g., traded Bitcoin for Ethereum)?

That exchange could be viewed as a sale of the Bitcoin (a taxable event) and a subsequent use of the proceeds to purchase Ethereum. Alternatively, the exchange could be regarded as a like-kind exchange under Section 1031 of the Internal Revenue Code. If so, then what would otherwise be a taxable capital gain might be deferred and taxed in a later year.

Note: The new tax law just passed by Congress and signed by the President will limit like-kind exchange treatment to real estate transactions beginning with the 2018 tax year.

To date, the IRS has provided no hints as to whether, or under what circumstances, virtual currency exchanges might qualify for like-kind-exchange treatment.

Another tax issue could result from what is generally referred to as the Bitcoin fork, which occurred in August, 2017. At that time, a new coin – Bitcoin Cash – was created when a group of Bitcoin miners introduced and followed new protocols, causing the Bitcoin blockchain to split into two.

As a result, anyone who owned Bitcoin at the time of the fork also became the owner of an equivalent number of units of Bitcoin Cash.

- Is that a taxable event?
- Is it ordinary income?
- A dividend?
- A non-taxable stock split?

The IRS hasn't said.

Many observers expect the IRS, at some point, to answer these and other questions. Until the IRS does, taxpayers, in consultation with their tax advisors, will have to determine for themselves how to handle the tax implications for the various types of cryptocurrency transactions in which they engage during a particular tax year.

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