



Robert W. Wood

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Bitcoin: Tax Evasion Currency

In [IRS Takes A Bite Out Of Bitcoin](#), I said that Bitcoin doesn't obviate taxes. Dissenters argued that the anonymity of the upstart digital currency is all that matters. Perhaps they can [evade taxes](#) and the IRS won't catch them.

But that doesn't mean there's no income. Start with how you classify Bitcoin, although that too can be debated. Transactions in Bitcoin could be property, barter, foreign currency, or a financial instrument.

Barter seems the most logical treatment, but not everyone agrees. And investing excitement doesn't encourage calm reflection. There's plenty of excitement about Bitcoin, even by the Wall Street Journal. See [The Mess the WSJ Made: Famed trader Joe Lewis not Investing in Bitcoins](#).

In fact, if the movie were remade today, [The Graduate's "One Word: Plastics"](#) might be Bitcoin. As [The People Making Real Money On Bitcoin](#), famously Facebooked Tyler and Cameron Winklevoss [announced](#) an SEC filing for the "[Winklevoss Bitcoin Trust](#)." It would allow institutional investors to dabble in the virtual currency without having to buy it directly from a Bitcoin Exchange. See [Overview](#).



The bitcoin logo (Photo credit: Wikipedia)

But the allure of avoiding taxes is like a siren song. In [Is Bitcoin the New Tax Haven?](#), Paul Caron quotes from [Omri Y. Marian](#)'s paper [Are Cryptocurrencies 'Super' Tax Havens?](#) Mr. Marian notes the pressure facing financial institutions to hand over account holders, withhold and remit taxes. The fight against offshore evasion is raging. And although FATCA was enacted in 2010, the dreaded law is just now coming into its own.

That could be nice timing for Bitcoin. It is anonymous, which is a good start. Think of Bitcoin like unmarked, non-sequential bills. Indeed, the fact that Bitcoin is not dependent on the existence of financial intermediaries is key. Mr. Marian suggests that much more government regulation is coming once the authorities recognize Bitcoin's potential for serious tax evasion.

The Treasury unit called FinCEN, the Financial Crimes Enforcement Network, already has [rules about Bitcoin](#). The IRS is likely to follow. For example, I expect IRS Forms 1099 can't be too far off. If you pay a consultant with a new car or in Bitcoins you may have to issue a Form 1099 for that value.

If you are paying wages with Bitcoin, you can hardly withhold some of the Bitcoin and send it to the IRS. If you exchange Bitcoins for cash, whether you have gain may depend on whether Bitcoin is really currency or commodity. The latter seems more likely, meaning you have gain to the extent of the appreciation in your Bitcoin. See IRS [Bartering Tax Center](#).

FinCEN says Bitcoin exchanges and Bitcoin miners should register as Money Services Businesses and comply with anti-money laundering regulations. Still, ordinary Bitcoin users don't have to register just to purchase goods and services. The IRS treats it as pay in kind, just as if you paid in groceries or anything else of value. You must value what's provided, withhold income and employment taxes in cash and send the money to the IRS. You also must issue a Form W-2.

With no banking or government involvement, Bitcoin may be anonymous. It may even be ideal for someone who intentionally tries not to pay tax. That may be a small piece of the Bitcoin payment universe. But for most people who file tax returns and report their income whether or not it shows up on a Form W-2 or 1099, it probably isn't the tax haven some are suggesting it is.

The IRS will surely take steps to regularize tax reporting. What's more, a Government Accountability Office [report](#) says the IRS could do a better job

telling people they have to pay tax on Bitcoin transactions. Like it or not, that message is probably coming.

You can reach me 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.