Forbes

Robert W. Wood
THE TAX LAWYER

TAXES | 5/05/2013

Sorry Bitcoin, IRS Gets Reports

In IRS Takes A Bite Out Of Bitcoin, I said that Bitcoin doesn't obviate taxes. Yet many are pointing out the anonymous nature of this upstart digital currency. I suspect that some may just figure the IRS won't catch them, and maybe they're right. Yet I've also been learning more about Bitcoin usage, especially from the entertaining series of Living On articles by Kashmir Hill, including Living On Bitcoin For A Week: Bitcoiners Are The New Vegans.

The bitcoin logo (Photo credit: Wikipedia)

Some of the pioneer user stories are amazing, especially given the wild swings in value the currency has experienced. Lawyers generally aren't quick to adapt, but some now accept Bitcoins. See Lawyer Says He'll Accept Bitcoins From Clients To Keep Things 'Discreet'. If one criminal defense lawyer is doing it–hey, some accept real estate and other harder to unload assets–there will be others. See My clients can pay me in bitcoins, criminal defense lawyer says.

But on tax reporting, are merchants and professionals that accept Bitcoin reporting them as income? I bet they are, and some people paying in Bitcoin must be deducting payments too. If you're in business, don't you almost have to?

If lawyers accept Bitcoin, they must report the income and clients must deduct it. Some payments to criminal defense lawyers are personal and nondeductible. But fees for business-related crimes get deducted all the time. See [Acquitting John Edwards, $2M; Deducting His Legal Fees, Priceless](#).

Why do I think there must be some IRS Forms 1099 for Bitcoin payments? In business, if you pay someone a consulting fee of $600 or more, you issue a Form 1099. You can do it when you pay them, but most businesses issue the forms the following January. It's a reminder to the worker to report the pay at tax time. A copy goes to the IRS just in case the worker forgets.

The IRS cares deeply about the web of these reporting rules. Increasingly, much of the tax system is driven by them. They track payments by payor and payee Taxpayer ID numbers. Businesses that fail to issue the forms are subject to penalties. See [Didn't Receive A Form 1099? Don't Ask](#).

If you pay a consultant in kind—whether in Super Bowl tickets, a new car or Bitcoins—you have to issue a Form 1099 for that value. If the worker isn't an independent contractor but is an employee, wage withholding is a bigger problem to resolve. After all, how do you withhold on Bitcoin?

If you pay an employee in Bitcoin, you can't withhold some of the Bitcoin and send it to the IRS. 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 have to issue a Form W-2 too.

How commonly are wages paid in Bitcoin? Probably not very, though Ms. Hill quotes Brewster Kahle, founder of the Internet Archive, as saying 13 of 39 employees at the Archive receive [part of their salaries in Bitcoin](#). Employers must pay part of the wages in cash so there's cash to send to the IRS for taxes.

To be sure, with no banking or government involvement, Bitcoin may well be anonymous. Perhaps what I'm describing is a tiny piece of the Bitcoin payment universe. Yet even many cash transactions are the subject of IRS tax forms, and I'll bet some Bitcoin pay ends up on a Form 1099 or W-2. If I'm right and these practices spread, the IRS may have to specifically address them. Until then, digital pioneers accepting and paying in Bitcoin are tax pioneers too.

Robert W. Wood practices law with [Wood LLP,](#) in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, [Tax Institute),](#) he can be reached 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.