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Bitcoin's \$13.50 To \$1,200 Eleven Month Climb--Now Taxes

Even if you weren't intrigued by other aspects of the rock star digital currency, it's hard to argue with over 5,000% appreciation in less than a year. The Wall Street Journal asked [Should You Invest in Bitcoin?](#) and printed a [WSJ special section: "Bitcoin or Bust"](#). The conclusion: sure, why not buy and hold some?

It's easy to see why. Only 11 months ago, Bitcoin was \$13.50. Its meteoric rise is downright astounding even if the price has dipped a bit since its peak. It makes some worry this bubble will burst. Plus, [Bitcoin thefts soar as online criminals target easy payday after currency's value quadruples in the space of three weeks.](#)

Adding to its cachet, the currency isn't issued by any bank or government. It is mined using high powered computers doing what amounts to math. Once created, Bitcoins can be traded or used to purchase goods and services.

These days, if your digital wallet has Bitcoin in it, you can buy a lot more goods and services. There are debates about just how anonymous Bitcoin is,



(Photo credit: antanacoins)

but it is clearly more anonymous than most currencies or other forms of payment. For that reason, it has featured in some illegal activities, including the now shuttered website Silk Road.

Congress recently held hearings on the upstart currency. The Fed took notice too. In fact, Federal Reserve Chairman Ben Bernanke wrote that Bitcoin and other virtual currencies “may hold long-term promise, particularly if the innovations promote a faster, more secure and more efficient payment system.”

Bitcoins exist only online and are stored in virtual wallets. The total number of Bitcoins is not supposed to exceed 21 million. If you don't want to try mining for yourself, you can purchase Bitcoins through websites like Coinbase.com and Mt. Gox.

Still, the peer-to-peer nature of Bitcoin doesn't obviate taxes. If you swap one product or service for another, tax is due, as the IRS explains at its [Bartering Tax Center](#). If you provide services or sell goods for Bitcoin, you have income. If you exchange Bitcoins for cash, whether you have gain may depend on whether Bitcoin is currency or commodity.

One key question these days is whether you are taxable on the appreciation in Bitcoin you bought at \$13.50 that is now worth \$1,000. Currency wouldn't be, but it isn't clear that's what Bitcoin is in the eyes of the IRS. Transactions in Bitcoin could be property, barter, foreign currency, or a financial instrument. Barter seems most logical, but not everyone agrees.

So far, the IRS hasn't ruled on the point. And investing excitement doesn't encourage calm reflection. [Facebook](#) litigants 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](#).

Some suggest marking Bitcoin to market each year, which would be a good deal for the IRS. Essentially, that would valuing and reporting gain or loss at the end of each year even if you continue to hold it. Surely no one will do that this year unless it is mandated, which it is not.

Indeed, until the IRS rules differently, if you are holding highly appreciated Bitcoin you probably won't be taxed until you dispose of it. That should be easy to track if you buy Bitcoin for cash and then sell it for cash. The difference is income, either capital or ordinary.

But if you swap for either services or goods on either or both ends, determining value may not be so easy. Bitcoin may be accepted as currency and may not be easy to trace, but so are trades and barter. When you barter or swap one item for another, both parties have tax consequences.

That's so even if one party wants credit for later. Even straight up trades are taxed. Earning trade or barter dollars through a barter exchange is considered taxable income, just as if your product or service was sold for cash. Recordkeeping may not seem necessary but it is if you're trying to comply with the tax law.

Most Bitcoin transactions probably aren't on the tax radar. The IRS may not know about your swap unless you receive a [Form 1099](#). Still, the IRS says you must report any income on your return regardless of whether you receive a Form 1099.

The FinCEN rules say Bitcoin exchanges and Bitcoin miners should register as Money Services Businesses and comply with anti-money laundering regulations. In [Are Cryptocurrencies 'Super' Tax Havens?](#), [Omri Y. Marian](#) notes the pressures now facing financial institutions to hand over account holders, withhold and remit taxes. Bitcoin's success so far is remarkable, but the IRS is likely to pay more attention as a result.

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.