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Dear IRS, I Don't Actually Own That Bitcoin

It's tax time, and crypto gains can be painful, especially if you lost money after a taxable event but still have to pay the higher taxes. Taxes are an annual job, and the IRS says that Bitcoin and other cryptocurrency is property for federal tax purposes. Just about any transfer can trigger taxes. Currently, a crypto for crypto exchange *cannot* qualify as a tax-free 1031 exchange. Transfers are treated as *sales* for tax purposes, even when you are buying something with your bitcoin. The fact that crypto is property might prompt you to consider the concept of ownership. Wouldn't it be nice if some looming tax problem turned out not to be yours, but instead, someone else's?

If you are holding crypto for someone else, is it really yours, or does it belong to the person on whose behalf you are holding it? Put another way, if there are taxes to pay, and you are holding the crypto for the benefit of someone else, who has to pay the taxes? You might think the answer would be 100% clear, but it may not be. First, start with the proposition that federal income tax liability is generally allocated based on ownership under local law. *See Lipsitz v. Commissioner*, 220 F.2d 871, 873 (4th Cir. 1955).

The issues can be intensely factual. Who has to pay can turn on who has control over and benefits and burdens of the property. The same thing can happen with bank accounts. There may be one nominal owner, but the money might effectively be held in trust for someone else. Who has to pay tax on the interest may not be so clear. Local law ownership and beneficial ownership are not always the same. The IRS can try to tax the *beneficial* owner of an account, regardless of that person's rights to the funds under prevailing local law.

The IRS and the courts often look beyond local law to impose taxes on the party who is the *beneficial* owner. In *Chu v. Commissioner*, T.C. Memo. 1996-549, a man was subject to income tax as the beneficial owner of a bank account, even though he was not the owner of the account under local law. Conversely, if you are just holding something as an agent, you shouldn't be taxed. As one tax case put it, if someone "holds legal title to property as an agent, then for tax purposes the principal and not the [agent] is the owner." See *Montgomery v. Commissioner*, T.C. Memo. 1989-295 (citing *Commissioner v. Bollinger*, 485 U.S. 340 (1988)).

A *nominal* owner is *not* the owner for federal income tax purposes. In general, income should be taxed to the *principal*, even if the agent is a joint signatory. In *Bollinger*, 485 U.S. at 349, the Supreme Court said that "the law attributes tax consequences of property held by a genuine agent to the principal". The Court enunciated a three-part agency safe harbor. Under it, you won't be treated as the owner for tax purposes if:

- A written agency agreement is entered into with the agent contemporaneously with the acquisition of the asset;
- The agent functions exclusively as an agent with respect to the asset at all times; and
- The agent is held out as merely an agent in all dealings with third-parties relating to the asset.

What if you don't meet all three conditions? The Tax Court has said that these *Bollinger* factors are non-exclusive. *See Advance Homes, Inc. v. Commissioner*, T.C. Memo. 1990-302. Even an *oral* agency agreement might suffice, although if you're in a tax fight, you surely want to have it in writing. Assuming a true agency, the agent should not face taxes on income over which he has no control and no beneficial right. The Tax Court has defined beneficial ownership as the "freedom to dispose of the accounts' funds at will." *See Chu*, T.C. Memo. 1996-549. Courts may weigh factors including: (1) which party enjoys the economic benefit of the property; (2) which party has possession and control; and (3) the intent of the parties.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.