TAX-FREE CRYPTOCURRENCY TRANSACTIONS COULD COME WITH REPORTING OBLIGATIONS

Date: 15 September 2017

Tax Alert

By: Claire S. White

As cryptocurrencies such as Bitcoin and Ethereum become more prevalent in investment circles and acceptable for commercial transactions, the United States Internal Revenue Service ("IRS") has said little other than to label "virtual currencies" as property and state that transactions involving virtual currencies may be subject to taxation under generally applicable law.[1] However, on September 7, the United States Congressional Blockchain Caucus [2] (the "Caucus") introduced the Cryptocurrency Tax Fairness Act (the "Act"), which would exempt certain cryptocurrency transactions and create a cryptocurrency-specific information reporting requirement.

THE CRYPTOCURRENCY TAX FAIRNESS ACT

Under the Act, gross income would not include "gain from the sale or exchange of virtual currency for other than cash or cash equivalents." However, the amount excluded "with respect to a sale or exchange shall not exceed $600." In other words, transactions that result in gain of less than $600 that use virtual currency to acquire anything other than cash or a cash equivalent would not be subject to income tax. This deceptively simple language presents several questions.

First, it is not clear what is meant by "cash equivalent" in this context. Importantly, would other virtual currencies be considered cash equivalents? In Notice 2014-21 (the "Notice"), the IRS declared that it will treat "virtual currency" as property. The Act would not change that classification and refers to "virtual currency" (as opposed to any of the other terms used to describe digital or cryptocurrencies), which may indicate that the Caucus agrees with the IRS definition. However, the Notice could be interpreted to indicate that the IRS views virtual currency as a cash equivalent, at least in some contexts. In part, the Notice states that "in some environments, [virtual currency] operates like 'real' currency -- i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance." However, the term "cash equivalent" is rarely used in the Code or Treasury Regulations, leaving an open question as to what exactly the Caucus means by the term.

In addition, the Act appears to provide a per transaction exclusion. This is helpful in the case of routine transactions that taxpayers typically do not think of as taxable: for example, using Bitcoin to pay for a Microsoft Windows subscription. This tactic has been used in a few very limited contexts, typically through IRS guidance. However, a broadly applicable exception such as that in the Act is unusual. Also, exclusions from gross income typically apply to an annual aggregate amount. Accordingly, should this exception be read as an indication that the Caucus wants to encourage the use of cryptocurrencies in routine transactions?

Finally, in what may be a response to the IRS's ongoing litigation to obtain records of cryptocurrency exchanges executed using the Coinbase platform [3] or simply a strategic effort to increase voluntary compliance by

©2005-2026 K&L Gates LLP. All Rights Reserved.

taxpayers using cryptocurrencies, the Act also requires that the U.S. Department of the Treasury issue guidelines for reporting virtual currency transactions that give rise to gain or loss. Although the Notice stated that cryptocurrency transactions are generally subject to reporting under existing provisions of the Code, existing reporting mechanisms would not account for many types of cryptocurrency transactions. Given that the Act specifically directs Treasury to devise information reporting, the inclusion of this directive indicates that the Caucus intends that reporting be broadened. Nonetheless, the Act provides little direction regarding the details of the information reporting requirements.

For example, by not specifying that reporting applies to only cryptocurrency transactions that do not give rise to excluded gain, the Act indicates that *all* cryptocurrency transactions will be reportable. Reporting all transactions would be consistent with the general goal of increasing voluntary compliance (which generally increases with information reporting). However, must the report be made per transaction? Or annually? The latter would increase information reporting compliance and be consistent with most existing provisions in the Code, but the Act is silent. Another concern is that the information reporting requirement in the Act is not part of the provision that would be added to the Code. Therefore, it may be necessary to create a new statute under which the IRS would issue reporting guidelines if they are to vary from existing statutory authority. Also, which agency of Treasury will issue the information reporting regulations and collect the reports? While the IRS is an obvious choice, responsibility could be delegated by the Secretary of the Treasury to a different branch of the Treasury, for example, the Financial Crimes Enforcement Network, which already collects information about cryptocurrency transactions as well as information about U.S. persons' foreign financial accounts (which could be viewed as bearing some resemblance to cryptocurrency "wallets").

Considering the growing international importance of cryptocurrency transactions and the volume of reporting that may be required, it is important that Congress consider taxpayer burdens while the Act is considered — particularly if an additional provision under the Code is necessary — and that the officials at Treasury begin considering how reporting could be made efficiently enough to increase taxpayer compliance while providing the government with adequate information.

WHAT NOW?

The Act shines a spotlight on many unanswered and controversial questions concerning the taxation and reporting of virtual currency transactions. If enacted, implementing the new law would require the IRS (or perhaps another Treasury agency) to develop an efficient and robust reporting and compliance regime that provides the tools Treasury needs to ensure tax compliance while also encouraging voluntary compliance by taxpayers. Given the White House's instruction to overhaul regulatory guidelines, Treasury and IRS resource constraints, and the complexity of the issues surrounding virtual currencies, issuing workable guidelines in a timely manner would be a challenge. In the meantime, the Notice leaves open several areas that the Caucus or the IRS could consider for future action, for example:

- whether or when the IRS will view virtual currencies as a specific type of property, e.g., securities or commodities, which may particularly impact U.S. federal income taxation of many partnerships and non-U.S. persons; [4]

©2005-2026 K&L Gates LLP. All Rights Reserved.

- when the IRS will treat a person as engaged in a trade or business in respect of virtual currencies, e.g., through mining or trading activities;
- whether a mining pool, that is, a group of people collectively mining for virtual currencies, constitutes a publicly traded partnership; and
- whether U.S. law should conform to that of a growing number of countries that treat cryptocurrencies as currency for purposes of at least some types of taxation.

If you are interested in the legislative process around cryptocurrency taxation or have questions about the Act, please reach out to any of the contacts listed below.

Notes:
[1] For example, under current guidance, if a consumer uses Bitcoin to pay for a Microsoft Windows subscription, the consumer would generally recognize taxable gain on that transaction if the value of the Bitcoin used increased since the consumer purchased or mined that Bitcoin.
[2] Formed in February of this year by Congressmen Jared Polis (D-CO 2nd District) and David Schweikert (R-AZ 6th District), the Caucus is a bipartisan effort focusing on the use of blockchain technology to improve government and healthcare services and manage identity protection. In addition, in June of 2017, Congressmen Polis and Schweikert wrote to the Secretary of the Treasury to request further guidance in regard to the taxation of cryptocurrency transactions.
[3] N. Dist. Ca., Docket 3:16cv06658.
[4] The views of other regulators may influence the IRS' view on this point. For example, the CFTC and SEC have provided some indication of how they view certain types of cryptocurrencies. A CFTC order regarding Bitcoin is *In re Coinflip, Inc., d/b/a/ Derivabit, et al.*, CFTC Docket No. 15-29 (Sept. 17, 2015), http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf. The SEC recently released an investigative report ruling concerning treatment of DAO tokens, which may be found at https://www.sec.gov/litigation/investreport/34-81207.pdf. Our alert concerning the SEC report may be found at http://www.klgates.com/dao-and-the-art-of-securities-regulation-sec-clarifies-that-digital-tokens-may-be-securities-08-01-2017/.

KEY CONTACTS



CLAIRE S. WHITE
PARTNER

SEATTLE
+1.206.370.8033
CLAIRE.WHITE@KLGATES.COM



JUDITH RINEARSON
PARTNER

NEW YORK
+1.212.536.3928
JUDITH.RINEARSON@KLGATES.COM

©2005-2026 K&L Gates LLP. All Rights Reserved.

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.