

Policy Position for Equalizing Tax Treatment of Convertible Virtual Currencies **February 2018**

I. Current IRS Tax Guidance Thwarts Consumer Adoption

In 2014, the IRS issued Notice 2014-21 that addressed the tax treatment of “convertible virtual currency” for U.S. tax purposes, finding that convertible virtual currency should be treated as property, not currency.¹ As property, a consumer will realize gain or loss upon a sale or exchange of virtual currency. This means that if a taxpayer uses virtual currency to buy a good or service, such as a cup of coffee, s/he would recognize gain or loss on the use of the virtual currency at that time and must track the original basis (cost) of the virtual currency used for the purchase as well as the ultimate purchase price. The Notice also confirmed that payments made using virtual currency are subject to certain information reporting requirements. For example, if an employee is paid in virtual currency, that amount would have to be reported on the employee’s Form W-2.

Despite receiving comments and an acknowledged need for additional guidance on its treatment of virtual currencies, the IRS has issued nothing further since 2014 – a situation criticized by the Treasury Inspector General for Tax Administration (TIGTA) in a detailed 2016 report.²

More troubling, the IRS’s next action on virtual currency came from its enforcement division. On November 17, 2016, the Department of Justice filed an action seeking an order to serve an IRS John Doe Summons on Coinbase.³ Casting the perception that all virtual currency users were tax evaders, the John Doe Summons sought detailed and extensive information about all of Coinbase’s customers for 2013-2015. From the breadth of customer information sought, it is clear that the IRS is using this burdensome tool to gather information about the industry as much as identify the tax liability of any particular Coinbase customer.⁴

II. Financial Transactions in Virtual Currency Should Be Exempt from Capital Gains and Investment Income Tax

When transactions in virtual currency are taxed capital gains rates, the average user will decide to

¹ Press Release, Internal Revenue Serv., IRS Virtual Currency Guidance: Virtual Currency Is Treated as Property for U.S. Federal Tax Purposes; General Rules for Property Transactions Apply (Mar. 25, 2014), <https://www.irs.gov/newsroom/irs-virtual-currency-guidance>.

² Press Release, Treasury Inspector Gen. for Tax Admin., Rising Use of Virtual Currencies Requires IRS to Take Additional Steps to Ensure Taxpayer Compliance (Nov. 8, 2016), https://www.treasury.gov/tigta/press/press_tigta-2016-34.htm.

³ Press Release, Dep’t of Justice, Court Authorizes Service of John Doe Summons Seeking the Identities of U.S. Taxpayers Who Have Used Virtual Currency (Nov. 30, 2016), <https://www.justice.gov/opa/pr/court-authorizes-service-john-doe-summons-seeking-identities-us-taxpayers-who-have-used>.

⁴ On July 6, 2017, the IRS narrowed the scope of the John Doe summons to seek less information and only apply the summons to users with at least the equivalent of \$20,000 in any one transaction type (buy, sell, send, or receive) in any one year during the 2013-15 period. However, it still requests considerably more information than necessary for determining a Coinbase customer’s tax liability. On Nov. 28, 2017, the U.S. District Court for Northern California ordered Coinbase to produce “(1) the taxpayer ID number, 2) name, 3) birth date, 4) records of account activity including transaction logs or other records identifying the date, amount, and type of transaction (purchase/sale/exchange), the post transaction balance, and the names of counterparties to the transaction, and 5) all periodic statements of account or invoices (or the equivalent)” for accounts with at least the equivalent of \$20,000 in any one transaction type in any one year during the 2013 to 2015 period. United States v. Coinbase, Inc., No. 17-cv-01431-JSC, 2017 U.S. Dist. LEXIS 196306 (N.D. Cal. Nov. 28, 2017).

hold off on making a smaller dollar purchase to avoid the hassle of documenting their basis and sales price, especially for purchases that may occur on a more frequent basis. Indeed, the ability of virtual currencies to facilitate micropayments and help reach the unbanked and underbanked has been widely discussed because the associated costs and fees are so low that, finally, such **micropayments** and **cross-border transfers** become cost-effective. Imposing such a tax on these financial transactions effectively scuttles this potential. Certainly, the person thinking of buying a cup of coffee will think twice before incurring the tax liability, or wondering if they may be able to take a loss – all considerations that are absurd in these contexts.

- Note, Central Banks around the world are exploring, and in some cases actually conducting, issuances of fiat currency using a blockchain. How can something treated as a currency by Central Banks be considered property?

For these reasons, we believe that financial transactions in virtual currencies should not be treated as property and be exempt from capital gain or loss and investment income tax. This adjustment to federal tax policy would serve to **encourage growth of the blockchain industry**, in particular, micropayments and commerce, which serve so many important functions and have not even begun to reach their full potential.

III. Esteemed Policy Organizations Support This Position

The Heritage Foundation supports this approach. “The current tax treatment of alternative currencies creates a major barrier to the common use of alternative [including virtual currencies and explicitly blockchain-based] currencies.”⁵ And supports the elimination of tax and other legal impediments to the development of alternative currencies. **The Cato Institute** has stated that “Congress should also prohibit any taxation of private exchange media, whether physical or digital, that would make using such media more costly than using dollar-based monies. Among other things, that would mean exempting alternative exchange media from either sales or capital gains taxes.”⁶ Grover Norquist and his team at **Americans for Tax Reform** (ATR) has also expressed support for this position.

IV. Conclusion

Congress should expressly **exempt convertible virtual currency transactions from investment and capital gains treatment and associated reporting requirements to promote commercial growth and support the blockchain industry.**

⁵ David Burton, and Norbert Michel, *Removing Tax Barriers to Competitive Currencies*, THE HERITAGE FOUNDATION (Sept. 13, 2017), <http://www.heritage.org/monetary-policy/report/removing-tax-barriers-competitive-currencies>.

⁶ CATO INSTITUTE, “Monetary Policy”, ch. 56, *CATO Handbook for Policymakers*, 8th ed. (2017), <https://www.cato.org/cato-handbook-policymakers/cato-handbook-policy-makers-8th-edition-2017/monetary-policy>.