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# Balance *sheet*

## Virtual Currency

By Ashlyn Strahley

As we enter a new decade and an increasingly digital world, we will continue to see the rise in popularity of virtual currency. If you are unfamiliar with virtual currency, it is very much what it sounds like. It is virtual currency that can be used to pay for goods or services, or even held for investment. Despite its rise to prominence over the last several years, there has been little guidance from the IRS on the issue. Recently though, the IRS has issued more guidance and has begun cracking down on virtual currency transactions.

For federal tax purposes, the IRS treats virtual currency as property. Because it is classified as property, you must recognize any gain or loss every time it is exchanged for goods or services. Paying for goods or services using virtual currency such as Bitcoin (the most popular form of virtual currency) is becoming easier and more commonplace every day. It is also becoming more common to receive virtual currency as payment for goods or services provided. If you receive virtual currency as payment, it must be included in income at the fair market value of the currency as of the date it was received. In most situations, the values of virtual currency are listed on an exchange like [www.coinbase.com](http://www.coinbase.com). To convert it to the fair market value, you convert the virtual currency into U.S. dollars using the listed exchange rate.

It is also important to keep in mind that if virtual currency is later exchanged for other property, you will have to recognize if there is any gain or loss. You will report a gain if the fair market value of the property received exceeds your basis in the virtual currency or a loss if the fair market value of the property received is less than your basis in the virtual currency. If you are holding virtual currency for investment purposes for over a year, it will be subject to preferential long-term capital gain rates.



Employers can even pay employees and/or independent contractors using virtual currency. If they use virtual currency to pay employees, the fair market value of the currency will still be subject to federal income tax withholding, FICA and FUTA taxes, and must still be reported on Form W-2. If an independent contractor receives virtual currency for performing services, the fair market value of the currency will be subject to self-employment tax. It is also required to be reported to the IRS on Form 1099-MISC if the fair market value of the payment exceeds \$600, just like other non-employee compensation.

Bearing all of this information in mind, there are a few best practices to keep in mind when dealing with virtual currency. One of the most important is to maintain detailed records of your virtual currency. Records should summarize such things as when the currency was received, the fair market value of the currency upon the date of receipt, and why you are holding the currency. One effective way to keep track of multiple batches of currency is to store each purchase in a separate online wallet. Records should be maintained to show when each wallet was established as well. And of course, let us know when you engage in virtual currency transactions. The IRS has been on a sharp lookout for those using virtual currency to evade taxes. Keeping us informed will allow us to properly report your virtual currency transactions. If you would like to know more about virtual currency, please contact our office.

Items presented are not intended to be technically complete. Additional information may be required to make an informed decision.  
You cannot rely upon this information for avoiding tax penalties.