Tax Matters

Smart Planning, Succession Solutions & Tax Updates

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BitCoin: Currency or Property?

Is Bitcoin an online payment system? Is it a digital currency? Is it a commodity or is it property? Is it all of these things or none of these?

Digital v. Virtual Currency. To understand Bitcoin, you need to first understand the difference between digital currency and virtual currency. Virtual currency encompasses digital currency, but digital currency does not necessarily include virtual currency. There is a distinction between the two currencies and this distinction is important in understanding how each form of currency functions. Virtual currency operates within a bounded, specified economic system such as on-line gaming, (think Eve Online and the World of Warcraft). Virtual currency is essentially a good, and not a medium of exchange because it exists within a confined system. Whereas, digital currency, such as Bitcoin, is not. Instead, it can work outside the boundaries of a virtual world.

So is Bitcoin currency? If you recall from your high school economic class, currency has three functions or characteristics: (1) a medium of exchange, (2) a store of value, and (3) a unit of measure. The first, exchangeability, involves the ability to switch something for a different currency or the ability to make payments. The second is the ability to act as a store of value, meaning that an asset will more or less hold its value over time without suffering from massive fluctuations. The third, a unit of measure used to value goods, services, assets, liability, income and expenses. Value can be stored and then retrieved at a later date. It seems Bitcoin is slowly working its way to all three characteristics. So for the time it's still considered a digital currency in waiting.

So for the time being most governments, including the United States, do not consider Bitcoin "real" currency. Rather under United State tax law, Bitcoin is treated as property, not currency. This means that the general tax principals applicable to property transactions apply to transactions using Bitcoin.

Tax Consequences of Bitcoin: If you are holding Bitcoin, you need to first determine how you are holding it. Is it investment property? Or is being held as Inventory in a trade or business? If you have ventured into buying Bitcoin, then you are likely holding it as investment property (think stocks or bonds). Let's take a look at Joe Consumer who buys one Bitcoin at the price of $25 back in 2010. Joe holds onto the Bitcoin for four years. He then sells it in 2014 for $250. Joe will have a long-term capital gain of $225, which will be taxed at Joe Consumer's applicable capital gains rate rather than his ordinary income tax rate. The gain is considered long-term because Joe held the Bitcoin for more than one year. What if Joe, the Businessman, had purchased the Bitcoin as Inventory for sale to the public in his business? Then Joe, the Businessman, would have realized ordinary gains (or losses), rather capital gains (or losses) once he sold the Bitcoin.

Okay… makes sense, but what if Joe Consumer is not selling his Bitcoin? Instead, he is using his Bitcoin as currency to buy a product. It does not matter. If Joe Consumer uses his Bitcoin that he purchased at $25 in 2010 to buy a widget with a fair market value of $250 in 2014, Joe will have a still have a capital gain of $225. Likewise, if Joe bought a widget with a fair market value of $10, he will have a capital loss of $15. This is where Bitcoin differs from regular currency. Keep in mind Bitcoin sold or used within a year of purchase is taxed as short-term gains (or losses) and subject to ordinary income tax rates.

What if you "mine" your own Bitcoin? Any new Bitcoin generated as a result of mining is considered income. The taxable amount reported is the fair market value of the Bitcoin at that date. For example, if you successfully mine 5 Bitcoin in October worth $500 each, and then an additional 3 Bitcoin in December worth $300, you would report $3,400 as gross income on your tax returns for that taxable year.

Remember, Bitcoin may be defined as a currency, but in the United States it's taxed like property.

Bitcoin Factoids & Terminology

What is Bitcoin? Bitcoin is money based on an open and transparent mathematical design. Bitcoin is decentralized, no single institution, government or person controls Bitcoin.

Where does Bitcoin come from? BitCoin gets "mined" into existence. Miners use special software to solve math problems and are issued a certain number of Bitcoins in exchange. Mining Bitcoin serves to add transactions to the block chain and to release new Bitcoin.

What is Block chain? Block chain is a shared public ledger on which the entire Bitcoin network relies. All confirmed transactions are included in the block chain. This way, Bitcoin wallets can calculate their spendable balance and new transactions can be verified to be spending Bitcoin that are actually owned by the spender. The integrity and the chronological order of the block chain are enforced with cryptography.

IRA One-Rollover-Per-Year Rule

Beginning in 2015, you can make only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs you. The limit will apply by aggregating all of an individual's IRAs, including SEP and SIMPLE IRAs as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of the limit.

- Trustee-to-trustee transfers between IRAs are not limited because this type of transfer is not a rollover.
- Rollovers from traditional to Roth IRAs ("conversions") are not limited

Transition Rule Ignores some 2014 Distributions. IRA distributions rolled over to another (or the same) IRA in 2014 will not prevent a 2015 distribution from being rolled over provided the 2015 distribution is from a different IRA involved in the 2014 rollover.

Example: If you have three traditional IRAs, IRA-1, IRA-2 and IRA-3, and in 2014 you took a distribution from IRA-1 and rolled it into IRA-2, you could not roll over a distribution from IRA-1 or IRA-2 within a year of the 2014 distribution but you could roll over a distribution from IRA-3. This transition rule applies only to 2014 distributions and only if different IRAs are involved. So if you took a distribution from IRA-1 on January 1, 2015, and rolled it over into IRA-2 the same day, you could not roll over any other 2015 IRA distribution (unless it's a conversion).

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Don't forget, we have relocated!!
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LaSota Law has the ability to meet clients in Bala Cynwyd | Malvern | King of Prussia | Philadelphia | Plymouth Meeting | Radnor

Mary R. LaSota is an experienced attorney who represents individuals in a wide range of estate, business and tax planning issues. Tax Matters is bimonthly newsletter providing timely smart succession solutions and tax updates. Do you have a question or an idea for the next Tax Matters' issue? Email Mary R. LaSota at mlasota@lasotalawllc.com