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Virtual Currency

Bitcoin Accounts May Be Subject to FBAR, FATCA Reporting as IRS Focus Sharpens

BNA Snapshot

Key Development: Experts say IRS may require virtual currency accounts held in foreign exchanges to be reported on the FBAR.

Key Takeaway: They say it is also possible the accounts might eventually have to be reported under FATCA.

Next Steps: Senior IRS official has said agency is looking at FBAR and FATCA implications for virtual currency.

By Alison Bennett

Nov. 12 — Taxpayers may soon have to report bitcoin and other virtual currency accounts held in foreign exchanges to the IRS as the agency's focus on foreign assets sharpens, experts told Bloomberg BNA in interviews in October and November.

They said there is a strong possibility that bitcoin accounts could fall within the scope of assets individual taxpayers must reveal to the Internal Revenue Service on the Report of Foreign Bank and Financial Accounts (FBAR).

Eventually, experts said, it is even possible that the foreign exchanges themselves may be considered foreign financial institutions (FFIs) that have to report the accounts to the IRS under the Foreign Account Tax Compliance Act (FATCA).

"I think there is a real chance that the Treasury will conclude that bitcoin accounts held in foreign exchanges will be foreign financial accounts subject to FBAR reporting," Bryan Skarlatos, a partner with Kostelanetz & Fink LLP in New York, said.

He told Bloomberg BNA this is because of the IRS's broad definition of a foreign financial account. Also key, Skarlatos said, is the broad purpose behind FBAR reporting. That purpose is both to enhance transparency "and track the flow of money, in whatever form, through domestic and foreign financial systems," he said.

Court Ruling a Sign?

Both Skarlatos and Peter D. Hardy, a principal with Post & Schell PC in Philadelphia, said a June ruling by the U.S. District Court for the Northern District of California could be a sign that the government may require FBAR reporting for digital currency accounts.

In *United States v. Hom*, the court found that online accounts held for the purpose of foreign online gambling had to be reported on an FBAR (109 DTR K-3, 6/6/14).

Skarlatos said he wouldn't be surprised if the U.S. Financial Crimes Enforcement Network—which regulates bitcoin from a financial perspective—adopts the reasoning of the California court for its work with virtual currency.

Hardy said he believes it is only a short hop to apply the court's ruling to digital currency accounts. Currently, FBAR reporting is required for foreign accounts worth more than $10,000.

"I think that conceptually, it's a very short step to take that law and perhaps conclude that if you have an online account in virtual currency and it's over $10,000, that could be subject to FBAR reporting regardless of whether the exchanger has any interest in complying with the law," Hardy said. "The individuals have to consider this."

Right now, the IRS treats virtual currency as property. Speaking at the fall meeting of the American Bar Association Section of Taxation, a senior official said the IRS doesn't have a stance yet on whether the currency is subject to FBAR or FATCA reporting even though the agency is well aware of the issue.

IRS Stance Evolving

In the *IRS guidance ruling* that digital currency is property, “we did not address FATCA or the question of whether these exchanges are FFIs and do not yet have a published position on that,” Andrew J. Keyso, IRS associate chief counsel (Income Tax & Accounting), said.

“It's something that is evolving,” Keyso told a meeting of the Civil & Criminal Tax Penalties Committee.

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>
> *Tyson Cross*
> *Bitcoin Tax Solutions*

Jake Benson, chief executive officer and founder of Libra Services Inc., told Bloomberg BNA that he too wouldn't be surprised if bitcoin accounts were subjected to FBAR and potentially even FATCA reporting, even though it isn't happening this year.

The government isn't saying taxpayers should become complacent, Benson, whose company helps taxpayers handle their digital currency tax responsibilities through software, said. “They're just saying, ‘We just need some time to think about it.' ”

Benson said he believes the issue boils down to intent. “If digital currency operates or functions like money, it's not surprising that the existing money framework would apply,” he said.

Tyson Cross, an attorney at San Diego-based Bitcoin Tax Solutions, said he has already been advising clients to file FBARs for exchange accounts where they have combinations of cash and digital currency, if the cash exceeds the $10,000 threshold.

“There's a difference between bitcoins and proceeds from bitcoins,” Cross told Bloomberg BNA. “There's a good argument that the cash in the account is subject to FBAR. It's safe and probably the correct interpretation.”

False Security

The fact that IRS hasn't yet said bitcoin is subject to such reporting gives many bitcoin owners a false sense of security, Cross said. “It's a trap for a lot of people who just conclude their whole bitcoin account isn't taxable,” he told Bloomberg BNA.

Daniel Winters, a sole proprietor in Bridgewater, N.J., whose practice deals largely with overseas Americans, said he too believes the IRS's definition of a financial account for FBAR reporting is broad enough to catch bitcoin accounts in foreign exchanges.

“It's a common-sense answer,” he told Bloomberg BNA. “You're not going to hurt yourself by reporting these accounts. My approach would be to err on the side of caution.”

Winters said the question of whether foreign bitcoin exchanges would be considered financial institutions under FATCA is “a completely separate issue” and one that may take longer to answer.

Both Cross and Benson said the IRS's view that bitcoin is property is confusing for many because it means that every transaction with the digital currency is taxable, whether it is used to buy something or gets sold.

“It's much more favorable to the taxpayer if it's treated as a foreign currency,” Cross said.

Speaking at the ABA tax section meeting, the IRS's Keyso said the issue was “one of the big questions” raised by Notice 2014-21, the government's first tax guidance on bitcoin.

He said taxpayers were asking, “Why didn't we treat bitcoin as currency, wouldn't it have eliminated this issue of, I take my bitcoin down to the coffee shop or the pizza parlor and I have a gain recognition transaction?”

Difficult Definition

According to Keyso, “We just were not able to get there under current law that this is a currency. It's not a widely circulated or widely used medium of exchange, at least at this point, and the Office of Chief Counsel was not comfortable with treating it as a currency, at least at this point in time.”

Both Cross and Benson said the taxation surrounding bitcoin, stemming from its treatment as property, remains immensely complex and a source of confusion for many.

“From a practical standpoint it's unworkable,” Cross told Bloomberg BNA. Tracking each transaction and calculating the gain is so difficult that it puts taxpayers in a position where they may be more likely to decide not to comply with the tax code, he said.

Benson said his company's software is designed to help taxpayers deal with that complexity. The basic idea is that, “Since there's a public ledger of all bitcoin transactions, why don't we use that as a reference for all the transactions?” he said. “Instead of manually taxing, you can automate it and all you need is your public bitcoin address. It's a way to remove this accounting nightmare.”

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