

# When Filing Taxes, Don't Forget Virtual Currency Income

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In a March 23 [news release](#), the IRS reminded taxpayers that income from virtual currency transactions must be reported on income tax returns, and that certain virtual currency transactions are taxable like any other property transactions. Taxpayers should note that despite the pseudo-anonymity of virtual currencies, the IRS has been able to successfully subpoena a major exchange for the [accounts and information](#) of thousands of holders.

As the IRS news release highlighted, the consequences for non-compliance are significant. Taxpayers who do not report income from virtual currency transactions can be audited for those transactions and potentially liable for penalties and interest. More egregious violations could subject taxpayers to criminal prosecution for charges including tax evasion and filing a false tax return. Convictions for tax evasion and filing a false tax return could lead to a prison term of up to three to five years, respectively, and monetary fines of up to \$250,000.

The release also directed taxpayers to [IRS Notice 2014-21](#) (which provides [guidance](#) on how existing general tax principles apply to certain virtual currency transactions) and noted that, among other things:

- payments made using virtual currency are subject to information reporting to the same extent as any other payment made in property;
- virtual currency payments to independent contractors and other service providers are taxable, and normally the payer must issue Form 1099-MISC;
- [wages paid to employees using virtual currency](#) are taxable to the employee and must be reported on a Form W-2 by the employer;
- certain third parties who settled virtual currency payments on behalf of merchants that accept virtual currency from customers must report payments to those merchants on Form 1099-K, Payment Card and Third Party Network Transactions; and

- the character of gain or loss from the sale or exchange of virtual currency depends on whether the virtual currency is a capital asset in the hands of the taxpayer.

The release makes it clear that income from virtual currency transactions must be reported on income tax returns. However, the guidance in the March 23 release and IRS Notice 2014-21 does not apply to all virtual currencies and it is unclear how income from virtual currency transactions not covered by this guidance should be treated and reported for tax purposes. Furthermore, the application of this guidance to any specific taxpayer depends on the taxpayer's particular situation. Taxation of virtual currencies is complex and there remains a great deal of uncertainty regarding the application of the tax law and a taxpayer's compliance obligations. We will continue to follow developments in this area.

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