

State Taxation of Virtual Currency: Sales Tax and Other Implications of Cryptocurrency Transactions

THURSDAY, AUGUST 30, 2018, 1:00-2:50 pm Eastern

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State Taxation of Virtual Currency: Sales Tax and Other Implications of Cryptocurrency Transactions

THURSDAY, AUGUST 30, 2018

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Sales Taxation of Bitcoins

08/30/2018

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Sales Taxation of Bitcoins

Agenda

Sales Taxation of Bitcoins

Agenda

- Bitcoin factual summary
- Federal income tax treatment of Bitcoins
- Sales tax consequences of accepting Bitcoins in exchange for taxable items
- Sales tax consequences of purchasing Bitcoins
- Sales tax consequences of mining Bitcoins

Sales Taxation of Bitcoins

Factual Summary

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work?

- A completely decentralized and anonymous medium of exchange used over the internet
- No government or central bank support or control
- Users transfer Bitcoins via the internet through an open source network known as the Bitcoin Network
- The Bitcoin Network hosts the Blockchain

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

— What is the Blockchain?

- A publicly accessible ledger of all Bitcoin transactions.
- Sales and purchases of Bitcoin are posted to the Blockchain after verification.
- The Blockchain uses public-key cryptography to solve double-spending.

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

— How do people use Bitcoin?

- Run the software that implements the Bitcoin protocol on their own computer or
- Create an account on a website that will run the Bitcoin software for its clients; or
- Create a Bitcoin wallet which provides the use of a numerical address that is similar to a bank account number.

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

- Bitcoin transaction verification or “mining”
 - Each Bitcoin transaction must be verified to ensure that the person attempting to spend the Bitcoins actually owns said Bitcoins.
 - This verification process is called “mining.”
 - Bitcoin mining is how new Bitcoins enter circulation.
 - Mining is a very computationally intensive process.

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

- What is a Bitcoin “miner”?
 - any person or organization running specific software on specialized computer hardware to validate Bitcoin transactions to the Blockchain.
 - Once a miner verifies a Bitcoin transaction, the transaction is posted to the Blockchain and the miner is rewarded with a set number of Bitcoins for her effort.
 - Mining Bitcoins is a very computationally intensive process that requires a large amount of computing power.

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

— Bitcoin transaction example:

- Chris wants to send Bitcoins to Jonathan in exchange for a good or service.
- Chris initiates the transaction through his Bitcoin wallet.
- Bitcoin miners verify the transaction and post it to the Blockchain.
- Jonathan receives the Bitcoins.
- The miner receives new Bitcoins for its efforts.
- The Bitcoins that the miner receives were not previously in circulation.

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

— Bitcoin advantages:

- Anonymous
- No government control
- No financial intermediary
- No transaction costs
- No known way to tamper with the system

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

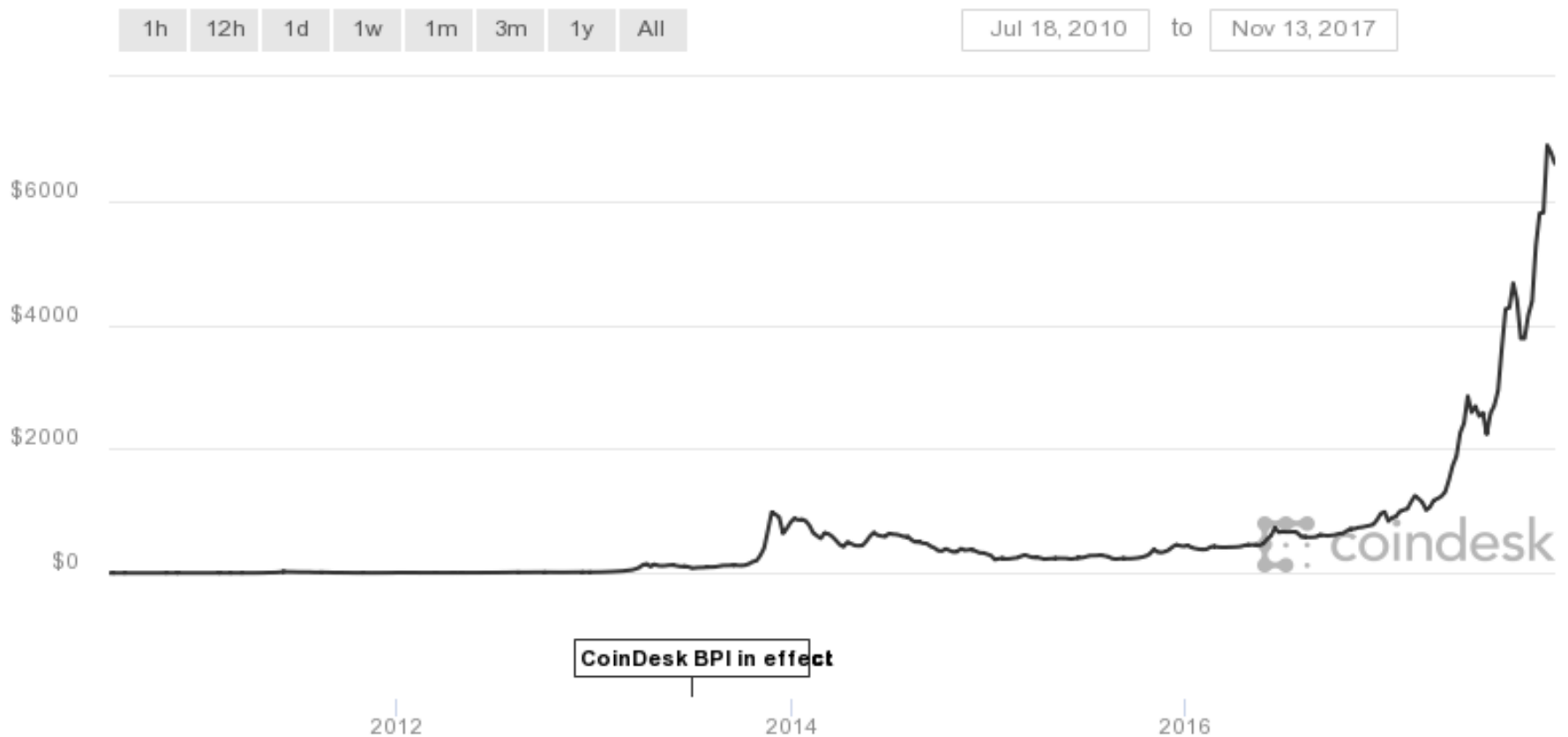
- Three basic ways to obtain Bitcoins:
 - Purchase Bitcoins using traditional fiat currency.
 - Exchange a good or service for Bitcoins.
 - Mine a transaction and receive Bitcoins not previously in circulation.
- Companies that accept Bitcoins as payment?
 - Microsoft, Overstock, Expedia and at least one governmental entity.
- Questions?

Sales Taxation of Bitcoins

Factual Summary

What are Bitcoins and how do they work? (Contd.)

Bitcoin valuation



Sales Taxation of Bitcoins

Federal Income Tax Treatment of Bitcoins

Sales Taxation of Bitcoins

Federal income tax treatment of Bitcoins

Internal Revenue Notice 2014-21

- Bitcoins are property rather than currency.
- The Internal Revenue Code rules regarding foreign currency are inapplicable.
- Receiving Bitcoins in exchange for goods or services results in gross income.
- Gain or loss on the sale or exchange of Bitcoins is capital if the Bitcoins are a capital asset in the hands of the taxpayer.
- Mining Bitcoins results in gross income to the miner in the amount of the fair market value of the Bitcoins.

Sales Taxation of Bitcoins

Using Bitcoins To Purchase Taxable Items

Sales Taxation of Bitcoins

Sales taxation – Exchanging Bitcoins for taxable items

States that have issued guidance on virtual currency

— California

- Treated as barter transactions.
- State follows federal guidance: Bitcoins are property not currency.
- Measure of tax is the price of the taxable item
 - Example: Bitcoins are exchanged for a taxable item with a list price of \$50.00. Tax is imposed on \$50.00; not fair value of the Bitcoins at the time of the transaction.
 - California SBE Special Tax Notice, No. L-382, 06/01/2014; California SBE Tax Information Bulletin, No. 388, 09/01/2014.

Sales Taxation of Bitcoins

Sales taxation – Exchanging Bitcoins for taxable items (Contd.)

States that have issued guidance on virtual currency

— New York

- Bitcoin transactions are treated as barter transactions.
- In contrast to California, sales tax imposed on fair value of Bitcoins exchanged at the time of the transaction.
- New York Technical Service No. TSB-M-14(5)C, 12/05/2014.

— Tax base differences?

- Value of Bitcoins exchanged vs price of taxable item?
- What if these values are different?

Sales Taxation of Bitcoins

Sales taxation – Exchanging Bitcoins for taxable items (Contd.)

States that have issued guidance on virtual currency

— Other states

- Kentucky, Michigan, New Jersey, and Wisconsin follow New York approach.
 - The tax imposed on fair value of Bitcoins exchanged.
- Washington follows California approach.
 - The tax is imposed on the price of the taxable item.
 - Washington, Other Official Material, Accepting virtual currency as payment for goods or services, 01/28/2015.

Sales Taxation of Bitcoins

Sales taxation – Exchanging Bitcoins for taxable items (Contd.)

States that have not issued guidance on virtual currency

- Virtual currency will likely be treated as a barter transaction.
- Many states specifically include the term “barter” in their definition of “sales” for sales tax purposes.
- A “barter” transaction is generally defined as an exchange of taxable items without using money.
- The lack of traditional currency in a sales transaction will likely not impact the taxability of the transaction for sales tax purposes.

Sales Taxation of Bitcoins

Sales taxation – Exchanging Bitcoins for taxable items (Contd.)

States that have not issued guidance on virtual currency

— Sales tax collection on barter transactions

- Transferor of the taxable item likely has the obligation to collect tax on the transfer of the item.
- Is the tax base the fair market value of the taxable item transferred or the fair market value of the Bitcoins received?
- Is seller required to collect sales tax in cash?
- If seller collects sales tax in Bitcoins, capital gain or loss could result from time Bitcoins are collected to when they are redeemed for cash.
- Can you pay sales tax with Bitcoins? Maybe.
 - Seminole County in Florida becomes first governmental entity to accept Bitcoin.
<http://seminoletax.org/forms/bitcoin-announcement.pdf>

Sales Taxation of Bitcoins

Sales taxation – Exchanging Bitcoins for taxable items (Contd.)

States that have not issued guidance on virtual currency

- What if Bitcoins themselves are also taxable as property?
 - Do both the transferor of the taxable item and the Bitcoins have to collect sales tax?
 - Seller of tangible item or good and user of Bitcoins may both be obligated to collect sales tax.
 - If transferor of Bitcoins doesn't collect sales tax on the transfer of Bitcoins, seller may be liable to collect sales tax on the transfer of the good or service and use tax on the Bitcoins.
 - Collect tax in Bitcoins?
 - Collect U.S. Currency in addition to Bitcoins?

Sales Taxation of Bitcoins

Purchasing Bitcoins

Sales Taxation of Bitcoins

Sales taxation – Purchasing Bitcoins

States that have issued guidance on the purchase of virtual currency

- Michigan, Missouri, and New Jersey have issued guidance stating that the purchase of virtual currency is not subject to sales tax.
- These states reason that virtual currency is not tangible personal property and as such, not subject to sales tax.
- Also, likely not taxable in states that do not tax digital goods or software transferred electronically. E.g. California.

Sales Taxation of Bitcoins

Sales taxation – Purchasing Bitcoins (Contd.)

States that have not issued guidance on the purchase of virtual currency

- Taxable as digital good or digital download?
 - Is it downloaded?

 - Is it a digital good like an app or a game?

- Washington
 - Sales tax on “digital goods.”

 - A “digital good” is “sounds, images, data, facts, or information, or any combination thereof, transferred electronically.”

 - Taxable?

Sales Taxation of Bitcoins

Sales taxation – Purchasing Bitcoins (Contd.)

States that have not issued guidance on the purchase of virtual currency

— Connecticut

- Imposes tax on “digital downloads”
- A digital download is “software, books, magazine or newspaper articles, artwork, ringtones, games, music, videos, concerts, and sporting events.”
- Taxable?

Sales Taxation of Bitcoins

Sales taxation – Purchasing Bitcoins (Contd.)

States that have not issued guidance on the purchase of virtual currency

— Taxable as the purchase of currency?

- Illinois
 - Exempts from sales tax all gross receipts derived from the sale legal tender.
- Colorado
 - Exempts sales of “coins” from sales tax.
 - “coins” defined as “monetized bullion or other forms of money designated as a medium of exchange under the laws of this state, the United States, or any foreign nation.”
- Florida
 - Imposes sales tax on sales of foreign currency sold at a rate above the exchange rate.

— No state has included virtual currency in its definition of currency

Sales Taxation of Bitcoins

Mining Bitcoins

Sales Taxation of Bitcoins

Sales taxation – Mining Bitcoins

- No states have issued guidance that specifically addresses mining of Bitcoins.
- If we assume that Bitcoins are a taxable item, is the mining and subsequent use of the Bitcoins subject to use tax?
- Mining Bitcoins is not a “transaction”
 - No buyer and seller
 - Miner unlocks Bitcoins that were previously unavailable

Sales Taxation of Bitcoins

Sales taxation – Mining Bitcoins

- Similar to extracting natural resources
 - Mining Bitcoins and extracting natural resources both involve converting something that was non-taxable to something that is taxable (assuming the natural resources and Bitcoins are taxable).
 - No state has explicitly imposed a severance tax on mining Bitcoins.

Sales Taxation of Bitcoins

Sales taxation – Mining Bitcoins (Contd.)

- State guidance on natural resource extraction
- Michigan Regulation Section R205.99
 - if an extractive operator ... consumes or uses it himself in other than the manufacturing or producing of a product for ultimate sale, extractions ... used are taxable and the extractor shall account for and remit the tax to the state.
- Washington Regulation Section 458-20-134(4).
 - persons manufacturing or extracting tangible personal property for commercial or industrial use are subject to use tax on the value of the articles used.
- Maine Administrative Guidance
 - A sub-contractor that extracts rock from its own pit and uses that rock in a construction job is not subject to use tax on the amount rock used.

Sales Taxation of Bitcoins

Sales taxation – Mining Bitcoins (Contd.)

- What does “use” mean for Bitcoins?
- The term “use” is typically defined as “exercise of any right or power over a taxable item incident to the ownership of that property.”
- For Bitcoins, is this simply possessing the Bitcoins?
Spending the Bitcoins?
- Questions?

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