



# Virtual Currency

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### Virtual Currency

Currency is money in any form when in use or circulation as a medium of exchange. When a currency is legally recognized by a government to be valid for meeting a financial obligation, it is called legal tender. Coins and banknotes are usually defined as legal tender in most countries. Legal tender is backed by a central government, and the government controls the supply.

Virtual currency is a digital asset. It is not legal tender in most countries and is not backed by a central government or bank. It is decentralized and is global. It is a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value other than a representation of the U.S. dollar or a foreign currency. Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of cryptocurrency are generally referred to as coins or tokens.

#### Fair Market Value (FMV)

For federal income tax purposes, transactions using virtual currency must be reported in U.S. dollars. You will be required to determine the FMV as of the date of payment or receipt of the virtual currency.

#### Virtual Currency Income Received

**Barter income.** When you barter with someone you are exchanging one good or service for another without the payment of money. Barter exchanges are common in virtual currency exchanges. The FMV of virtual currency received in a barter exchange is subject to income tax as if it was U.S. dollars. When virtual currency is received in the course of a trade or business, the FMV of the virtual currency must be included in business income in the year of receipt and is subject to self-employment tax.

**Example:** Jill has a cleaning business and cleans George's house for a year in exchange for cryptocurrency. The FMV of the cryptocurrency when received is \$15,000. Jill recognizes \$15,000 as business income on her tax return even though she did not receive any U.S. dollars.

**Employees.** The FMV of virtual currency paid as wages is subject to federal income tax withholding, FICA tax, and unemployment taxes. It also must be reported on Form W-2, *Wage and Tax Statement*.

#### Virtual Currency Used to Purchase Goods or Services

For federal income tax purposes, the main difference between using virtual currency to purchase goods or services versus the U.S. dollar is that virtual currency is treated as property. The tax basis of the U.S. dollar is its face value. When a product or service is purchased using the U.S. dollar, there is no gain or loss on the exchange of that U.S. dollar for the product or service. In contrast, the tax basis of virtual currency is the cost to acquire it. When a product or service is purchased using virtual currency, gain or loss is the difference between the fair market value of the product or service and the cost basis in the virtual currency that is exchanged for that product or service.

**Example #1:** Brad uses two U.S. dollars to purchase a cup of coffee. Since Brad's tax basis in those two U.S. dollars is their face value (\$2), and the fair market value of the cup of coffee is \$2, there is no gain or loss on the transaction.

**Example #2:** Brad uses virtual currency to purchase a cup of coffee that is worth \$2. Brad had previously acquired the virtual currency at an ATM machine by exchanging one U.S. dollar for the virtual currency. Brad has a \$1 taxable gain on the purchase of the coffee, the difference between the fair market value of the coffee (\$2) and the tax basis in the virtual currency (\$1).