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TAX REPORT

No One Knows How Much to Pay in Bitcoin Cash Taxes

With little guidance from the IRS on tax issues for digital currencies, experts offer their best guesses

Tax experts say there has been no guidance on how to treat the sudden receipt of Bitcoin Cash, a new alternate to bitcoin, above. **PHOTO:** BENOIT TESSIER/REUTERS

By Laura Saunders

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Before rejoicing over a Bitcoin Cash windfall, here's a warning: You may owe taxes on it.

After years of discord over bitcoin's future, the digital currency recently split into two competing versions: one called bitcoin and an alternate called Bitcoin Cash. As a result, each bitcoin owner received an equal amount of Bitcoin Cash, or the right to it.

But tax experts say there has been no guidance on how to treat the sudden receipt of Bitcoin Cash.

The Internal Revenue Service declined to comment on the issue. It hasn't clarified many tax issues pertaining to digital currencies since it issued bare-bones guidance in 2014.

Jim Calvin, a buy-side tax specialist at Deloitte, thinks the receipt could be taxable this year for technical reasons. If so, recipients would have ordinary income, although the amount isn't clear. It could be based either on the value of Bitcoin Cash when issued or when investors could trade it, which wasn't immediately. One source quoted the price of Bitcoin Cash on Aug. 1 as ranging from $210 to $426.

Thus Bitcoin Cash recipients could owe tax this year at rates as high as 39.6%. It's unclear whether the 3.8% net investment income tax would also apply, says Mr. Calvin.

Then again, the IRS could say that the receipt of Bitcoin Cash isn't taxable because it's a "property division." In this case, no tax would be due until the holder sells or transfers the Bitcoin Cash. But the cost basis of both bitcoin holdings would need to be adjusted to account for the split. (Cost basis is the starting point for measuring taxable gain after a holding is sold.)

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"Investors need clear guidance from the IRS so they'll know what they owe and when," says Mr. Calvin.

As tax experts debate how to classify the split, the IRS appears focused elsewhere when it comes to digital currencies. The top of its agenda is to root out those who use these currencies for tax evasion.

All IRS criminal investigators have received training in virtual currency crimes over the past few years. The agency has agreements with Chainalysis, a provider of bitcoin investigation software, to detect money laundering, according to an IRS spokesman.

And it is sending a strong message by seeking customer-account information from Coinbase, a San Francisco-based digital-currency-services company. Last month, the IRS narrowed the summons after some lawmakers protested that it was too broad.

The latest version asks for accounts held between 2013 and 2015 with transactions of $20,000 or more. It also excludes customers who bought bitcoin but didn't sell it. Experts say the summons will stick.

"The IRS got the information it wanted on Americans hiding money in offshore accounts, and it will get the information it wants on Americans evading taxes through virtual currencies," says Bryan Skarlatos, a criminal tax attorney with Kostelanetz & Fink in New York.

In the absence of IRS guidance, here are experts' best guesses on other tax issues for digital currencies:

Lot identification. Investors can instruct brokers which shares they intend to sell of stock held in a taxable account. This choice often affects the taxes due on a sale.

The rules hold true for bitcoin, says Mr. Calvin, except there's no broker to instruct. He suggests bitcoin investors keep careful records and inform a third party, such as an adviser, how lots are to be chosen for sale ahead of time.

Nondeductible losses. When bitcoin is held for investment, gains are typically taxable and losses can offset gains.

But there's an exception: If the bitcoin is for personal use—say to buy a meal or a boat—then gains on it are taxable but losses aren't deductible, says tax strategist Bob Gordon of Twenty-First Securities Corp. This longstanding rule also applies to houses, he notes.

Wash-sale rules. These rules penalize taxpayers who sell shares at a loss and buy them within 31 days before or after the sale.

Mr. Gordon says wash-sale rules don't apply to digital currencies because they aren't securities. But investors should avoid simultaneous transactions solely to capture losses, he warns. "Sales need to have a nontax as well as a tax reason."

Like-kind exchanges. Section 1031 allows taxpayers to defer taxes on exchanges of similar assets, sometimes for decades.

While the rules apply to digital currencies in theory, Silicon Valley tax attorney Roger Royse, of Royse Law Firm, urges caution. Exchanging one digital currency for another to diversify risk may work, but more complex swaps may not.

Taxpayers with like-kind exchanges have to file a special form, he says, "and it's like waving a red flag at the IRS."