

The two faces of bitcoin

What if your kids surprise you this year by stuffing your holiday stocking with bitcoin? Actually, it would be stuffed in your virtual stocking online, not the one by the fireplace, and it really isn't coins, it's virtual currency.

So what do you do with these bitcoins everyone talks about? Is it really the new money?

The idea of bitcoin has been attributed to an elusive tech genius who invented the decentralized system for buying and selling virtual currency. Bitcoins are traded online, where their values fluctuate rather wildly, hitting as low as 30 cents and as high as \$1,242 per bitcoin. To be accepted for payment, bitcoins must be authenticated by their electronic chains of title, just as the pedigree of valuable artwork needs to be checked.

Bitcoins began as a means of payment for playing online video games. Their use has since migrated from the virtual world to the real world. As of August 2014, bitcoins are accepted as a form of payment for real world products at such retail sources as Dell, Dish Network, Overstock.com, and Virgin Galactic.

But wait! Are bitcoins treated just like U.S. currency? What happens when you use your bitcoins to buy, for example, a couch or a tablet?

The anonymity blanketing bitcoin transactions troubled the U.S. Treasury, which was afraid it could create a new underground criminal economy. The Treasury also denied that bitcoins are a form of currency in America, saying only the U.S. government can

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issue currency having authorized, widely accepted monetary value.

As a result, the U.S. Treasury has said bitcoins are a commodity, and when giving up a commodity, in exchange

for receiving another product, you engage in a "barter sale." That means you have created a "double-headed" transaction. You bought your couch or your tablet, and you sold your bitcoins for a value equal to the value of the couch or tablet you bought. Therefore, you must realize taxable gain or loss on the exchange of bitcoins, depending upon whether the value of your bitcoins at the time of sale is more or less than what the bitcoins cost you. You must report the transaction on your tax return and pay income taxes on the gain. If you aren't a professional, and you lose money in the bitcoin transaction, you may be denied a tax loss deduction. Worse yet, if your bitcoins are stored on an exchange outside of the U.S., the strict rules requiring you to report foreign assets or foreign accounts come into play, and your tax return becomes that much more complicated. Failing to observe these tax rules could subject you to severe penalties. The simple purchase transaction now has two heads to it.

So when you retrieve those bitcoins from your virtual stocking this year, you might also hear the whisper of "Bah, Humbug" from deep within your electronic device, which surely emanates from Washington.

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