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Accepting Payment in Bitcoin: Considerations for Merchants

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As cryptocurrencies such as bitcoin gain more attention and acceptance, and as technology evolves to make transferring digital funds easier, more businesses are beginning to consider accepting cryptocurrencies as a form of payment in lieu of fiat currencies. Many of the businesses that already do are household names, most notably including Overstock.com, which began accepting bitcoin back in 2014. Other well-known merchants that have since joined the fray include Dish Network, Virgin Galactic, Wordpress, Intuit, Newegg.com, Expedia.com, OkCupid, Reddit, and Microsoft. A handful of law firms are allowing clients to pay their legal fees in cryptocurrency as well.

Before businesses and online retailers accept cryptocurrency as payment, a thorough analysis is necessary to determine whether the potential benefits outweigh the inherent risks and costs, and what the legal ramifications are. Some of the key issues are set forth and discussed below.

Volatility

One of the key attributes of cryptocurrencies is volatility (particularly short-term volatility), meaning that their price is constantly fluctuating when measured against fiat currencies. This raises a number of concerns for businesses that accept payment in cryptocurrency. First, for retailers, what happens when a customer wants to return a product? If the customer paid the equivalent of $100 in bitcoin for the product, but the value of the same amount of bitcoin has now increased to $125 or decreased to $75, what amount of bitcoin should the customer receive upon returning the product? There are a number of viable solutions to this problem, including providing store credit for these returned items (the Overstock solution), issuing refunds in U.S. dollars based on the original purchase price, or not allowing returns. Whatever the merchant decides, this should be written into its terms and conditions so that customers are aware of the return process before making any purchases using cryptocurrency.

Another consideration for businesses related to volatility is whether or not to hold on to the cryptocurrency once a payment has been made. Does the business want to treat the cryptocurrency as an investment? Use it to pay employees and suppliers (which raises a separate range of issues)? Exchange it for fiat currency immediately? This is a business decision that will have financial implications for the company.

Although beyond the scope of this article, it is worth mentioning Stablecoins, which are a type of cryptocurrency that (ostensibly) lack the volatility of cryptocurrencies like bitcoin, and which may be suitable for everyday use by the public as a medium of exchange. Stablecoins may be backed by fiat currency or by another type of cryptocurrency, or they may have a mechanism in place to keep the cryptocurrency from fluctuating without being collateralized. This type of cryptocurrency may solve the volality-related problems that merchants face using a cryptocurrency like bitcoin, while still offering many of the benefits (instant processing, secure payments, etc.).

Tax Implications

The Internal Revenue Service (IRS) published a notice in 2014 with answers to frequently asked questions about how existing tax principles apply to transactions using virtual currency. Importantly, the IRS states that the use of convertible virtual currency (meaning a virtual currency that has an equivalent value in fiat currency, or that acts as a substitute for fiat currency, and includes bitcoin) has tax consequences that may result in tax liability.

For federal tax purposes, virtual currency is treated as property, and not as currency, meaning that general tax principles that are applicable to property will also be applicable to virtual currency. Any taxpayer that receives virtual currency must include the fair market value of the virtual currency when computing its gross income, which is measured in U.S. dollars as of the date of receipt, and may be based on an exchange rate that is established by market supply and demand.

When a business that has accepted a cryptocurrency payment then exchanges that cryptocurrency for fiat currency, this exchange is treated as a gain or loss if the value of the fiat currency exceeds or is less than the taxpayer’s basis of the virtual currency. This will be considered a capital gain or loss if the virtual currency is a capital asset to the taxpayer (this generally includes investment property such as stocks and bonds), and will be considered an ordinary gain or loss if not a capital asset (meaning that it is inventory or other property held for sale to customers). Any business considering accepting payment in cryptocurrency will need to perform this analysis, keep comprehensive records of its transactions, and be aware of the tax implications, which differ from accepting payment in fiat currency.

Other Considerations

Another issue that businesses should bear in mind is that cryptocurrencies, unlike fiat currencies held in a bank account, are not insured by the Federal Deposit Insurance Corporation (FDIC). This means that if a business’s digital wallet provider goes bankrupt or its private key is stolen and it loses a significant amount of its cryptocurrency, the business will not have the same recourse that it would otherwise. This is not to say that the business will have no recourse at all – merchants will have contractual relationships with their payment processors and digital wallet providers, and should review these terms closely to understand what their rights are (and negotiate more advantageous terms, if possible).

Businesses considering transacting in cryptocurrencies should also be aware of the money service business rules and regulations promulgated by the Treasury Department’s Financial Crimes Enforcement Network (FinCEN) and state financial regulators. Merchants that solely accept payment in cryptocurrency for their own accounts are likely not subject to these rules and licensing/registration obligations, but engaging in certain other cryptocurrency activities might fall under FinCEN’s jurisdiction.

Conclusion

There are a number of efficiencies that may be gained for businesses that wish to accept payment in cryptocurrency. However, because cryptocurrencies operate differently and are treated differently by regulators than fiat currencies, merchants need to be aware of the potential legal and business implications before doing so. With the proper preparation and analysis, it may be the right decision for your business.

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