TZEDEK DC
Legal Help for People in Debt

Cryptocurrency: Questions and Myths

Frequently Asked Questions

1. What are cryptocurrencies? Are they like money?

Cryptocurrencies (also referred to as **virtual currencies**) are decentralized encrypted digital "currencies" that can be transferred or traded person-to-person through the internet without a third-party financial institution (such as a bank or government). Cryptocurrency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value.

Cryptocurrency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as **"convertible" virtual currency**. Bitcoin is one example of a convertible virtual currency. In some environments, Bitcoin operates like a "real" currency, but it does not have **legal tender** status in the United States, which means it is not a form of payment that by law must be accepted if offered to pay a debt.

Unlike traditional money that is issued by governments, cryptocurrency is not controlled by a central bank. In most counties (except El Salvador), businesses are not required to accept it for the purchase of goods and services, and it may not be used to pay taxes. Also, the value of cryptocurrencies tends to be far more volatile or unstable than traditional currency.

2. What is Bitcoin?

Bitcoin was created in 2008 and was one of the earliest cryptocurrencies. It is currently the most popular and largest convertible currency. Bitcoin is a digital asset that relies on **blockchain technology**. There is a limited amount of Bitcoin in circulation and a finite amount that can ever be "mined."

Bitcoin transactions are partially anonymous in that an individual that transacts in Bitcoin is identified by an **alpha-numeric public key/address**. Bitcoin relies on **cryptography** (and unique digital signatures) for security based on public and private keys and complex mathematical algorithms. Bitcoin runs on a decentralized peer-to-peer network of computers and "miners" that operate on open-source software and do "work" to validate and irrevocably log transactions on a permanent **public distributed ledger** visible to the entire network.

3. How much is Bitcoin worth?

The price of Bitcoin varies dramatically from day to date and week to week. In 2021, the value of a single Bitcoin climbed to a high of about $63,000 before falling 54% then going up some again. In August 2021, prices started around $39,000 and fell to as low as $29,000. It is not necessary to purchase or sell and entire Bitcoin; rather, it is possible to purchase or sell very small increments of a Bitcoin.

4. Who can use Bitcoin?

Bitcoin is open to anyone with internet access. However, some people or companies may choose only to transact with users that are verified through a **"know your customer" service** similar to those used by banks.

5. How do I get Bitcoin?

In the United States, you can buy Bitcoin from licensed, online money service businesses. Some popular sites include **Coinbase**, **CashApp**, and **Kraken**. Several retailers also offer **"Bitcoin ATMs"** where you can use cash to add funds to a Bitcoin wallet. For either of those options, you will need to provide a picture of your government-issued identification to buy, sell, or trade in Bitcoin. You should also know that some platforms let you "buy" Bitcoin, but do not let you send Bitcoin.

You can also create your own **Bitcoin wallet**. A helpful guide for choosing your wallet is available at this link. With your own wallet, friends, family, or other people can send you Bitcoin. Note, however, if you try to transact in Bitcoin with individuals directly, you will have to be careful to keep your electronic wallet and electronic private keys safe to avoid theft or fraud.

6. Do I need a bank account to use Bitcoin?

You do not need a bank account to use Bitcoin, but many online platforms may require that you link a bank account to sell and "cash out" your Bitcoin into dollars.

7. What are the risks and benefits of using Bitcoin?

Risks

Purchasing virtual currencies—spending dollars to purchase Bitcoin for your personal wallet, for example—on a **cryptocurrency exchange or platform** comes with a number of risks, including:

- Most Bitcoin exchanges or platforms are not regulated or supervised by a government agency.
- Bitcoin exchanges may lack critical system safeguards, including consumer protections.
- There could be volatile price swings or "flash crashes."
- Prices can be manipulated.
- There may be cyber risks, such as hacking of customer wallets.
- Platforms can sell from their own accounts and put customers at an unfair disadvantage.

Because of the decentralized nature of Bitcoin, once a transaction is initiated, it cannot be cancelled or reversed. Senders must therefore be extra-cautious about to whom they are sending Bitcoin. Additionally, the value of Bitcoin is constantly changing, so users should understand that it may be worth less (or more) soon after purchase.

Virtual currencies are commonly targeted by hackers and criminals who commit fraud. There is no assurance of recourse if your virtual currency is stolen. Be careful how and where you store your virtual currency and private keys.

Benefits

Bitcoin can be quicker and have a lower transaction fee than other methods of payment. Additionally, when using your own wallet and sending to or receiving directly from a friend, you do not have to worry about a third party such as a bank or merchant freezing a transaction or reversing it.

8. What does El Salvador's decision to make Bitcoin "legal tender" mean?

In 2021, El Salvador declared that citizens can use Bitcoin to purchase goods and services and pay their taxes in El Salvador. El Salvador is requiring all businesses to accept Bitcoin so long as the business has the technological means to do so. Businesses may list prices in Bitcoin (BTC) alongside US Dollars (USD). Since El Salvador is the first country to make Bitcoin legal tender, there is still much uncertainty surrounding the practical use of Bitcoin as money, and it will take time for businesses and consumers to become fluent in the technology and account for its price volatility as compared to dollars.

9. What are the fees associated with sending Bitcoin? How do they compare to sending US Dollars?

The average **transaction fee** changes based on how many Bitcoin transactions are happening each day. In 2021, transaction fees were as high as $62, but they typically range between $2 and $10.

Importantly, this transaction fee applies to *every* transaction for sending Bitcoin, even if it is just sending to friends and family. So if (1) you buy Bitcoin, (2) you send it to family in El Salvador (or anywhere else), and (3) your family spends it at a grocery store, three transaction fees will be incurred—one for each of the transactions in this example.

There are efforts underway to dramatically lower these transaction fees, but as of August 2021, these efforts were mostly unstable and not available for most users.

10. How will purchasing and sending Bitcoin affect my taxes?

It is essential that you keep track of all Bitcoin transactions (purchases, sales, and transfers) for tax purposes. Since the IRS currently categorizes Bitcoin as a commodity, you will incur **capital gains tax** each time you sell or transfer Bitcoin if the price when you sell or transfer it is higher than the price at which you bought it. Bitcoin platforms in the United States should send you a tax **Form 1099** reporting on your gains and will report the same information to the IRS.

11. Are there other laws I should be aware of if I'm using cryptocurrencies?

With cryptocurrencies other than Bitcoin, it is important to understand that—depending on the cryptocurrency you are dealing with—you may be transacting with a security or a commodity, which have different tax consequences. All cryptocurrencies are not treated the same. Currencies that are fully developed and currently in use (like Bitcoin) are **commodities**. Currencies that are in development and asking for investment to fund development are **securities**. Additionally, anti-money laundering laws that apply to sending US Dollars also apply to sending cryptocurrencies.

12. How is sending money with Bitcoin different than sending money with Western Union?

On average, sending Bitcoin is faster and has a smaller transaction fee than **Western Union** (although, if sending Bitcoin becomes more popular, fees and wait time could surpass a Western Union transaction). Sending Bitcoin will often carry more complex tax implications given its current commodity status in the United States. Additionally, since the value of Bitcoin is unstable, $100 of Bitcoin that a person owns today may only be worth $80 by the time the person wants to spend it.

Overall, Bitcoin use carries with it more uncertainty and risk than a traditional Western Union transfer of US Dollars.

Common Myths

1. "I've heard cryptocurrency is for criminals and is mostly used for crime."

There is nothing inherently criminal about using cryptocurrencies. However, because of its decentralized nature and the partial anonymity it affords to users, it has become a popular means of payment for criminal activity and tax avoidance. In the past few years, its association with crime has declined somewhat as regulators have caught up to the technology and its legitimate uses have expanded.

2. "I've heard cryptocurrency is a good investment to get rich quickly."

Investing in cryptocurrency carries high risks given its volatility and the lack of comprehensive regulation. The value of a cryptocurrency can swing dramatically on a day-to-day or week-to-week basis. For most consumers, purchasing cryptocurrency should be viewed as more of a gamble than a safe investment.

Importantly, a widely reported study in 2019 found that 95% of Bitcoin traders lose money. Hype online is also widely driven by paid promotions that may not be honestly disclosed and is not representative of the experience of the vast majority of investors.

You should be on the lookout for any of these warning signs of **investment fraud**:

- **"Guaranteed" high investment returns.**

  All investments have risk, and investors should question any so-called "guaranteed" return. Be wary of anyone who promises that you will receive a high rate of return on your investment, especially with little or no risk. Claims such as "risk-free," "zero risk," "absolutely safe," and "guaranteed profit" are hallmarks of a fraud.

- **Complicated language that is difficult to understand.**

  Fraudsters often use complex new technologies to perpetrate investment schemes. They can claim their technology is highly secret. Investors should always be suspicious of hard-to-understand pitches that accompany promises of outsized returns. Sometimes the language includes spelling, grammar, and typographical errors that can make the description confusing—another red flag the "investment" could be a scam.

- **Unlicensed sellers.**

  Many investment frauds involve unlicensed individuals or unregistered firms. Check license and registration status at on investor.gov.

- **Sounds too good to be true.**

  If the investment sounds too good to be true, it probably is. Remember that investments providing higher returns typically involve more risk.

- **Unsolicited offers.**

  An unsolicited sales pitch may be part of a fraudulent investment scheme. Exercise extreme caution if you receive an unsolicited communication—meaning you did not ask for it and do not know the sender—about an investment opportunity. Fraudsters may use fake names and misleading photos and also provide United States phone numbers even though they may be operating abroad.

- **Pressure to buy RIGHT NOW.**

  Fraudsters may try to create a false sense of urgency to get in on the investment. Take your time researching an investment opportunity before handing over your money.

Before making any investment, carefully read any materials you are given and verify the truth of every statement you are told about the investment. Investigate the individuals and firms offering the investment and check out their backgrounds on investor.gov and by contacting your states securities regulator.

3. "I've heard cryptocurrency keeps my information private from the United States Government."

You will need to set up an account with your name and corresponding identification information to buy, sell, or trade cryptocurrencies in the United States. Bitcoin transactions are part of a public ledger, so the United States Government can uncover details of a transaction and trace it to a wallet or individual.

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