# Think Twice Before Paying Employees in Cryptocurrency

**January 2021**

With the increasing use of Bitcoin and other cryptocurrencies, employers may wonder whether they should start paying employees with these cryptocurrencies. Paying employees with cryptocurrency may generate goodwill among current or prospective employees, especially younger people, those who lack access to traditional bank accounts, or those who remit payments to families in other countries.

But employers may want to exercise caution. While cryptocurrency has developed at a rapid place, the laws that may apply to new forms of commerce have not. Paying employees with cryptocurrency therefore leaves many unresolved issues related to tax, securities, and employment law. Here are a few issues for employers to consider before paying employees with cryptocurrency.

***Tax Issues***

What exactly is cryptocurrency? This question is not theoretical. The answer creates vastly different tax consequences for employers and employers.

The IRS said that virtual currency like Bitcoin is property, not currency. Under this characterization, paying employees in cryptocurrency would be no different than if the employer paid the employee in other property like inventory. Employees would owe income tax on the fair market value of the cryptocurrency they receive (measured at the time of receipt). Employers would need to withhold an amount of federal and state income tax related to the payment based on that value, and may recognize gain or loss if it held the cryptocurrency before payment.

Still, there is a possibility that some cryptocurrencies, especially stablecoins and currencies issued by foreign governments, may instead be characterized as currency. If so, employers and employees would no longer recognize gain or loss when they exchange the cryptocurrency. But employers and employees would recognize ordinary foreign exchange gain or loss for any transaction involving foreign currency. Tracking foreign exchange gain or loss may create many administrative difficulties.

***Wage Payment Law***

The Fair Labor Standard Act requires employers to comply with certain minimum wage and overtime provisions. To satisfy these requirements, employers must pay their employees in cash or its equivalent, which some cryptocurrencies may not satisfy. Even if certain cryptocurrencies were ultimately found to satisfy the federal law requirements, state or local wage payment laws (such as those in Delaware, Illinois, Michigan, New Jersey, Pennsylvania, and Texas) may impose similar or additional requirements for the form of payment.

***Executive Compensation***

Employers may want compensation in cryptocurrency to be subject to performance milestones, just as employers restrict stock option grants. As long as payment is subject to a condition that has yet to be satisfied, the employee is generally not taxed on that income. Still, as many executives well know, employees may want to make a section 83(b) election. If the payment is subject to a "substantial risk of forfeiture," the employee can elect to be taxed at the fair market value of the payment when the property is granted. Although the section 83(b) election accelerates income recognition, any subsequent increase in the value of the property is taxed at capital gain rates, not ordinary income rates. The election is advantageous if the recipient anticipates significant appreciation.

Even so, an employee can only make a section 83(b) election for "property." If an employer pays someone in cryptocurrency treated as currency, the employee could not make the election and would need to pay tax at ordinary rates when the cryptocurrency vests.

***Retirement Funds***

Employers and plan sponsors may face questions from employees looking to invest in cryptocurrency in 401(k) plans. But plan fiduciaries will need to consider employee requests in light of fiduciary obligations to act prudently and in the best interest of plan participants in the sections of investment options offered by a 401(k) plan

Among other risks presented by the prospect of offering cryptocurrency as an investment option, plan fiduciaries also have to consider what will happen if the plan or plan participants cannot recover cryptocurrency. One Bitcoin expert estimated that 25% of bitcoins are lost in circulation either because of lost keys or lost wallets. Furthermore, many high-profile and high-dollar hacks of cryptocurrencies like Bitcoin and Ether show that security breaches are real threats to those that hold cryptocurrency. Plan sponsors may need to implement robust procedures to prevent cryptocurrency from being lost, stolen, or forgotten about.

***Security Law Issues***

Employers may want to consider the potential applicability of U.S. securities law. Some cryptocurrencies may very well be "investment contracts," which is a type of "security" to which federal securities law applies. To determine whether the cryptocurrency is a security, employers may need to analyze whether the purchaser has a reasonable expectation of profits derived from efforts of others. In 2019, the Chairman of the Securities and Exchange Commission said that most initial coin offerings probably qualify as securities, but that mature cryptocurrencies like Bitcoin and Ethereum probably do not qualify as securities.

***Alternatives***

But even if employers don't want to start paying employees only with cryptocurrency, employers may consider limited and potentially more certain alternatives:

- Only offer payment for independent contractors using cryptocurrency, avoiding the issues presented by wage payment laws.
- Pay employees a blended compensation package of cryptocurrency and U.S. dollars (using conventional currency to satisfy FLSA and applicable requirements under state law).
- Pay employees in U.S. dollars but offer a conversion service for employees to transfer payment to cryptocurrency right after receipt.

For questions, please contact a member of our Tax or Benefits & Compensation team.