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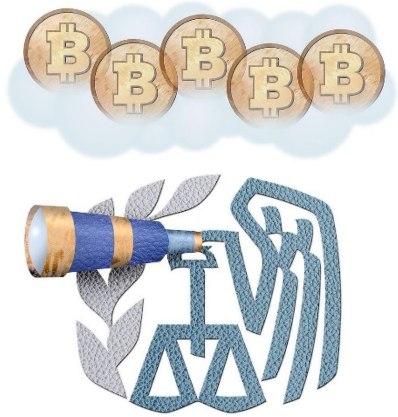

When the Remedy is More Destructive than the Disease

by Richard W. Rahn

The U.S. government once again proved that it does foolish and destructive things by trying to impose a tax that actually loses money. The Internal Revenue Service (IRS) demanded information from a San Francisco bitcoin exchange about who was buying and selling bitcoins. The IRS claims that bitcoins and other digital/cryptocurrencies are property and thus subject to a capital gains tax on any price increases and other reporting requirements when bitcoin is used in transactions. It seems that the IRS discovered that in 2015 only 802 people declared bitcoin-related losses or gains, despite tens of millions of transactions (I am willing to bet that most of these folks reported losses, which are deducible).

The IRS thus claims that every alternative currency transaction is a taxable event that must be reported on a taxpayer's tax return. Obviously, taxpayers who use alternative currencies for many daily purchases would have a tax return running into dozens, if not hundreds, of pages. Taxpayers would also have a much greater incentive to report losses than gains, so such regulations are almost certain to cause a revenue loss to Treasury. As a practical reality, the rules are basically unenforceable because the transactions are encrypted and for the most part invisible.

What is likely to happen is that those desiring to use alternative currencies will gravitate to foreign exchanges in places unlikely to cooperate with the IRS. Even if such exchanges hand over information about the initial purchase of the cryptocurrency, the actual use of the currency will be almost impossible to track. The gains and losses in digital currencies that have physical backing like gold, silver, aluminum, oil and wheat will almost certainly have a net price change close to zero over the long run. So even if no taxpayers were trying to evade the tax, Treasury would still not obtain any appreciable net revenue. Thus, it is fair to conclude that the folks at the IRS and Treasury don't understand the above or they are just trying to kill the efforts to create alternative currencies in the interest of enhancing their own power.

Governments have a long history of trying to enforce the unenforceable — e.g., laws against prostitution, alcohol, porn and pot. The government can do some selective enforcement, but the demand is going to be satisfied one way or another. Taxing and regulating cryptocurrencies will be even harder to enforce and, as noted, will bring in no net revenue.

Most people believe they should not be subject to the laws of a foreign power when they are at home. Yet Americans are subject to prosecution in some countries, including the United Kingdom, for things they have written and published in the U.S. The U.S. likewise often tries to extend U.S. law to other countries and to foreign individuals who neither reside in America or are U.S. citizens, and not in violation of their home country's laws. Countries have a long history of trying to impose their laws and rules outside of their own territory. The War of 1812 was in part set off by Britain, which refused to recognize that English seamen, who had moved to the U.S. and acquired American citizenship, were no longer subject to being impounded by the British Navy.

This past week, the European Union issued a new list of 17 so-called "tax havens" and put them on a black list with a demand that these countries and territories submit to EU laws and regulations. They also put another 47 countries on a "grey list" with the warning that they had better change their ways. The real problem is that the EU countries have tax rates well above the revenue-maximizing rates and governments that are so big that they have stifled economic growth. Rather than reform their own destructive economic policies, they are trying to build a global high-tax cartel. No tax competition will be allowed.

Many of the countries listed on the "black or grey lists" are poorer developing countries that are trying to attract international investment in order to raise their own growth rates and make their citizens more prosperous. The rich countries of Europe became rich before they had high tax rates and big governments, yet the Europeans want to deny other peoples the same opportunity they had a century ago — which is both hypocritical and mean-spirited.

The U.S. is equally hypocritical. Under the guise of trying to stop terrorist finance and tax evasion, it demands that foreign banks and financial institutions, even if they have no U.S. presence, report their customers to the U.S. government. The Foreign Account Tax Compliance Act is an expensive burden on foreign financial institutions and, for good reason, causes great resentment against the U.S. It is fundamentally undemocratic and hypocritical for one country to try to impose its laws on another.

The world would be far better off, and more peaceful and prosperous, if governments restrict law and rule-making to their own borders — and stop trying to enforce the unenforceable. All have preferences when it comes to the behaviors of others — but there is great virtue in minding one's own business.

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