Cryptocurrency Update

Moderator - **Zhanna Ziering, Esq.,** Moore Tax Law Group LLC, New York, NY

Panelist - **Sarah E. Paul, Esq.,** Eversheds Sutherland, New York, NY

Panelist - **Barry A. Fischman,** CPA, MST, Marcum LLP, New Haven, CT

Moore Tax Law Group

A Tax Controversy and Tax Litigation Boutique

Update from the Cryptocurrency Front

- THE IRS TAKES ACTION
  - In August of 2019, The Internal Revenue Service sent letters to more than 10,000 taxpayers that the Service has deemed to own or have owned cryptocurrency accounts.
  - This action was the Service's attempt in the ongoing battle to capture untaxed cryptocurrency transactions. The intent of these letters was to educate taxpayers about the tax filing requirements for reporting virtual currency transactions (such as Bitcoin) and to provide information about correcting errors made on previous tax returns.
  - Although the IRS does not specify how this list of taxpayers was obtained, some commentators believe that at least part of list was the result of the Service's Summons of Coinbase, Inc. (one of the largest virtual currency exchanges for Bitcoin and other virtual currencies) in 2017, from which it collected the names of approximately 14,355 cryptocurrency account owners who initiated transactions of $20,000 or more between 2013 and 2015.

Update from the Cryptocurrency Front

► The IRS takes action

- Many taxpayers are unlikely to fulfill their reporting obligations for their cryptocurrencies for a few reasons, but mainly because the administrative task of tracking virtual currency transactions for proper tax reporting is a nightmare.
  - There is no central bank or "data hub" for all transactions. Virtual currency is not considered to be legal tender by any country.
  - The exchanges (where the virtual currencies are traded) often do not share information with each other, although units of currency can be transferred between exchanges very easily.
  - Many of the exchanges do not require that participants identify themselves, and in fact, anonymity is sometimes a big draw for traders with criminal intent to escape taxation or even the law in general.

Update from the Cryptocurrency Front

- **THE IRS TAKES ACTION**
  - Given this extraordinary complexity involved with regulating and tracking virtual currency transactions, there is currently no requirement for the exchanges to furnish 1099-Bs to participants, properly reporting sales proceeds and cost basis (similar to stocks or other investments).

American Families Plan's Cryptocurrency Tax Compliance Agenda

- With more businesses willing to accept Bitcoin and other cryptocurrencies as payment. The absence of specific rules related to the reporting of business income from cryptocurrency transactions has created a "tax gap" that the U.S. Treasury Department intends to close.

- On May 20, 2021, Treasury released a report that included a set of proposed tax compliance initiatives with the goal of closing the gap between taxes owed and taxes actually paid. These measures are encompassed in the American Families Plan, which establishes rules for the proper reporting of cryptocurrency.

American Families Plan's Cryptocurrency Tax Compliance Agenda

- Under current regulations, the IRS may not be able to trace crypto income when such transactions go unreported by exchanges, businesses and financial institutions, causing opportunities for tax evasion.

- Under the new proposed reporting rules, banks and other financial institutions would be required to report information about account inflows and outflows to the Internal Revenue Service in order to facilitate detection of unreported income.

- Also included in the plan is a new rule that would require businesses to file a current transaction report when they receive cryptocurrency worth more than $10,000, just as most businesses are required to report cash payments in these amounts. These reports would help the IRS detect tax evasion and money laundering, similar to 1099 forms, which provide information to the IRS about all types of income received.

American Families Plan's Cryptocurrency Tax Compliance Agenda

- Final rules regarding the reporting of cryptocurrency transactions are not yet established, but businesses that accept cryptocurrency as payment are advised to prepare now by maintaining records and ensuring that such payments are reported as income.

Bipartisan Infrastructure and Jobs Act Passed by the House of Representatives 11-5-2021

- **INFORMATION REPORTING FOR BROKERS FOR DIGITAL ASSETS**
  - The bill contains a controversial provision which requires any "broker" to report digital asset transfers.
  - The rather broad definition of a "broker" includes those who regularly provides services in connection with the transfer of such assets.
  - Failure to report subjects the taxpayer to civil penalties without reasonable cause.

Bipartisan Infrastructure and Jobs Act Passed by the House of Representatives 11-5-2021

- **INFORMATION REPORTING FOR BROKERS FOR DIGITAL ASSETS**
  - The Treasury Department will need to issue further guidance with respect to this provision.
  - Applies to returns and statements required to be filed and furnished after December 31, 2023.
  - The delayed effective date likely means that there may be legislative changes to this rule over the next couple of years.

Bipartisan Infrastructure and Jobs Act Passed by the House of Representatives 11-5-2021

► **INFORMATION REPORTING FOR BROKERS FOR DIGITAL ASSETS**

- The Infrastructure Act amends various sections of the Tax Code to broadly define a cryptocurrency "broker" and to require such brokers to report the cost basis and sale proceeds of the transfer of digital assets.
- This change subjects cryptocurrency to the same reporting regulations placed on securities such as stocks and bonds.

Bipartisan Infrastructure and Jobs Act Passed by the House of Representatives 11-5-2021

► INFORMATION REPORTING FOR DIGITAL ASSETS

- In addition to being treated as securities, the Infrastructure Act imposes reporting requirements that treat cryptocurrency as cash. Taxpayers receiving $10,000 or more per year in cryptocurrency must now report those payments on Form 8300, just as they would with cash payments.

- In addition to individual taxpayers who may be invested in cryptocurrency and other digital assets, the impact of this new reporting regulation will be immediately felt by the growing number of businesses that accept cryptocurrency payments in lieu of more traditional paper or plastic.

Bipartisan Infrastructure and Jobs Act Passed by the House of Representatives 11-5-2021

► **BROAD DEFINITION OF DIGITAL ASSETS**

- These new requirements may apply widely, as the Infrastructure Act imposes a broad definition of the term "digital asset" to include: ""[A]ny digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary."
- Broad definition covers all cryptocurrencies and potentially other forms of digital assets, such as NFTs.

2021 Year-End Review

► VIRTUAL CURRENCY TRANSACTIONS

- The Service believes that transactions involving virtual currency are underreported by taxpayers. The IRS does treat virtual currency as property that can produce a gain or loss as it is traded, sold, or used.

- The recently enacted Bipartisan Infrastructure Bill would require information reporting with respect to such digital/virtual assets such as cryptocurrency generally effective for statements required to be furnished after December 31, 2023.

2021 Year-End Review

► **VIRTUAL CURRENCY TRANSACTIONS**

- The Financial Crimes Enforcement Network (FinCen) issued a Notice stating that current regulations do not define a foreign account that holds virtual currency as a type of reportable account on the FBAR, unless it is a reportable account under the regulations. The Network intends to propose an amendment that would include virtual currency as a type of reportable account.

- The Form 1040 individual income tax return also includes a question involving virtual currency.
  - At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? Yes No

IRS Provides Guidance on Virtual Currency question in FAQ

- **Background**
  - Confusion was created as to the proper way to answer this question where the taxpayer only purchases virtual currency with cash and holds it. The draft Form 1040 instructions issued on December 31 included in examples of transactions which would require a "yes" response:
    - A purchase or sale of virtual currency; and
    - An acquisition or disposition of a financial interest in a virtual currency;
  - However the final version of the instructions eliminated the references to "a purchase" or "an acquisition" for adequate consideration in the examples while not changing the wording in of the question.
    - It clearly asks if the taxpayer during 2021 otherwise "**acquire**" any financial interest."
    - The examples provided in the instruction contain language indicating that they were not an all-inclusive list.

Frequently Asked Questions on Virtual Currency Transactions

- Q5(a). The 2021 Form 1040 asks whether at any time during 2021, I received, sold, exchanged, or otherwise disposed of any financial interest in any virtual currency. During 2021, I purchased virtual currency with real currency and had no other virtual currency transactions during the year. How do I answer the question on the Form 1040? (added March 10, 2022)

- A5(a). If your only transactions involving virtual currency during 2021 were purchases of virtual currency with real currency, you are not required to answer "yes" to the Form 1040 question, and should, instead, check the "no" box.

- The IRS has issued a warning about how to answer the cryptocurrency question on the front page of your tax return.
  - You may respond no if you bought and held cryptocurrency with U.S. dollars, or transferred digital assets between your wallets.
  - However, you'll need to check yes if you sold crypto, exchanged one virtual currency for another, used it for purchases, received it as payment, acquired it through mining or staking and more.

IRS Guidance

- **The IRS has issued a warning about how to answer the cryptocurrency question on the front page of your tax return.**
  - You may respond no if you bought and held cryptocurrency with U.S. dollars, or transferred digital assets between your wallets.
  - However, you'll need to check yes if you sold crypto, exchanged one virtual currency for another, used it for purchases, received it as payment, acquired it through mining or staking and more.
- **It should be noted that, as IRS has been accustomed to doing, this guidance is issued in FAQ format, which technically has little precedential authority and can be changed in the future.**
  - However, until it is changed, we can follow this position.

Taxing Cryptocurrency - Background

- IRS Notice 2014-21, issued in 2014, stated that virtual currencies should be taxed as property.
- In 2017, the IRS was granted access to taxpayers' information for transactions totaling more than $20,000 from cryptocurrency brokers such as Coinbase.
- Throughout 2018 and 2019, the IRS dedicated more focus to tracking down unreported income.
- For the first time, Form 1040 asked taxpayers "[a]t any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?"
- In 2021, the IRS announced Operation Hidden Treasure, which was meant to train IRS staff to better identify tax evasion.

Taxing Cryptocurrency

- Cryptocurrency may be subject to capital gains when exchanged or sold at a profit. Swapping digital coins, cashing out for U.S. dollars or even making a purchase may be taxable events.

- The gain or loss is the difference between the purchase price, known as basis, and the value when selling or exchanging, and the tax rates depend on the holding period.

- If digital assets are held for more than one year, the taxpayer might qualify for long-term capital gains rates of 0%, 15% or 20%, depending on level of taxable income.

Taxing Cryptocurrency

- Many crypto investors sell or exchange more frequently triggering short-term capital gains, levied at regular income tax rates, up to 37% for high income taxpayers.

- Figuring out basis to calculate gain or loss may not be easy with limited reporting from digital currency exchanges.
  - Query how does the taxpayer identify cryptocurrency sold?

Taxing Cryptocurrency

- Prior to IRS guidance issued in 2019, there were numerous potential cost basis methods for taxpayers to use for calculating gains/losses on crypto.
- The 2019 guidance made it clear that there are only two cost basis methods to use: (1) First in First Out (FIFO); and (2) specific identification.
  - FIFO: The first assets you purchased will be the first assets that will be disposed.
  - Specific identification: Specific identification allows taxpayers to select which assets they are disposing of.

Taxing Cryptocurrency

- **IRC Sec 475(f) – Mark to market election to be treated as a dealer**
- **Query - does cryptocurrency qualify as a security or commodity?**
- **Under IRC Sec 475 the term security is defined to include any:**
  1. share of stock;
  2. Partnership or beneficial ownership interest in a widely heldp or public traded partnership or trust:
  3. Debt instrument; and
  4. Certain swaps
  5. Certain derivatives that are identified as a hedge of security
- **Under IRC Sec 475 the term commodity is defined to include:**
  1. any commodity that is actively traded

Taxing Cryptocurrency

- **Investor vs Trader**
  - **An investor is generally defined as seeking to profit from changes in the market price of their holdings.**
    - An investor is passively accumulating earnings on their investments.
  - **A trader is generally defined as seeking to earn a speculative return based market fluctuations and short-term changes.**
    - A trader is engaged in the business of buying and selling investments.

Taxing Cryptocurrency

- ► **Wash Sale Rules**
  - ➢ **IRC Sec 1091 rules only apply to stock and securities.**
    - ❖Losses on Cryptocurrency and NFTs may not be subject to the wash sale rules.

- ► **Build Back Better Act – included provisions to treat Cryptocurrency and NFTs as securities.**

Moore Tax Law Group
A Tax Controversy and Tax Litigation Boutique

EVERSHEDS SUTHERLAND

MARCUM ACCOUNTANTS ▲ ADVISORS

Taxing NFTs

- Creating an NFT in itself is not a taxable event. However, selling the NFT on a marketplace is a taxable event. When you sell an NFT, you will have to pay taxes on the profits.
- The IRS has not issued specific tax guidance on NFTs, and many questions remain.
- The tax treatment is expected to vary as between creators/dealers and investors, and there is an open question as to whether the IRS will treat NFTs as collectibles.
- The number of taxable events that occurs with NFT acquisition and sale depends on the currency used.

Tax Forms To Be Filed With the IRS

1. **Form 8949** (Sales and Other Dispositions of Capital Assets)
   - ✓ Form 8949 is used to report cryptocurrency & Non-Fungible Tokens (NFT) capital gains and losses.
   - ✓ To accurately fill out this form, taxpayer needs to keep detailed records of the cost basis (how much they paid for each coin), the market value of the coin at the time of sale, and how long they held each coin.
2. **Form 1040 Schedule D** (Capital Gains and Losses)
   - ✓ Schedule D summarizes what was reported on Form 8949.
3. **Form 1040 Schedule 1** (Additional Income and Adjustments to Income)
   - ✓ Schedule 1, Line 8 (Other Income) is used to report ordinary income coming from airdrops, forks, and staking income.

Tax Preparation Software for Digital Asset investors

TAXbit

ZenLedger

CoinTracker

TokenTax

Koinly

Thank You

		
Zhanna Ziering, Esq.	**Sarah E. Paul, Esq.**	**Barry A. Fischman, CPA, MST**
646.357.3875 zhanna.ziering@mooretaxlawgroup.com	212.301.6587 sarahpaul@eversheds-sutherland.com	203.781.9630 barry.fischman@marcumllp.com
Moore Tax Law Group *A Tax Controversy and Tax Litigation Boutique* www.mooretaxlawgroup.com	EVERSHEDS SUTHERLAND us.eversheds-sutherland.com	MARCUM ACCOUNTANTS ▲ ADVISORS www.marcumllp.com
Moderator	**Panelist**	**Panelist**