

— 2024 —

TAXACT PROFESSIONAL

EDUCATION

◆ **FORUM** ◆

A Simple Approach & Overview to Virtual Currency, aka Digital Assets

PRESENTER : Allan "A.J." Reynolds, EA



Meet Your Presenter

- **Allan “A.J.” Reynolds, EA**

- ❑ Recipient of the 2024 Excellence in Education Award from the National Association of Enrolled Agents

- ❑ Immense experience in various areas of taxation, which encompasses over 35 years

- ❑ Practice centers on individual, business, estate & trust tax preparation

- ❑ Specializes on various areas of IRS Representation

- ❑ Speaks for multiple organizations

Meet Your Presenter



Meet Your Presenter



Quote of the Session

“I do think Bitcoin is the first [Encrypted Money] that has the potential to something like change the world.”

-- Peter Thiel --



Objectives

- Define virtual currency, aka cryptocurrency
- Examine and translate crypto's vocabulary
- Analyze IRS notices, revenue rulings, FAQs concerning crypto, Infrastructure Bill, and provide updates
- Inspect the 18 tax principles
- Discuss common cryptocurrency tax events

Objectives

- Assess any **FinCEN** regulations
- Identify and discuss **Form 8938** requirements
- Formulate best practices concerning virtual currency
- Establish an engagement letter for our tax practices



What's Virtual Currency? Hard to tell!

- **GAO report** : “...the term virtual currency is sometimes used interchangeably with other terms, such as digital asset or cryptocurrency. The term digital asset, as used by the Securities and Exchange Commission, refers to an asset that is issued and transferred using distributed ledger technology, including, but not limited to, virtual currencies.”

What's Digital Assets? Hard to tell!

- **IRS in Notice 2014-21:** “Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. ... Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as “convertible” virtual currency.”

□ 6 pages, 16 FAQs – March 2014

What's Virtual Currency? Hard to tell!

- **IRS in Rev. Rul. 2019-24:** “Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of cryptocurrency are generally referred to as coins or tokens

Crypto Classification – Not SO Easy

- ❑ In 2015, the Commodity Futures Trading Commission concluded that BTC is a commodity
 - ✓ This treatment likely applies to many other virtual currencies.
 - ✓ The CFTC has conducted a number of fraud investigations and legal actions related to virtual currencies.
- ❑ SEC thinks crypto is a security
 - ✓ SEC Chair Gary Gensler stated in April 2023... “The law is clear,” Gensler said. “If you’re a securities exchange, clearinghouse, broker, or dealer, you must come into compliance, register with us, and deal with conflicts of interest and disclose important information. For 90 years, these laws have helped protect investors like you.”

Form 1040 Digital Assets Question

- All taxpayers filing Forms 1040, 1040-SR, 1065, 1120S, 1120, and 709 must check a box indicating whether they received digital assets as a reward, award or payment for property or services or disposed of any digital asset that was held as a capital asset through a sale, exchange or transfer.

Form 1040 Digital Assets Question

❖ 2024 Question on 1040

At any time during 2024, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.)

Yes

No

Form 1040 Digital Assets Question

- **Examples of digital assets transactions include:**
 - ✓ A sale of digital assets.
 - ✓ The receipt of digital assets as payment for goods or services provided.
 - ✓ The receipt or transfer of digital assets for free, without providing any consideration, that does not qualify as a bona fide gift.
 - ✓ The receipt of new digital assets as a result of mining and staking activities.

Form 1040 Digital Assets Question

- **Examples of digital assets transactions include:**
 - ✓ The receipt of new digital assets as a result of a hard fork.
 - ✓ An exchange of digital assets for property, goods or services.
 - ✓ An exchange or trade of digital assets for another digital asset(s).
 - ✓ Any other disposition of a financial interest in digital assets.

Form 1040 Digital Assets Question

❖ Reporting digital assets transactions

- If the “yes” box is checked, taxpayers must report all income related to their digital asset transaction.

- ✓ **Ordinary Income**

- ✓ **Capital Gain or Loss**

- ✓ **Self Employment Income**

Form 1040 Digital Assets Question

- When to check the “**No**” Box
 - ✓ **Digital assets owned, but did not engage in any transaction during the year.**
 - ✓ **Holding digital assets in a wallet or account.**
 - ✓ **Transferred digital accounts from one wallet or account to another wallet or account that taxpayer owns or control.**
 - ✓ **Digital assets were purchased using real currency, including through electronic platforms such as PayPal and Venmo**



No

Taxable Virtual Currency Transactions

Taxable



SALES

If virtual currency is sold for cash, traded for currency, or used to buy something, the transaction is taxable.

AIRDROP

An airdrop is a random distribution of coins during a marketing effort. The IRS considers marketing giveaways to be ordinary income.

MINING

This action creates ordinary income. For example, if one joins a mining pool and spends \$8,000 on electricity and is rewarded with a Bitcoin worth \$9,800. Even if one doesn't sell the coin, the \$1,800 profit must be reported.

STAKING

Some blockchains reward participants for putting up their virtual currency as collateral and then certify the transactions. The reward coins are treated like bank interest, as ordinary income.

Source: Treasury Inspector General for Tax Administration's (TIGTA) review of the IRS's guidance related to virtual currency and digital assets.

Non-taxable Virtual Currency Transactions



Nontaxable

Transfers of virtual currency from a wallet, address, or account belonging to themselves to another wallet, address, or account that also belongs to themselves, the transfer is a nontaxable event.

SELF TRANSACTIONS

If one receives virtual currency as a bona fide gift, the gift is nontaxable.

BONA FIDE GIFTS

Donation of virtual currency to a charitable organization described in Internal Revenue Code (I.R.C.) Section 170(c), one will not report income, gain, or loss from the donation.

CHARITABLE CONTRIBUTIONS

When a distributed ledger undergoes a protocol change that does not result in the creation of a new cryptocurrency. Soft forks do not result in any income.

SOFT FORKS

Source: Treasury Inspector General for Tax Administration's (TIGTA) review of the IRS's guidance related to virtual currency and digital assets.

Virtual Currency – Case Study

- William is disgusted by interest rates paid by his bank.
- He opened an account on a digital asset exchange.
- In January of 2023, he purchased \$1,000 worth of BTC.
- A month later, he invested another \$1,000 in BTC.
- In December of 2023, he exchanged some BTC for ETH.
- William sends a referral code to his brother, Mike, and received a reward from the exchange for doing so.
- As of Dec 31, 2023, William's investments were worth almost \$3,000 but hadn't been sold.

Virtual Currency – Case Study

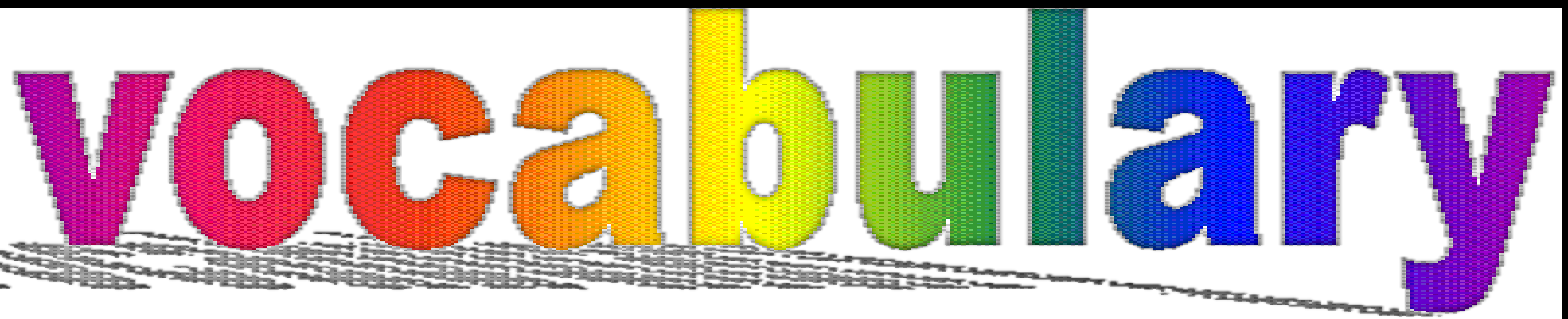
- Do I have taxes as a result of the purchase of the BTC?
- Do I have taxes as a result of the exchange of BTC for ETH?
- Do I have taxes as a result of the growth in value of BTC and ETH?
- Is that referral reward taxable income?

William's Questions

Virtual Currency – Case Study

- Do I have taxes as a result of the purchase of the BTC?
✓ **NO**
- Do I have taxes as a result of the exchange of BTC for ETH?
✓ **YES**
- Do I have taxes as a result of the growth in value of BTC and ETH?
✓ **NO**
- Is that referral reward taxable income?
✓ **YES**

*William's Questions
with Answers*



vocabulary

Key Concepts and Vocabulary

The Blockchain

- All cryptocurrencies are built on blockchain technology
- The blockchain:
 - Distributed in real-time between participants with no central authority
 - Authentication/verification of new entries determined by consensus
 - Veracity of the ledger mathematically provable by cryptography
 - Cannot be altered without network collusion
 - Transactions are time-stamped
- Provides a level of certainty and trust previously unavailable



The Blockchain

- **Distributed Ledger Technology**

- ✓ It's programmable
- ✓ The data is always encrypted
- ✓ The data is not all stored in one central location
- ✓ Data cannot be manipulated
- ✓ Records are time stamped



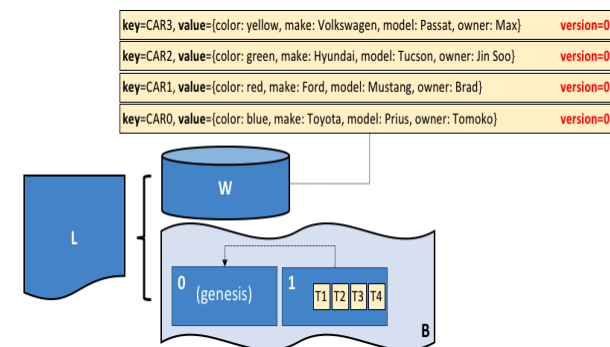
The Blockchain

❑ How does “Blockchain” technology work?

- Think of an Excel Spreadsheet
- Imagine each blockchain technology product, like Bitcoin
 - ✓ Bitcoin, has its own Excel Workbook, complete with its own custom code
- Every time someone buys, sells, or exchanges information on that blockchain, it's like adding a new line item to the Excel spreadsheet
- Once the virtual spreadsheet reaches its maximum capacity, that tab gets sealed in place and linked to previous tab in the spreadsheet

The Blockchain

- ❑ How does “Blockchain” technology work?
 - This forms a “chain of blocks” – hence the name “blockchain”
 - As transactions keep flowing, a new tab is opened, and the process repeats itself
 - All “miners”, the folks operating this digital spreadsheet, have their own copy of the document (i.e., the digital spreadsheet is “open-source coding”)
 - With more than one million unique individual Bitcoin miners worldwide, it’s a distributed network keeping the “blockchain” ship sailing smoothly and **securely**



Keys

- Ownership of this non-physical asset exists via possession of a string of alphanumeric characters called “keys.”

1DSsgJdB2AnWaFNgSbv4MZC2m71116JafG

- The private key conveys ownership; the public key is used to encrypt and decrypt data as cryptocurrency is received



Wallets



**Timmy Taxpayer buys
“Bitcoin” & stores it in his
“wallet”**

Wallets



Wallets

- **Hot wallets (are online) and have an “address”**
 - ✓ Desktop – utilizes an app
 - ✓ Web – stored on a website
 - ✓ Mobile – utilizes a phone app

Wallets

- **Cold wallets (are not online)**
 - ✓ Paper – keys are stored on paper
 - ✓ Hardware – an offline physical device
 - ✓ Brain – keys are memorized

Forks



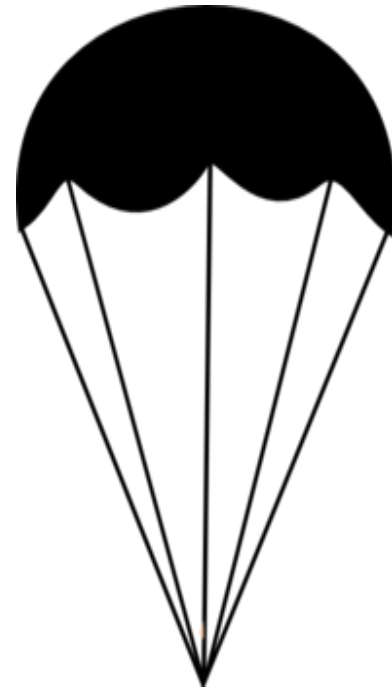
Forks

- Soft fork – software update with no impact on the coin holder
- Hard fork – software update that results in a new currency that may be distributed to a coin holder
- Hot wallets receive them automatically
- Why do I care? **(They're taxable!)**

Airdrops

- Distribution of currencies/tokens to various wallets
 - ❖ Typically promotional
 - ❖ Recipient may be unaware of receipt
 - ❖ Often sent to early users of a new platform, service, etc.
 - ❖ There are websites people can sign up for to receive airdrops

An airdrop is an unsolicited distribution of cryptocurrency token or coin, usually for free, to numerous wallet addresses.



Mining aka Staking aka Validating

- Mining is the process of verifying blockchain transactions via software.
- Successful miners receive “block rewards” aka small amounts of cryptocurrency.
- Miners are necessary to the functioning of the blockchain!



Blockchain Explorers

- A blockchain explorer is a piece of software that draws various data from a blockchain and then uses a database to arrange the searched data and present that data to the user in a searchable format.



Blockchain Explorers



- ❑ Blockchain explorer is like a search engine that allows you to browse and explore the contents of a Blockchain
- ❑ Provides ways to view and verify transactions
- ❑ Analyze data

Blockchain Explorers

Blockchain.com Wallet Exchange Explorer Pay Institutional ...

Be early to the future of finance

Buy Bitcoin, Ethereum, and other leading cryptocurrencies on a platform trusted by millions.

 Buy Trade Bitcoin BTC \$97,894.04 -0.42%	 Buy Trade Ethereum ETH \$3,355.80 -2.34%	 Buy Trade Dogecoin DOGE \$0.42 -5.23%	 Buy Trade Solana SOL \$251.89 -2.74%
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Blockchain Explorers

☐ Popular Blockchains which establish FMV as of a given date/time

✓ **Blockchain.com**

✓ **Etherscan**

✓ **GetBlock**

✓ **BlockCypher**

✓ **Blockchair**

IRS Guidance & Compliance Efforts



IRS Compliance Efforts

- 2016 – John Doe Summons to Coinbase
- 2017 – Coinbase is ordered to comply
- 2018 – Virtual currency one of “Top Five” Compliance Campaigns
- 2019 – Letters 6173, 6174, 6174-A and The Crypto Question
- 2020 – Crypto Question on Form 1040
- 2021 – Crypto Question, John Doe Summons to Circle and Kraken, Operation Hidden Treasure
- 2022 – Infrastructure Act requires reporting by brokers

IRS Chief Counsel Advice

- CCA 202035011
- CCA 202114020
- CCA 202124008
- CCA 202302011
- CCA 202302012
- CCA 202316008

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

Number: **202035011**
Release Date: 8/28/2020

UIL: 61.00-00, 61.09-00, 61.09-07, 83.00-00

CC:ITA:B04:JYu
PRESP-114156-20

date: June 29, 2020

to: Carolyn A. Schenck
National Fraud Counsel and Assistant Division Counsel (International)
(Small Business/Self-Employed)

from: Ronald J. Goldstein
Senior Technician Reviewer, Branch 4
(Income Tax & Accounting)

subject: Taxation of Virtual Currency Received in the Crowdsourcing Labor Market

This memorandum responds to your request for advice regarding the tax consequences for an individual who receives convertible virtual currency for performing microtasks through a crowdsourcing or similar platform.

Guidance

❖ Transactions Reported by year

- ✓ 2016.....4,164
- ✓ 2017.....88,040
- ✓ 2018.....93,848
- ✓ 2019.....102,278
- ✓ 2020.....253,265
- ✓ 2021.....842,888

Guidance

❖ **Infrastructure and Investment Jobs Act**

- In addition, cash reporting rules (for cash payments of \$10,000 or more) has been extended to cryptocurrency. Businesses accepting payments of \$10,000 or more in cryptocurrency will have to file Form 8300.

- ✓ **Effective Jan. 1, 2024**

- ✓ **Form 8300 Must be e-filed**

Virtual Currency – Form 1099-DA

- Draft Form 1099-DA
- 1099-DA requires more information than counterpart 1099-B
- IRS is looking for more specific information

Virtual Currency – Form 1099-DA

 Draft Form 1099-DA

7A7A VOID CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		Applicable checkbox on Form 8949		OMB No. 1545-XXXX 2025 Form 1099-DA		Digital Asset Proceeds From Broker Transactions
FILER'S TIN		RECIPIENT'S TIN		1a Code for digital asset		Copy A
RECIPIENT'S name		RECIPIENT'S name		1b Name of digital asset		
Street address (including apt. no.)		1c Number of units		1d Date acquired		For Internal Revenue Service Center
City or town, state or province, country, and ZIP or foreign postal code		1e Date sold or disposed		1f Proceeds \$		
Account number		1g Cost or other basis \$		1h Accrued market discount \$		For filing information, Privacy Act, and Paperwork Reduction Act Notice, see the General Instructions for Certain Information Returns.
CUSIP number		1i Wash sales loss disallowed \$		2 Check if basis reported to IRS <input type="checkbox"/>		
5 Check if loss is not allowed based on amount in 1f <input type="checkbox"/>		6 Gain or loss: <input type="checkbox"/> Short-term <input type="checkbox"/> Ordinary <input type="checkbox"/> Long-term		3a Reported to IRS: <input type="checkbox"/> Gross proceeds <input type="checkbox"/> Net proceeds		September 9, 2024
9 Check if digital asset is a noncovered security <input type="checkbox"/>		10 Digital asset is a noncovered security because: <input type="checkbox"/> Broker did not provide custodial services for it <input type="checkbox"/> Broker provided custodial services and it was transferred in to broker <input type="checkbox"/> Broker provided custodial services and it was acquired prior to 2026		3b Check if proceeds from: <input type="checkbox"/> Reserved for future use <input type="checkbox"/> QOF		
11b If 11a checked, number of transactions		11c For aggregate reporting of specified NFTs, aggregate gross proceeds reported in 1f that are attributable to first sales by creator or minter \$		4 Federal income tax withheld \$		www.irs.gov/Form1099
14 State name		15 State identification no.		7 Check if 1f is only cash <input type="checkbox"/>		
16 State tax withheld \$		12a Number of units transferred in		8 Check if broker relied on customer-provided acquisition information <input type="checkbox"/>		
12b If transferred in, provide transfer-in date		13		11a Check if gross proceeds reported in 1f is an aggregate amount for: <input type="checkbox"/> Qualifying stablecoins <input type="checkbox"/> Specified NFTs		

Form 1099-DA Cat. No. 735671 www.irs.gov/Form1099DA Department of the Treasury - Internal Revenue Service

Guidance

❖ Basis Reporting

- ❑ The final regulations anticipate that brokers' first reporting of the gross proceeds from sales of digital assets will be for sales occurring on or after January 1, 2025, which would be reported in 2026.
- ❑ The final regulations require brokers to provide information about basis from 'covered' positions acquired on or after **January 1, 2026**, for sales occurring on or after **January 1, 2026**.

**SCHEDULE 1
(Form 1040)**

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to www.irs.gov/Form1040 for instructions and the latest information.

OMB No. 1545-0074

2024

Attachment
Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR

Your social security number

v Digital assets received as ordinary income not reported elsewhere. See instructions

8v	
----	--

z Other income. List type and amount:

8z	
----	--

9 Total other income. Add lines 8a through 8z

9	
---	--

10 Combine lines 1 through 7 and 9. This is your **additional income**. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8

10	
----	--

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 71479F

Schedule 1 (Form 1040) 2024

Guidance

- ❖ **Final Regulations on Digital Asset Reporting (T.D. 10000)**
 - ✓ 365 pages
 - ✓ Effective 60 days after publication in Federal Register (July 09, 2024)
 - ✓ Brokers to file information returns and furnish payee statements on dispositions on digital assets
 - ✓ Real Estate reporting persons to file information returns and furnish payee statements with respect to real estate purchasers who use digital assets to acquire real estate from transactions after January 1, 2026

Guidance

❖ **Notice 2024-56**

- ✓ **Transitional relief on reporting penalties & backup withholding**
- ✓ **Calendar year 2025**
- ✓ **Provided broker makes good faith effort**
- ✓ **Limited relief from backup withholding**

Guidance

❖ **Notice 2024-57**

✓ **Notifies brokers will not have to file information returns or furnish payee statements on digital asset sales and exchanges for following transactions**

- a. **Staking**
- b. **Liquidity**
- c. **Wrapping & unwrapping**
- d. **Lending**
- e. **Notional principal contract**
- f. **Short sales**

Guidance

❖ Revenue Procedure 2024-28

✓ **Transition from universal or multi-wallet approach to allocating basis in digital assets to wallet by wallet or account by account approach**

□ **Permits taxpayers to rely on any reasonable allocation of units of unused basis to wallets or accounts that hold the same number of remaining digital asset units based on taxpayers' records of unused basis and remaining units in those wallets or accounts.**

❖ **Experts say, investors need to assign basis, or original purchase prices, for each crypto wallet before 2025**

Guidance

- ✓ **Definition of “digital asset” is expansive and includes NFTs and stablecoins**
- ✓ **Requiring broker reporting **DO NOT** include:**
 - ❖ **Video game tokens**
 - ❖ **Technology that do not create a new transferrable asset**

Guidance

❖ **Brokers will include:**

- Digital asset trading platforms**
- Digital asset payment processors**
- Certain digital asset hosted wallet providers**
- Real Estate reporting persons for dispositions of digital assets**

Guidance

❖ **NFT and Notice 2023-27**

- **IRS finalizing some of its rules, including specifying which NFTs will be considered collectibles.**

NFTs in the Art World

- First known art NFT created by Kevin McCoy in 2014
- Created by code and appears as a pulsing digital light
- Sold for \$1.4M at Sothebys
- Most expensive? The Merge sold for \$91.8M in 2021, as 266,445 different pieces
- Bought by 28,983 collectors
- Sold via an NFT gallery called Nifty Gateway



NFTs in Music

- Music is being sold directly from artist to consumer
- An entire album called “When You See Yourself” by Kings of Leon was released via NFT in 2021
- Typically, 50% of music revenues go to artist and remaining 50% goes to agents, lawyers and distributors
- NFTs change the math considerably!



Videos via NFT

- Video clip featuring Donald Trump sold in 2021 for \$6.6M
- “Charlie Bit Me” YouTube video sold for \$760,999 in 2021
- Video clip of LeBron dunking a basketball sold for \$208,000



How to Sell a Tweet

- First you tweet the tweet
- Then you open the tweet exchange platform *Valuables*
- You enter the tweet's URL into the site
- And wait for people to make offers to own the tweet!
- Jack's \$2.9M is obviously income; any basis??



How to Sell a Tweet

- Dress your online avatar with high fashion!
- Designers like Burberry, Karl Lagerfeld, and Louis Vuitton are selling digital fashion via NFT
- A digital dress (Iridescence) sold for \$9,500 in 2019
- Digital fashion can also be used to “dress up” your photograph!
- (Go to dressx.com and check it out)



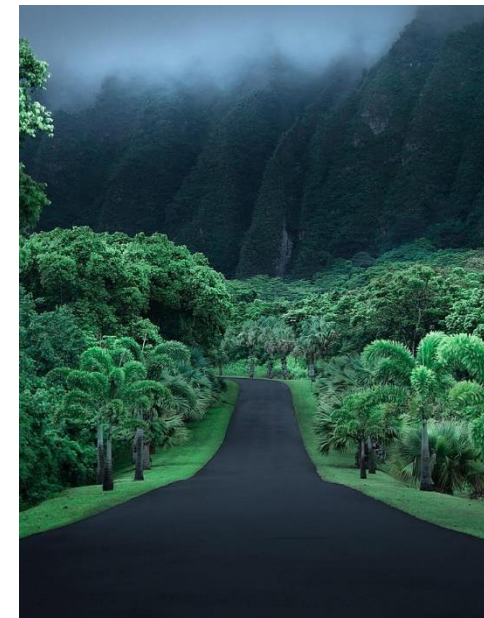
Memes

- Monetizing memes is now a thing
 - Ownership of the image of the dog from Dogecoin sold for \$4M June 2021
 - The new owner “fractionalized” the meme, which means selling fractional shares



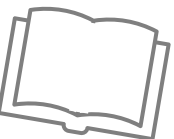
Photographs

- Zoë Roth's father took this picture and entered it in a photo contest in 2007
 - "Disaster Girl" went viral and out of control; she was pictured looking back as the Titanic sank, at a mushroom cloud, etc. (Not nice.)
 - Now 21 years old, she sold the photo via an NFT for \$500K April 2021
- Cath Simard took this photo of a road in Hawaii
 - Tired of chasing down copyright infringers, she sold the rights to it as an NFT for \$300K



Other Collectibles

- Remember Pokémon cards? And Magic the Gathering?
- New digital trading cards include Curio Cards, Crypto Strikers, Rare Pepe, Candy Digital, SoRare, Gods Unchained, Spells of Genesis, Age of Chains, Bitcorns, Force of Will, Ether Legends, VeeFriends
- Marketplaces include OpenSea, Rarible, Super Rare, Foundation, Nifty Gateway, Mintable, Makers Place, Stacks Art, STX NFT, Byzantion, KnownOrigin and many more
- Platforms charge a fee, usually a percentage
- Payment is made in crypto, usually ETH or BTC



Digital Art Example 1

- John created a piece of digital art and minted it as an NFT. It's called "Cashing In."
- He sold the NFT for \$75,000 to Bob
- John's expenses were fees, software and a computer
- **What are the tax implications?**



Digital Art Example 2

- Bob bought it for \$75,000
- He promptly resells it for \$90,000
- His expenses are just fees
- **What are the tax implications?**



Digital Art Example 3

- Alice bought it from Bob for \$90,000
- She uses it as a business logo
- **What are the tax implications?**



Guidance

❖ Notice 2023-34

▪ **Modification of Notice 2014-21**

- ❑ IRS indicated that other countries' recognition of cryptocurrency as legal tender “for a limited purpose” does not change the treatment of that currency for U.S. tax purposes
- ❑ 2014-21 stated cryptocurrency was not legal tender in “any jurisdiction”
- ❑ Following the change, virtual currency addressed in 2014-21 is no longer described as not having “legal tender status in any jurisdiction.”

Guidance

❖ CCA 202302012

- **IRS stated that a qualified appraisal would be required for charitable contributions of cryptocurrency exceeding \$5,000**

Guidance

❖ CCA 202302012

▪ Qualified Appraisals

✓ [Charitablesolutionsllc.com](https://www.charitablesolutionsllc.com)

✓ [Cryptoappraisers.com](https://www.cryptopraisers.com)

✓ [Mpival.com](https://www.mpival.com)

❑ Taxpayer can't deduct as a charitable contribution any fees paid to find the FMV of donated property.

Guidance

❖ CCA 202302011

- **Taxpayer not entitled to loss for cryptocurrency that had declined in value significantly**
 - ❖ **Taxpayer state crypto was worthless**
 - ❖ **However, was still being traded on at least one exchange**
 - ❖ **Taxpayer still had control of the crypto**

Guidance

- ❖ **CCA 202302011 (continued)**
 - **Possible solutions for taxpayer**
 - ❖ **Loss must occur via a sale or exchange**
 - ❖ **No wash sale rule!**
 - ❖ **Taxpayer could sell and repurchase**
 - ❖ **Losses are capital and subject to \$3,000 annual cap**

Guidance

- ❖ **Revenue Ruling 2023-14**
 - **IRS rules on including Cryptocurrency Staking Rewards in Income**
 - ❖ **When taxpayer gain dominion and control over rewards**
 - ❖ **FMV of the rewards received determined as of the date and time gains control**
 - ❖ **Includes staking through cryptocurrency exchanges**



The Eighteen (18) Tax Principles



The 18 Tax Principles

- 1.Virtual currency is treated as property.
- 2.The \$200 exemption for foreign currency does not apply.
- 3.Receiving virtual currency for services is income, valued at the FMV as of the date and time of receipt, subject to FICA tax and all the usual reporting requirements.
- 4.Receiving virtual currency as wages is treated as earned income, valued at the FMV of the currency as of the date of receipt, subject to FICA tax and all the usual reporting requirements.
- 5.Exchanging virtual currency for other property results in a gain or loss.
- 6.Character of any gain or loss depends on how the property is held.

The 18 Tax Principles

7. Virtual currency received from mining is treated as self-employment income if trade/business.
8. Payment of virtual currency worth \$600 or more, in the course of trade/business, requires filing a 1099.
9. Payments of virtual currency are subject to backup withholding requirements.
10. Third-party settlers are required to file Form 1099-K if the usual requirements are met.
11. Currency received via a fork or an airdrop is taxable ordinary income, valued at the FMV as of date and time of ability to dispose, reported on Schedule 1.
12. Basis of virtual currency includes fees and commissions.

The 18 Tax Principles

13. Virtual currency is considered received as of the date and time the transaction is recorded on the digital ledger.
14. Inventory options are specific identification or FIFO.
15. A blockchain explorer can be used to establish virtual currency basis for IRS purposes.
16. Virtual currency is treated as appreciated property for donation purposes.
17. Transfer from one cryptocurrency account or wallet to another account or wallet owned by the same taxpayer is not a taxable event.
18. Like-kind exchange is not permitted for virtual currencies.

Common Crypto Transactions



Selling & Trading

- Many clients are essentially “day traders” in cryptocurrency
- Record-keeping is often poor
- Tax requirements not generally understood
- So getting the right numbers for your tax return can be difficult!

What Clients Might Give Us

TOKEN	BUY/SELL DATE	PRICE PER TOKEN	AMOUNT	PRICE PAID	
ETH/BTC	Sell	11/17/2016	0.013	2.19958	0.02859454
ETH/BTC	Sell	11/17/2016	0.013	0.99958	0.01299454
ETH/BTC	Sell	11/17/2016	0.013	0.98958	0.01286454
ETH/BTC	Sell	11/17/2016	0.013	0.41793063	0.0054331
GNT/BTC	Buy	11/17/2016	0.000024	142.6272355	0.00342305
GNT/BTC	Buy	11/17/2016	0.0000197	275.1023068	0.00541952
GNT/BTC	Buy	1/31/2017	0.00002775	8.54386424	0.00023709
GNT/BTC	Buy	1/31/2017	0.00002753	13.30085019	0.00036617
GNT/BTC	Buy	1/31/2017	0.00002743	37.02826694	0.00101569
ETH/BTC	Buy	2/27/2017	0.01240252	4.05413194	0.05028145
ETH/BTC	Buy	2/27/2017	0.01235486	0.12880668	0.00159139
ETH/BTC	Buy	2/27/2017	0.01234081	0.01374293	0.0001696
GNT/BTC	Sell	2/27/2017	0.00001995	8.52250458	0.00017002
VSL/BTC	Sell	3/14/2017	0.00003202	396.2410596	0.01268764
1ST/BTC	Buy	3/31/2017	0.00034	104.3043235	0.03546347
1ST/BTC	Sell	4/11/2017	0.00023711	8.2134692	0.0019475
1ST/BTC	Sell	4/11/2017	0.00023585	15.02171792	0.00354287
1ST/BTC	Sell	4/11/2017	0.00023421	15.06853306	0.0035292
1ST/BTC	Sell	4/11/2017	0.00023258	15.08992638	0.00350962
1ST/BTC	Sell	4/11/2017	0.00023096	15.18922046	0.0035081
1ST/BTC	Sell	4/11/2017	0.00022936	15.28205274	0.00350509
1ST/BTC	Sell	4/11/2017	0.00022776	15.38315101	0.00350367
1ST/BTC	Sell	4/11/2017	0.00022618	3.79549194	0.00085846
ICN/BTC	Sell	4/19/2017	0.00038126	9.15242121	0.00348945
ICN/BTC	Sell	4/19/2017	0.00037768	0.00307849	0.00000116
ICN/BTC	Buy	4/21/2017	0.00034112	0.4767971	0.00016265

**Could be hundreds
of pages!**

Or Maybe This.....

Timestamp	Transaction Type	Asset	Quantity Transacted	Spot Price Currency	Spot Price at Transaction	Subtotal	Total (inclusive of fees)	Notes
2021-01-03T20:37:12Z	Buy	ETH	0.00936565	USD	962.03	\$9.01	\$10.00	Bought 0.00936565 ETH for \$10.00 USD
2021-01-03T20:39:34Z	Send	ETH	0.00936565	USD	957.14			Sent 0.00936565 ETH to Oxe629fB7B3Bd8cD6c56C05603D9c453709014e3f7
2021-08-22T17:47:08Z	Buy	ETH	0.01190774	USD	3192.04	\$38.01	\$40.00	Bought 0.01190774 ETH for \$40.00 USD
2021-08-22T17:48:36Z	Send	ETH	0.01190774	USD	3179.00			Sent 0.01190774 ETH to 0x15f48785CF1c40b4c29BAD7820F44d770DAA3f11
2021-08-23T16:12:45Z	Buy	ETH	0.0469036	USD	3347.50	\$157.01	\$160.00	Bought 0.0469036 ETH for \$160.00 USD
2021-08-23T16:14:21Z	Send	ETH	0.0469036	USD	3329.64			Sent 0.0469036 ETH to 0xF71cE185f20241E105A07F9bE011C7148DD51A59

Recommended Conversion Platforms!

- **TaxBit**
- **TokenTax**
- **BearTax**
- **CryptoTrader**
- **CoinTracker**
- **ZenLedger**

- **Changelly**
- **Cointracking**
- **Cryptotax**
- **Bitcoin.tax**
- **Koinly**
- **And many more!**

Do Not Know Basis?

- If a client can't prove basis and purchase date.....
 - ✓ It's short term
 - ✓ It's zero basis!

Cryptocurrency Earned Income

- Mining = Schedule C or hobby income
- Self-employment income = Schedule C or hobby income
- Wages reported on the W-2
- Social media = Schedule C or hobby income

“Interest” aka Rewards aka Other Income

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. CRYPTO COMPANY 12345 CRYPTO LANE CRYPTO, IA 51104		1 Rents \$	OMB No. 1545-0115 Form 1099-MISC (Rev. January 2022)	Miscellaneous Information
		2 Royalties \$	For calendar year 20 <u>22</u>	
		3 Other income \$ <input type="text" value="6053.22"/>	4 Federal income tax withheld \$	
PAYER'S TIN 42-1111111	RECIPIENT'S TIN 111-11-1111	5 Fishing boat proceeds \$	6 Medical and health care payments \$	Copy B For Recipient This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
RECIPIENT'S name PAT TAXPAYER Street address (including apt. no.) 5678 AVENUE OF THE STARS City or town, state or province, country, and ZIP or foreign postal code YOUR HOME TOWNS, IA 51101		7 Payer made direct sales totaling \$5,000 or more of consumer products to recipient for resale <input type="checkbox"/>	8 Substitute payments in lieu of dividends or interest \$	
		9 Crop insurance proceeds \$	10 Gross proceeds paid to an attorney \$	
		11 Fish purchased for resale \$	12 Section 409A deferrals \$	
Account number (see instructions) c7AD687FC1245		13 FATCA filing requirement <input type="checkbox"/>	14 Excess golden parachute payments \$	
		16 State tax withheld \$ ----- \$	17 State/Payer's state no. ----- -----	18 State income \$ ----- \$

Terminology Can Be Confusing!

It says it's staking.....but also says it's interest

So what is it?

Congratulations!

Starting today, you are earning 3.75% APY¹ on Cardano via staking.

How it works:



You automatically earn rewards on Cardano via staking



Earn interest at variable rates that change based on supply and demand



Opt out, request a trade or transfer at any time²



Watch your interest accrue in your account

Taxation of staking aka interest income

- ❑ Staking digital assets means locking up one's currency for a fixed period.
 - ✓ New coins are awarded to “stakers” based on how much currency was locked up.
 - ✓ May be called “rewards,” “interest” or similar terminology.
 - ✓ Report as ordinary income on Schedule 1, Line 8v.

CASE STUDY



RESEARCH



DATA



CONDITIONS



EXAMINATION



METHOD



IN-DEPTH



ANALYZING



RESULT

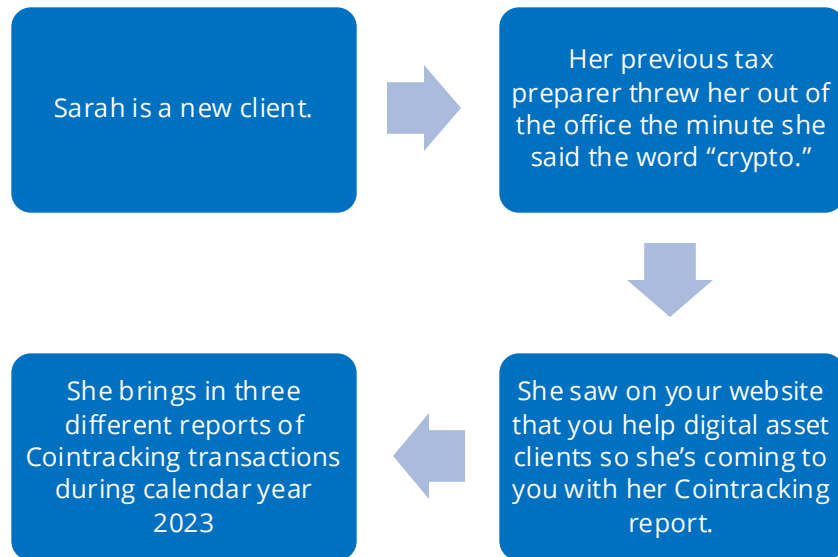
Case Study – Sarah places bets

- ❑ There are hundreds of websites and protocols that allow users to place bets and win rewards in digital assets like Bitcoin and Ethereum (Lucky Block, Metaspins, Cloudbet, etc.)
- ❑ Mary wins 1 ETH, FMV \$1,000 from a sports bet
- ❑ A month later, he sells it for \$1,200

What is Mary's tax situation? Where does she reported these transactions?



Case Study – Sarah’s Coin Tracking Report



Case Study – Sarah’s Coin Tracking Report

CoinTracking

1. Summary of profits and losses from trading cryptocurrencies for the year

Short-term & long-term capital gains/losses

Proceeds:	37,963.10 USD
Cost basis:	-39,370.15 USD
Short-term capital gains/losses:	-1,407.05 USD
Proceeds:	141,425.54 USD
Cost basis:	-8,829.27 USD
Long-term capital gains/losses:	132,596.27 USD

Short-term capital gains/losses:	-1,407.05 USD
Long-term capital gains/losses: (entered in Form 8949; fees are already taken into account (see FAQ))	132,596.27 USD

What is taxable here? Where is it reported?

Case Study – Sarah’s Coin Tracking Report

Interest and dividends from cryptocurrencies

Sum lending:	0.00 USD
Sum staking:	0.00 USD
Sum interest:	1,295.00 USD
Sum masternodes:	0.00 USD
Sum other income from cryptocurrencies:	1,295.00 USD
Sum dividends:	0.00 USD
Sum dividends from cryptocurrencies:	0.00 USD

Sum interest from cryptocurrencies: (entered in Form 1040 Schedule B Part I)	1,295.00 USD
Sum dividends from cryptocurrencies: (entered in Form 1040 Schedule B Part II)	0.00 USD

What is taxable here? Where is it reported?

Case Study – Sarah’s Coin Tracking Report

Other income from cryptocurrencies	
Sum gifts / tips:	10.00 USD
Sum mining (not commercial):	0.00 USD
Sum airdrops:	0.00 USD
Sum income:	0.00 USD
Sum other income:	0.00 USD
Sum rewards/bonus:	2,915.00 USD
Sum other income from cryptocurrencies:	2,925.00 USD

Sum other income from cryptocurrencies:	2,925.00 USD
(entered in Form 1040 Schedule 1 Part I)	2,925.00 USD

What is taxable here? Where is it reported?

Case Study – Donation of DA by Caroline

Caroline has BTC that she bought way back in 2013 for \$500 each.

She donates 5 BTC to Save the Children on December 25, 2023.

Caroline has a receipt from the organization.

Coinmarketcap.com shows the value of 1 BTC as of that date at about \$16,842!


She expects a **large** charitable contribution deduction!

But her tax preparer is frowning!



Case Study – Donation of DA by Caroline

Sample Appraisal Form


CharitableSolutions, LLC
MINIMIZING RISKS / MAXIMIZING GIFTS
3713 Pine Street • Jacksonville, FL 32205 • 404-375-5496
bryan@charitablesolutionsllc.com

Virtual Currency Appraisal

_____	Name
Donor Information	
_____	Social Security #
Donee	XYZ Charity

Date of Gift to Charity	September 20, 2017

Description of the Property	10 units of the virtual currency Bitcoin

Terms of Gift	Outright contribution to donee, no rights, restrictions or interests retained, and no agreement entered into.

Case Study – Donation of DA by Caroline

□ It's PRICEY!!!!

FEE: Please submit \$600 for the first appraisal and \$350 for each additional. Processing takes between 5 to 7 business days. If an appraisal is required within 48 hours, an additional \$100 rush fee will apply to each appraisal.

REQUIRED DOCUMENTATION: (Please send ALL documents together at one time):

1. Transaction details: Please include the number of coins transferred and a statement showing the charity received the coins on a specific date.
2. Acquisition Type (select one): Mined Payment for Service Investment
3. Acquisition Date:
4. Donor's cost basis **PER TOKEN**, as of gift date:

Pub 526 – You **can't** deduct as a charitable contribution any fees you pay to find the FMV of donated property.

Case Study – Donation of DA by Caroline

Form 8283 – Provided by the Appraiser

Part I Information on Donated Property						
2 Check the box that describes the type of property donated. See instructions for definitions.						
a <input type="checkbox"/> Art (contribution of \$20,000 or more)		d <input type="checkbox"/> Other real estate		i <input type="checkbox"/> Vehicles		
b <input type="checkbox"/> Qualified conservation contribution		e <input type="checkbox"/> Equipment		j <input type="checkbox"/> Clothing and household items		
b(1) <input type="checkbox"/> Certified historic structure NPS # <input type="text"/>		f <input type="checkbox"/> Securities		k <input type="checkbox"/> Digital assets		
c <input type="checkbox"/> Art (contribution of less than \$20,000)		g <input type="checkbox"/> Collectibles		l <input checked="" type="checkbox"/> Other		
3 (a) Description of donated property (if you need more space, attach a separate statement)		(b) If any tangible personal property or real property was donated, give a brief summary of the overall physical condition of the property at the time of the gift.			(c) Appraised fair market value	
A	1.2645944 Units of Virtual Currency - Bitcoin					\$21,008.33
B						
C						
	(d) Date acquired by donor (mo., yr.)	(e) How acquired by donor	(f) Donor's cost or adjusted basis	(g) For bargain sales, enter amount received	(h) Qualified conservation contribution relevant basis (see instructions)	(i) Amount claimed as a deduction (see instructions)
A	12/28/2013	Mining	16,614.34			12/25/2023
B						
C						

Case Study – How to Handle DA Losses



IRC §165 provides a deduction for losses that are evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year.



Taxpayer has not abandoned or otherwise disposed of the cryptocurrency, and the digital asset is not worthless because it still has value.



Taxpayer has not sustained a loss under IRC §165 and the corresponding regulations.



What might Ryan do for the current year?

Case Study – How to Handle DA Losses

- Loss on Form 8949 must occur via a sale or exchange of a capital asset at a loss
- \$3,000 annual cap, remainder carried forward
- Requires someone to buy or trade with you
- No wash sale rule!
- Ryan can sell and repurchase if he wishes!

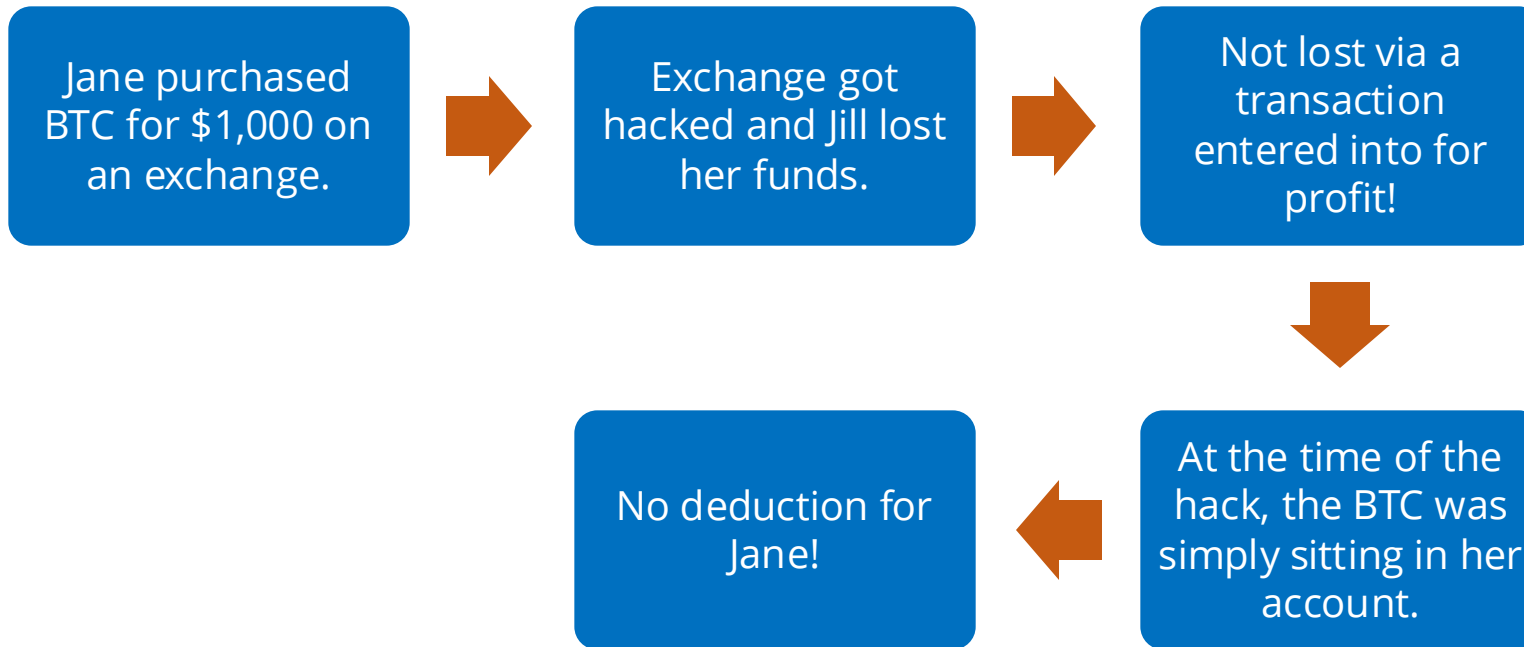


**Tax Planning
Strategies for Ryan**

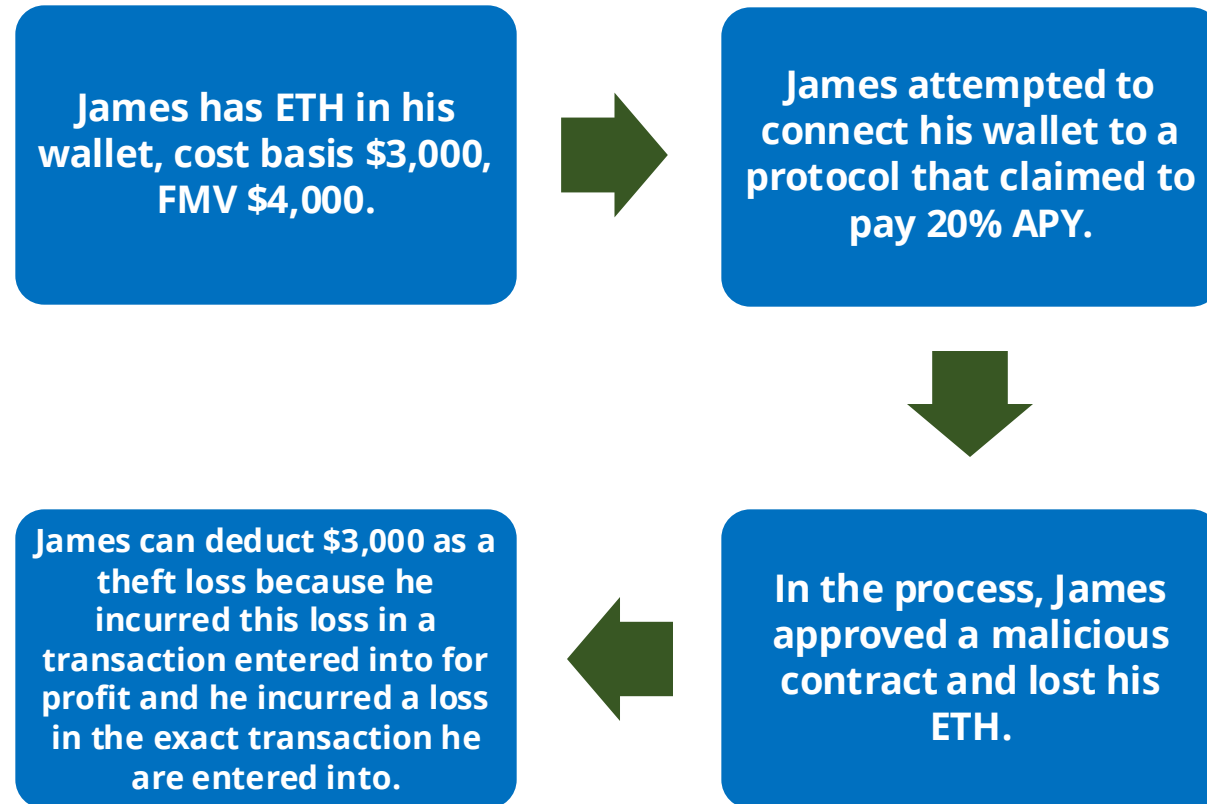
Case Study – Theft Losses of DA

- ❑ A theft is the taking and removal of money or property with the intent to deprive the owner of it, illegal under the law of the state where it occurred and done with criminal intent
- ❑ Account/wallet got hacked and the coins were stolen by the hacker.
- ❑ Bad actor misled you to approve a malicious contract and coins were lost as a result
- ❑ Bad actor misled you to send funds to a bad actor in return for goods/service you never received
- ❑ Again, there has to be a transaction entered into for profit and the loss occurred because of the transaction.

Case Study – Theft Loss of DA for Jane?



Case Study – Theft Loss of DA for Jack?



FinCen & Form 8938



Foreign Holdings

- FinCEN Notice 2020-2:
- Currently, the Report of Foreign Bank and Financial Accounts (FBAR) regulations do not define a foreign account holding virtual currency as a type of reportable account... **However, FinCEN intends to propose to amend the regulations implementing the Bank Secrecy Act (BSA) regarding reports of foreign financial accounts (FBAR) to include virtual currency as a type of reportable account under 31 CFR 1010.350.**



Best Practice # 1 – Engagement Letter

❖ Instructor Generic Question on Engagement letter

At any time during 2024, did you own Digital Assets / Virtual Currency (i.e. Bitcoin, Ethereum, NFTs)?

Yes

No

Best Practice # 1 – Engagement Letter

❑ **Best Practices: Engagement letter should state:**

- Tax laws that apply to virtual currency are subject to change and/or reinterpretation.
- The client understands that **MY TAX FIRM** will prepare the tax return using information that was provided by the client and under virtual currency tax law as it is now understood.
- **MY TAX FIRM** is not responsible for the taxes, penalties or interest that may result from withheld information or from changes/reinterpretations of virtual currency tax laws.

Client signs here: _____

Best Practice # 2 – Questionnaire

- 1) I earned cryptocurrency through mining or by working for others.**
- 2) I sold, traded or spent cryptocurrency.**
- 3) I gave or loaned cryptocurrency.**
- 4) I inherited or received cryptocurrency as a gift, an inheritance, or in some other manner.**
- 5) I lost cryptocurrency in some manner other than a sale.**

Best Practice # 2 – Questionnaire

- 6) I received forked/airdropped cryptocurrency.**
- 7) I held cryptocurrency in a foreign exchange.**
- 8) I purchased assets in an initial coin/initial exchange/initial DeFi/initial token or similar offering.**
- 9) I received interest, dividends, node rewards or similar type of income from cryptocurrency activities.**
- 10) I participated in cryptocurrency, NFTs, or other types of blockchain activities in a manner not mentioned above.**

Best Practice # 3

- ✓ **Avoid high-risk situations**
- ✓ **Here to stay, is Not going away!**



Best Practice # 4 – Client Documentation

- ✓ **Let client handle the data**
- ✓ **Let client provide as much information as possible**
- ✓ **Utilize online conversion platforms as needed**
- ✓ **Manually correct perceived errors**



Best Practice # 5 – Prioritize Education

- **Educate clients**

- ✓ Taxable transactions
- ✓ Earning/spending
- ✓ Selling/trading
- ✓ Forks/airdrops
- ✓ Inheriting/gifting
- ✓ Donating

- **Educate yourself**

- ✓ Ask questions of clients
- ✓ Check for new regulations
- ✓ Take classes

Questions?





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— 2024 —

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EDUCATION

◆ **FORUM** ◆

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