

30th Annual Tax Symposium

TAXES FROM THE CRYPT(O-CURRENCY)

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I. WHAT IS CRYPTOCURRENCY?

KEY TERMS

“Block Chain” – The underlying technology of Cryptocurrency. Block Chain is a system of recording information in a way that makes it difficult or impossible to change, hack, or cheat the system. Each block in the chain contains a number of transactions, and every time a new transaction occurs on the blockchain, a record of that transaction is added to every participant's ledger.

In the case of a “Coin” (such as Bitcoin, Ethereum, Dogecoin, etc.) the recorded information in the “Block Chain” is the record of the transaction – Buyer, Seller, amount, etc.

I. WHAT IS CRYPTOCURRENCY?

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“Distributed Ledger” – the “Chain” of Block Chain. It is an independent digital systems to record transactions, the details of which are recorded in multiple places at the same time with no central data storage locator. Because records are synchronized across numerous networks, all of the other networks will instantly know that the hacked record is false.

In other words: it is impossible (or at least very difficult) to hack a Block Chain everywhere simultaneously

But see: DOJ recovers \$2.3 million from Colonial Pipeline ransomware hackers.

I. WHAT IS CRYPTOCURRENCY?

KEY TERMS

“Forks” – When a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or the existing distributed ledger. If a Coin were a stock, a Fork would be a stock split.

I. WHAT IS CRYPTOCURRENCY?

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- a. **Hard Fork:** Both the original coins and the new coins will continue, and holders are given a chance to convert original coins into the new coins. (Think of this as a “stock split”)
- b. **Soft Fork:** Protocols change but no new coins are created. (Think of this as a “software update”)

I. WHAT IS CRYPTOCURRENCY?

KEY TERMS

Example

In 2014, BitCoin “hard forked” into BitCoin and BitCoin XT. The code contained in the new XT coins permitted a larger number of transactions per second. Holders of BitCoin were permitted to covert their Bitcoins into BitCoin XTs. If all BitCoins were converted to XTs, this would have been a “Soft Fork”

I. WHAT IS CRYPTOCURRENCY?

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“**Mining**” – a method by which Cryptocurrency users verify transactions in the Distributed Ledger, using highly complex and sophisticated computational processes. Miners receive coins as a reward for completing "blocks" of verified transactions, which are added to the Distributed Ledger (the amount of the reward is cut in half every 4 years).

I. WHAT IS CRYPTOCURRENCY?

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Example

When bitcoin was first mined in 2009, mining one block would earn you 50 BTC. In 2012, this was halved to 25 BTC. By 2016, this was halved again to 12.5 BTC. On May 11, 2020, the reward halved again to 6.25 BTC.

In September of 2021, the price of Bitcoin was about \$45,000 per bitcoin, which means Miners earned \$281,250.00 for each block

I. WHAT IS CRYPTOCURRENCY?

KEY TERMS

“NFT” or “Non-Fungible Token”—An NFT is a unit of data stored via a block chain which can be sold and traded. The NFT can be associated with a particular digital or physical asset (such as a file or a physical object) and a license to use the asset for a specified purpose. NFTs (and the associated license to use, copy or display the underlying asset) can be traded and sold on digital markets.

I. WHAT IS CRYPTOCURRENCY?

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In February 2021, the NBA sold a LeBron James slam dunk NFT (a 10 second “highlight clip”) for \$208,000. The owner now owns the rights to that 10-second clip.

II. HOW IS CRYPTOCURRENCY TAXED?

IRS Notice 2014 – 21, 2014-16 IRB 938

- a. Cryptocurrency is treated as property for tax purposes and not as currency. They are subject to ordinary “Short Term” or Long-Term” rates depending on how long the owner has held the coins.
- b. Receipt of bitcoins for services rendered is ordinary income based on the fair market value of the bitcoins.
- d. Basis of the cryptocurrency is the amount paid for the bitcoins, or the fair market value of bitcoins received for goods or services **as of the date of receipt**.
- e. Note: a Fork will not create taxable income if the taxpayer does not receive new units of cryptocurrency (but, in all Soft Forks, no new units considered “issued”).

Soft Fork = no taxable event; Hard Fork=a taxable event if units are converted

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f. **Taxable Events** for Cryptocurrencies:

1. Trading crypto to currency like the US dollar.
2. Trading one crypto for another cryptocurrency.
3. Spending crypto to purchase goods or services.

Example: Client owns 10 Bitcoins, which she bought for \$1000 (each Coin is worth \$100). Later, Client uses 3 of these coins to purchase a new Tesla for \$51,000. At the time of buying the car, 1 bitcoin is worth \$17,000. Client incurs a \$50,700 capital gain in doing so ($51,000 - 300$) and needs to report this gain on his taxes. (Apply short-term or long-term rates, depending on how long the Coins were held before buying the car).

4. Earning crypto as income. **This includes Coin Mining!**

NO LIKE-KIND EXCHANGES!

II. HOW IS CRYPTOCURRENCY TAXED?

NFTs

1. No clear guidance from the IRS YET.
2. Most observers believe that the proper tax treatment of NFTs is as a “**Collectible**” subject to a 28% flat rate.
3. But, Income derived from NFTs (i.e. royalties) are taxed as income. This is exceedingly rare.

II. HOW IS CRYPTOCURRENCY TAXED?

NFTs

Example: Bob buys an NFT of his favorite basketball player dunking for \$100. The clip appears in a SportsCenter highlight. ESPN pays Bob \$500 as a royalty. Bob then sells the NFT for \$300.

1. **Collectible-** $\$200 (\$300 - \$100) \times 28\%$
2. **Royalty-** \$500 as ordinary income.

II. OTHER CRYPTO-TAX ISSUES?

1. **GOVERNMENT ACTION.** Because Cryptocurrencies are the medium of choice for Bad Guys (terrorists, cybercriminals) the DOJ and IRS have taken a special interest in Crypto. A large Crypto component on a tax return is a good way to get audited.
2. **NFTs and Self-Directed IRAs.**
 - a. IRAs are not allowed to hold collectibles; likely, this means No NFTs
 - b. Self-Dealing prohibitions likely mean that no mining (which is considered a “Business Activity”) by the Individual IRA owner within the IRA may be permitted.
3. **Record Keeping and Volatility.**

II. OTHER CRYPTO-TAX ISSUES?

4. Regulations in the pipeline: there are currently 18 pending bills proposing different regulatory schemes. Among these are:
 - a. *\$1 Trillion Infrastructure Bill*: Requires brokers report large Crypto transfers to IRS
 - b. *Digital Asset Market Structure and Investor Protection Act (HR 4741)*: Empowers SEC and CFTC to regulate Crypto and subjects Crypto to the requirements (including reporting requirements) of the BSA.
 - c. *Digital Taxonomy Act (H.R. 3638)*: empowers FTC to regulate Crypto and changes Crypto's tax treatment from Property to Currency.

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THANK YOU



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QUESTIONS



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