30th Annual Tax Symposium

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TAXES FROM THE CRYPT(O CURRENCY)

By: Jordan B. Segal, Esq.

I. TERMINOLOGY (FROM IRS DEFINITIONS)

A. Bitcoin – a form of cryptocurrency. For purposes of this outline, bitcoin is used generically to represent all forms of cryptocurrency

B. Blockchain – the technology underlying cryptocurrencies

C. Distributed ledger technology – uses 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

D. Fork – occurs when a cryptocurrency on a distributed ledger undergoes a protocol change

1. Hard Forks:

   i. Result in creation of new cryptocurrency on a new ledger in addition to the legacy cryptocurrency

   ii. Transactions involving the new cryptocurrency are recorded on a new ledger

2. Soft Forks are more like a "software upgrade" and do not result in a new "chain"

E. 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).

F. NFTs – 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.

II. Cryptocurrency is Taxed as Property

A. IRS Notice 2014 – 21, 2014-16 IRB 938

1. Ruling issued in March 2014

2. Applies general tax principles to cryptocurrency

3. IRS ruled that cryptocurrency is treated as property for tax purposes and not as currency.

4. Receipt of bitcoins for services rendered is ordinary income based on the fair market value of the bitcoins

5. Payment for goods and services – if using bitcoins, will have gain or loss based on value of bitcoins transferred in excess of the basis of the bitcoins

6. 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

7. Basis – cryptocurrency exchanges can be used to determine fair market value

8. Form 1040, Schedule 1

   At any time during 2019, did you receive, sell send, exchange or otherwise acquire any financial interest in any virtual currency?

9. Taxable Events for Cryptocurrencies:

   a. Trading crypto to currency like the US dollar.

   b. Trading one crypto for another cryptocurrency.

   c. Spending crypto to purchase goods or services.

   d. Earning crypto as income.

10. NFTS are probably "Collectibles," but royalties from NFTs will be ordinary income.

III. OTHER ISSUES IN CRYPTO-TAX

1. Government actions against BAD GUYs

2. NFTs and Self-Directed IRAs.

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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. Coin prices are notoriously volatile. This can make records difficult to manage.

4. Regulations in the pipeline: there are currently 18 pending bills proposing different regulatory schemes. Among these are:

i. $1 *Trillion Infrastructure Bill:* Requires brokers report large Crypto transfers to IRS

ii. *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.

iii. *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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