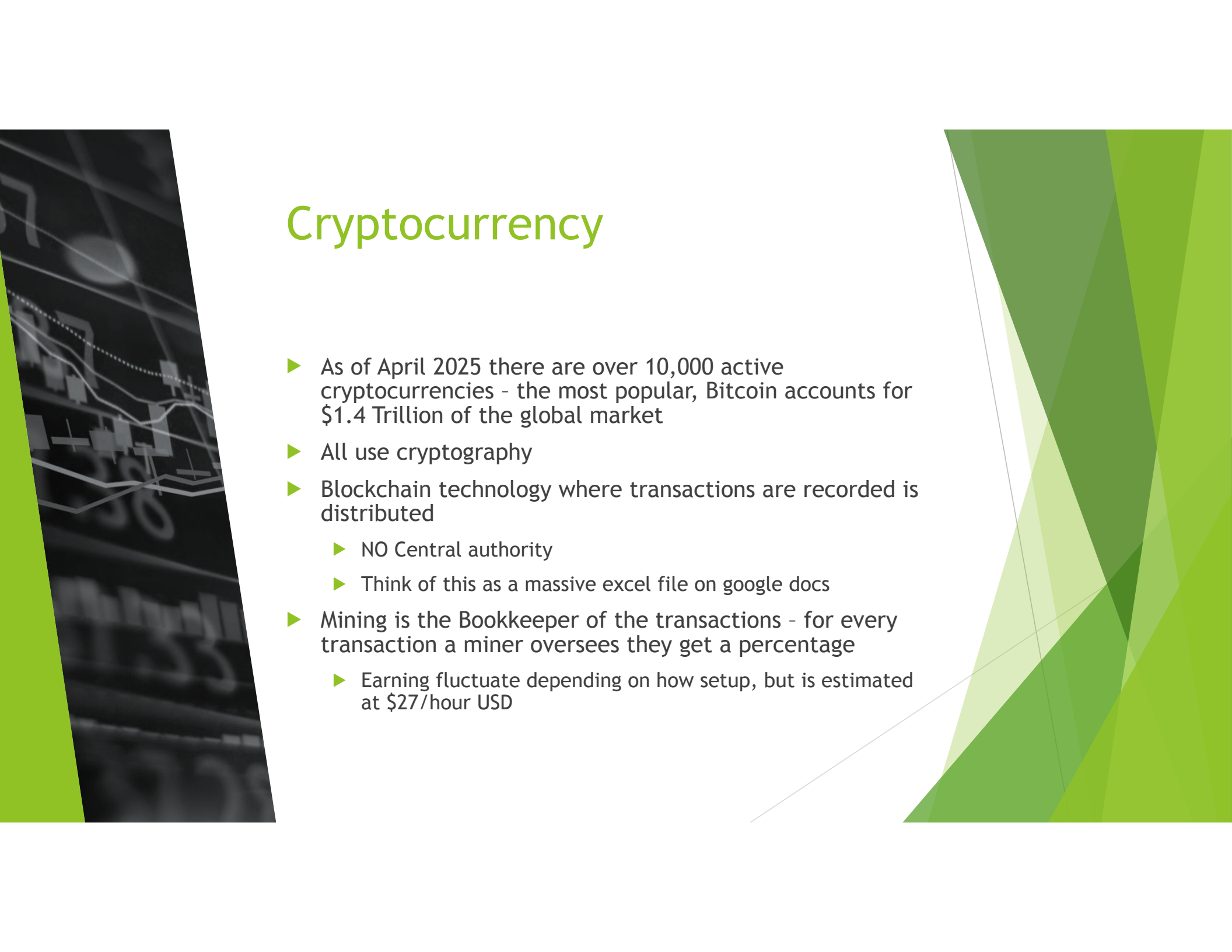




Cryptocurrency - The Darkside of taxes





Cryptocurrency

- ▶ As of April 2025 there are over 10,000 active cryptocurrencies - the most popular, Bitcoin accounts for \$1.4 Trillion of the global market
- ▶ All use cryptography
- ▶ Blockchain technology where transactions are recorded is distributed
 - ▶ NO Central authority
 - ▶ Think of this as a massive excel file on google docs
- ▶ Mining is the Bookkeeper of the transactions - for every transaction a miner oversees they get a percentage
 - ▶ Earning fluctuate depending on how setup, but is estimated at \$27/hour USD

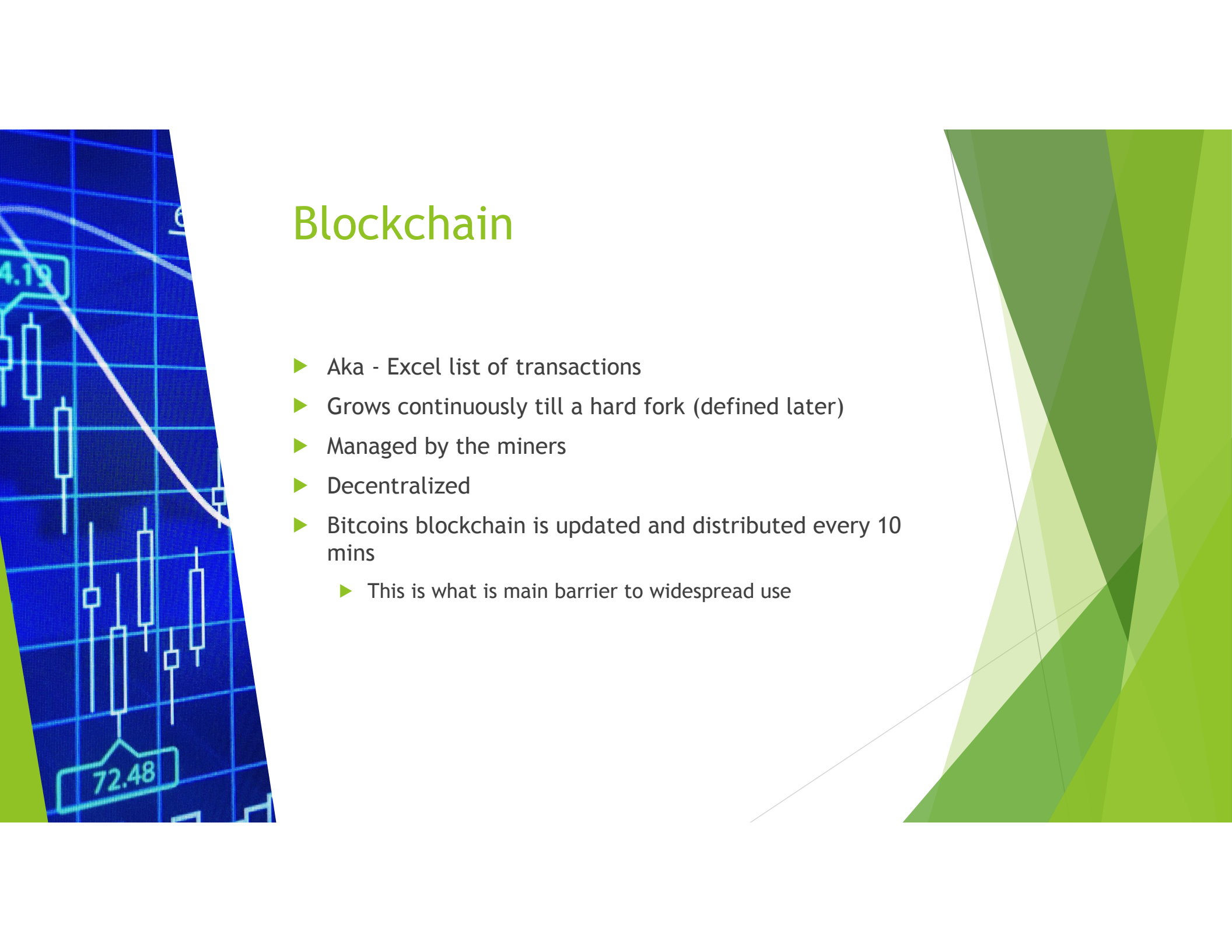
Wallets



This is where private keys are stored allowing for you to access your holdings to be able to spend them



Public key is what is stored on the blockchain (remember excel sheet), must have private and public keys to spend or use the coins



Blockchain

- ▶ Aka - Excel list of transactions
- ▶ Grows continuously till a hard fork (defined later)
- ▶ Managed by the miners
- ▶ Decentralized
- ▶ Bitcoins blockchain is updated and distributed every 10 mins
 - ▶ This is what is main barrier to widespread use



Blockgeeks

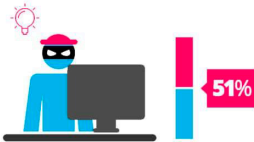
Proof of Work

vs.

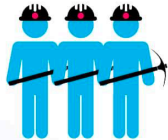
Proof of Stake



To add each block to the chain, miners must compete to solve a difficult puzzle using their computers processing power.



In order to add a malicious block, you'd have to have a computer more powerful than 51% of the network.



The first miner to solve the puzzle is given a reward for their work.



There is no competition as the block creator is chosen by an algorithm based on the user's stake.



In order to add a malicious block, you'd have to own 51% of all the cryptocurrency on the network.



There is no reward for making a block, so the block creator takes a transaction fee.

Different ways miners work

IRS Treatment

- ▶ Considered property (same as a stock)
IRS notice 2014-21
- ▶ FMV is always captured in the Blockchain
- ▶ If earned it is income IRS notice 2014-21
 - ▶ But what type ?
- ▶ 1040 Question
 - ▶ Yes - You would then have ordinary income, capital gain/loss, or SE Income
 - ▶ No - If you only purchased with real currency, held it and did nothing, transferred wallet to wallet
 - ▶ Answering incorrect is a criminal activity
 - ▶ Preparers answering incorrectly is criminal as well

IRS Treatment - cont

- ▶ IRS 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”

Typical Income Source of a Digital Asset



Selling it (like stocks)



Swapping it for another type of digital asset



Trading it for a personal asset (Bitcoin for a used car or a Starbucks coffee)



Staking, mining or validating services for payment in cryptocurrency



Exchange digital asset for property, goods or services



Payment for goods or services provided



Receipt of a new digital asset as a result of a hard fork or airdrop



Sales - Sold for cash, traded for currency, or used to buy something

Form 8949



Airdrop - Random distribution of coins; recipient may or may not know they receive anything

Line V of Schedule 1 income



Hard Fork - Software/Blockchain update that results in a new currency to the original currency holder (example: Bitcoin created Bitcoin cash, some users got a hard fork)

Line V of Schedule 1 income



Mining - Has income for example receives \$10,000 in coin value for mining, but spends \$8,000 on electricity, computer hardware/software. Coins do not need to be sold \$2,000 to create income

Most likely Schedule C



Staking - Some blockchains will give reward coins for a user putting up coins as collateral and certifying transactions

Line V of Schedule 1 income

How and where is Virtual Currency Taxed



Transfers - Move from wallet to wallet as long as both belong to them



Gifts - True gift given (gifting rules apply)



Donation - Donated to charity as described in IRC 170(c)



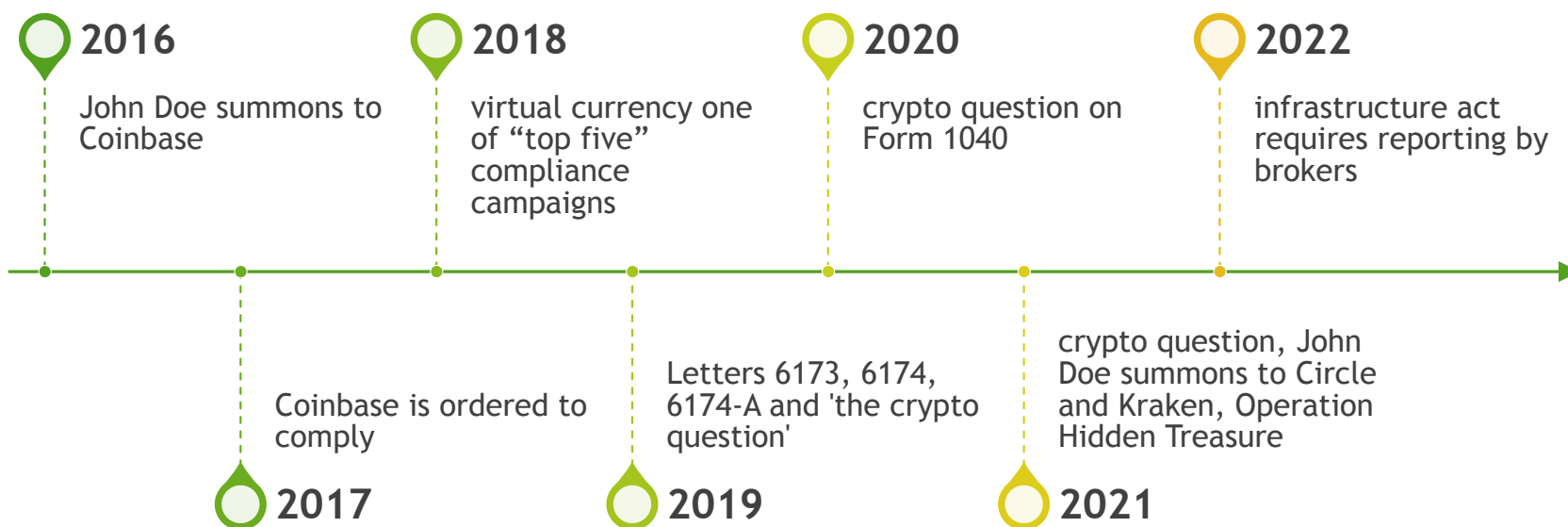
Soft Fork - Software/Blockchain updates, but no coins are received or lost

Virtual Currency Non-Tax items

What could and should preparers think about and do

- ▶ Update to engagement letter
 - ▶ Some firms have a special engagement letter dealing with just crypto
- ▶ Have clients get a Blockchain explorer program
 - ▶ Program goes out and looks at keys to gather all your transactions
 - ▶ Provides a summary of transactions
 - ▶ Blockchain.com; Etherscan; Getblock; Blockchair; BlockCypher are examples
- ▶ Detailed transactional reports from each crypto account in which they have taxable transactions, preferably with a summary
- ▶ Proof of sales, trades, or swaps **including basis amounts**
- ▶ **Appraised FMV** of any digital assets that are gifted
- ▶ Good records if their company takes income payments in digital assets or pays out expenses through digital assets
- ▶ As we see the world continue to evolve with more digital asset usage, we also will need to adapt to how our practice evolves with it

Compliance Efforts



Transaction reported by year

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

Guidance on losses

- ▶ CCA 202302011
 - ▶ Taxpayer not entitled to a 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
- ▶ 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
- ▶ Losing your Private Key is not a loss or casualty loss
 - ▶ Currency still being traded
- ▶ Your client agreed to an online deal with another person to transfer 10 units of his cryptocurrency for a used scooter. Once transferred the other party fails to deliver the scooter.

Guidance has come in bits and pieces

- ▶ Form 1099-DA
 - ▶ Notice 2024-56
 - ▶ Transitional relief on reporting penalties & backup withholding
 - ▶ Calendar year 2025
 - ▶ Provided broker makes good faith effort
 - ▶ Limited relief from backup withholding
- ▶ Definition of “digital asset” is expansive and includes NFTs and stablecoins
- ▶ April 2025, President Trump signed into law a measure that repeals the reporting requirements for digital asset brokers who participate in decentralized finance (DeFi) transactions and prohibits the IRS from issuing similar rule

18 Tax principals of Virtual Currency

- ▶ Virtual currency is treated as property
- ▶ The \$200 exemption for foreign currency does not apply
- ▶ 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
- ▶ 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
- ▶ Exchanging virtual currency for other property results in a gain or loss
- ▶ Character of any gain or loss depends on how the property is held

18 Tax principals of Virtual Currency

- ▶ Virtual currency received from mining is treated as self-employment income if
- ▶ trade/business
- ▶ Payment of virtual currency worth \$600 or more, in the course of trade/business, requires filing a Form 1099
- ▶ Payments of virtual currency are subject to backup withholding requirements
- ▶ Third-party settlers are required to file Form 1099-K if the usual requirements are met
- ▶ 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
- ▶ Basis of virtual currency includes fees and commissions

18 Tax principals of Virtual Currency

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