The Block Chain Gang: Criminal Enforcement & Tax Reporting for Cryptocurrencies & ICO Tokens

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- The discussion, comments or opinions expressed today are <u>not</u> to be considered official guidance of the IRS or other regulatory bodies and as a direct result should not be cited as guidance in any tax or other regulatory matters.

Overview

- Taxation of Cryptocurrencies and ICO Token Key Items
- Reporting Concerns for Cryptocurrencies and ICO Tokens
- Offshore Reporting Concerns
- Cryptocurrency and ICO Token Enforcement Concerns

Taxation of Cryptocurrencies and ICO Token Key Items

Taxation as Property-Notice 2014-21

- **Notice 2014-21**
  - Holds that cryptocurrency is treated as property rather than as currency.
  - Is the only significant guidance from the IRS thus far on the treatment of cryptocurrency.
  - The Notice does not indicate that cryptocurrency should necessarily be treated as security or commodity at any point in time.
- **Results in gains and losses**
  - Because of cryptocurrency's treatment as property, any transaction involving cryptocurrency has the potential to trigger gain or loss.
- **Basis tracking of each lot**
  - Each unit of cryptocurrency acquired will necessarily have its own basis.
  - Ordinary rules regarding basis tracking will apply.
  - Ostensibly, a taxpayer should track the basis of a specific cryptocurrency used in a transaction.
  - In certain situations, such as if cryptocurrency were held in inventory, basis may not match.

Taxation as Property

- **Complexities of tracking small transactions**
  - Most transactions involving cryptocurrency do not trigger reporting requirements unless they constitute contractor or employee wage payments.
  - The lack of reporting and the ease with which gain can be triggered make enforcement extremely difficult.
- **Record keeping: Sec. 6001**
- **Are gains subject to 3.8% Net Income Tax?**

Section 1031

- **Are exchanges eligible for nontaxable treatment under Sec. 1031**
  - Prior to TCJA, cryptocurrency, as property, was not expressly excluded from Sec. 1031.
  - Unclear the exact extent to which 1031 treatment would apply.
    - Cross-currency exchange allowed?
- **Post TCJA Sec. 1031 exchange concerns**
  - For 2018 reporting due to TCJA modification of Sec. 1031, Sec. 1031 exchanges only apply to real estate transactions.
  - Future legislation may allow Sec. 1031
    - Token Taxonomy Act, 115th Congress H.R. 7356

Limitations on Losses

- **Are losses not allowable if holdings are personal?**
  - If cryptocurrency is held for profit, personal losses would be treated as capital losses and used accordingly.
  - If, however, cryptocurrency is held purely for consumption, a taxpayer may be unable to recognize a loss on its disposition under Sec. 165(c)(2).

- Does the economic substance doctrine apply?

- Theft and Casualty Losses: Pre-TCJA of 2017

Wash Sale and Straddle Rules

- **Do wash sale or straddle rules limit losses?**
  - Personal property traded in an established financial market may be subject to straddle rules under Sec. 1092.
    - The straddle rules may defer loss recognition and alter holding periods.
  - Wash sale rules typically apply only to securities that are substantially similar.
    - Unclear whether cryptocurrency might ever be treated as a security.
    - SEC is taking position that ICO tokens (& possibly certain cryptocurrencies) may be securities for securities law purposes.
    - Also unclear whether exchanges of anything but the same currency would be treated as substantially similar.

Taxation of Cryptocurrency Forks

- **Is there analogous applicable law?**
  - Under standard property law, a taxpayer would recognize income as a result of a hard fork, but would only do so after it exercised dominion and control over the new currency?
    - Similar to mining.

- **Additional case:** *Gamble v. CIR,* 68 T.C. 800, 820-21 (1977).

- **"Dominion & control"**
  - *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

Cryptocurrency Forks – Practical Issues

- **Practical issues for tracking and valuing new asset**
  - If taxpayers don't track the basis of each unit of currency, they will have a difficult time determining gain or loss.

- **Allocation of basis issues**

- **Are Subchapter C rules for various types of reorganizations, stock dividends or stock splits helpful?**
  - Is it only to the extent that cryptocurrency is treated as a "stock" or "security" as those terms are defined for purposes of Subchapter C?

Businesses Accepting or Using Crypto

- **Receipt of cryptocurrency**
  - Reporting of cryptocurrency and gross receipts.
  - After receipt, holding cryptocurrency as an asset.
- **Reporting of cryptocurrency gain or loss on disposition**
- **Cryptocurrency for services**
  - Self employment and other employment tax considerations.
  - Cryptocurrency payments:
    - Remuneration for services: Form W-2
    - For contractors: Forms 1099 and 1042
  - Form 1099-K reporting for payments by merchants (if volume & $ threshold met)
  - Cryptocurrency payments and back-up withholding/TIN requirement

Taxation of Mining Operations

- **Expenses associated with cryptocurrency**
  - Expenses associated with mining?
  - Deductibility of mining-related expenses.

- **Structure of mining activities**
  - Do joint cryptocurrency mining activities constitute partnerships or associations for tax purposes?

Reporting Concerns for Cryptocurrencies and ICO Tokens

Filers

- March 23, 2018: IRS reminded taxpayers to report virtual currency transactions (IR-2018-71)
  - Noted that penalties and interest or criminal prosecution may apply when appropriate
  - Summarized Notice 2014-21
- July 2, 2018: IRS Announces the Identification and Selection of Five Large Business and International Compliance Campaigns
  - One campaign focused on virtual currency
  - Slated to include both outreach and examinations
  - Stated **not** contemplating a voluntary disclosure program specific to virtual currency

Information Reporting Concerns

- Are cryptocurrencies currencies or ICO tokens securities subject to Form 1099-B reporting or Form 1099-K
- Should exchangers and others secure W-9's from clients
- What is the impact of introduction of the CBOE Bitcoin futures on the analysis?
- Can the barter exchange reporting rules apply?
- Businesses who engage in cryptocurrency transactions greater that $10,000, Form 8300?
- Are miners properly reporting certain activities on Form W-2 or Form 1099-Misc?

Offshore Reporting Concerns

Reporting Aspects

- Protective FBAR filings
- Form 8938 filing
- Schedule B check the box for foreign bank accounts?
- FATCA (Foreign Account Tax Compliance Act)
- Are foreign exchangers considered foreign financial institutions and if so are they subject to FATCA?
- Should foreign exchangers secure W-9s from clients who are US Citizens?
- Interlinkage with FinCEN AML rules for MSBs

Practical/Enforcement Aspects

- Use of voluntary disclosure practice to get into compliance
- Qualified Amended Returns
- Impact of Coinbase summons enforcement on Disclosures

Cryptocurrency and ICO Token Enforcement Concerns

DOJ/IRS Enforcement

- IRS Focus
  - IRS-CI International Tax Enforcement Group
  - Joint Chiefs of Global Tax Enforcement (JK)
- Early Crypto Tax Enforcement Efforts
  - Coinbase: John Doe Summons
  - Bitfinex: FATCA Compliance
- Following the Transactions
  - Records are paramount
  - Big Data/Information mining

Emerging Enforcement Focus Areas

- John Doe Summons
- Examining level of voluntary compliance within this industry?
- Education, examinations and criminal enforcement?
- Future of virtual currency enforcement

Basic Criminal Enforcement Issues

- Establishing Tax Due & Owing/Loss
  - Government has burden of proving cost basis
  - May be restricted to specific identification method

- Exchange-Based Crypto
  - Fungible property
  - How does government specifically identify the cost basis of unreported, fungible crypto AFTER it's been sold?

- Multiple Taxpayer Wallets
  - Coins are often sold with one wallet but purchased with another
  - How does government determine the cost basis of coins transferred from unknown wallets?
    - May need to acquire records of the unknown wallets
    - Some wallet records will likely need to be compelled directly from the owner/taxpayer

Conclusion

Thank you!