



Virtual Currency

MATERIAL RELEVANT AS OF SEPTEMBER 20, 2022



Objectives

- Explain virtual currency fundamentals
- Describe Tax Practitioners' due diligence responsibilities for Client Returns affected by virtual currency transactions
- Explain the tax consequences from:
 - Sale or other exchange of virtual currencies
 - Use of virtual currencies to pay for goods or services
 - Investments in virtual currencies



Virtual Currency Uses

- Buying good and services
- Investments
- Payroll and bonuses
- Gaming/Sports
- Gambling
- Darknet Markets
- Money laundering





Notice 2014-21

- Virtual currency is a digital representation of value that functions as a...
 - Medium of exchange
 - Unit of account
 - Store of value
- In some environments, it operates like “real” currency



- Used to pay for good or service and held for investment
- Not U.S. legal tender (see 31 USC §5103)
- Taxed as property – not currency
- Subject to the capital asset rules (IRC§1221)
- Subject to information reporting



How can you get virtual currency?

- Buy it, mine it, work or trade for it
- Mined by solving complex mathematical problems
 - Solve a certain problem, get a mining reward
 - Miners also earn fees by posting transactions to the “Blockchain”
- What is the Blockchain?
 - The blockchain is a distributed public ledger that compares to a traditional ledger where a transaction is a line in the ledger, a block is a page, and the entire blockchain is a continuous accounting ledger.



How does virtual currency work?



1 Someone initiates a virtual currency transaction, such as sending one unit of a virtual currency to another individual.



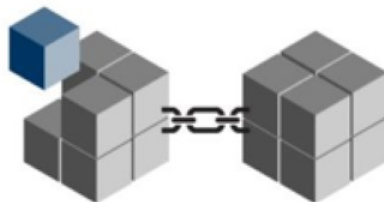
2 The transaction is broadcast to a peer-to-peer network of computers that support the blockchain.



3 The network of computers validates the transaction. For example, the network ensures that the virtual currency has not been previously spent.



4 Once verified, the transaction is combined with other transactions to create a new block of data. A block typically contains information about transactions that have not yet been linked to previous blocks, such as the date, time, and amount of virtual currency sent.



5 The new block is then added to the blockchain, which is made up of digital information (blocks) stored in the format of a distributed ledger (chain). Different virtual currencies transact on different blockchains.



6 The transaction is complete. For example, virtual currency has been deposited into the recipient's virtual wallet.



Circular 230 contains the minimum ethical requirements that practitioners are required to follow.

- Practitioners must exercise due diligence when determining the correctness of a tax position, whether that position is presented orally or in writing.
- Taxpayers may not be aware of tax consequences of virtual currency transactions.
 - Defining virtual currency as “property” clarifies understanding of the tax treatment.



Ordinary income

- Form 1040
- Form 1040-SS
- Form 1040-NR
- Form 1040, Schedule 1, Additional Income and Adjustments to Income

Capital gain or loss

- Form 8949, Sales and other Dispositions of Capital Assets
- Form 1040, Schedule D, Capital Gains and Losses



Virtual Currency Required Reporting

Form **1040**

Department of the Treasury—Internal Revenue Service (99)

U.S. Individual Income Tax Return

2021

OMB No. 1545-0074

IRS Use Only—Do not write or staple in this space.

Filing Status Single Married filing jointly Married filing separately (MFS) Head of household (HOH) Qualifying widow(er) (QW)

Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial		Last name		Your social security number	
If joint return, spouse's first name and middle initial		Last name		Spouse's social security number	
Home address (number and street). If you have a P.O. box, see instructions.				Apt. no.	
City, town, or post office. If you have a foreign address, also complete spaces below.			State	ZIP code	
Foreign country name		Foreign province/state/county		Foreign postal code	
				<input type="checkbox"/> You <input type="checkbox"/> Spouse	

Presidential Election Campaign
 Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund.

At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? Yes No



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Home address (number and street). If you have a P.O. box, see instructions.				Apt. no.	Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund.
City, town, or post office. If you have a foreign address, also complete spaces below.			State	ZIP code	
Foreign country name		Foreign province/state/county	Foreign postal code		
				<input type="checkbox"/> You	<input type="checkbox"/> Spouse

At any time during 2022, did you: (a) receive (as a reward, award, or compensation); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) . . . Yes No



Convertible virtual currency taxed as property, not currency

- No foreign exchange gain/loss

Income recognition upon receipt

- Payment for goods or services
- Basis if purchased as capital asset

Value

- Fair market value at date and time of receipt
- Definition of Receipt: dominion and control over units or when recorded on a distributed ledger



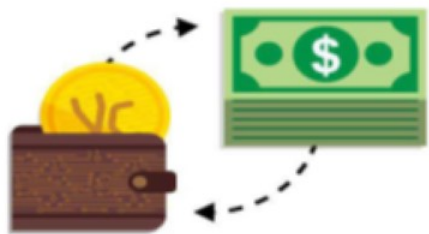
Income recognition events:

- Sale for cash (fiat currency)
- Exchange for other property
- Receipt as payment for goods or services
- Receipt of “Air Drop” virtual currency
- Exchanging one kind of virtual currency for another
- Receiving a mining reward or fees for blockchain transaction posting



Virtual Currency Transactions

Transactions That Could Affect Taxable Income



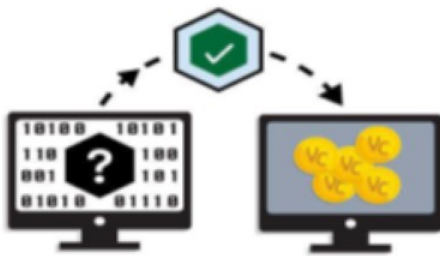
Selling virtual currency for U.S. dollars.



Exchanging one type of virtual currency for another.



Receiving virtual currency for services.

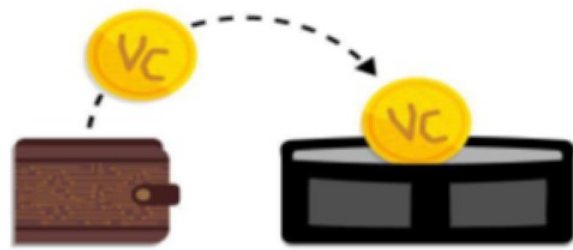


Mining virtual currency.

Transactions That Do Not Affect Taxable Income



Buying virtual currency with dollars and holding on to it.



Sending virtual currency to a different virtual wallet or account with the same owner.



Non-taxable events include, but not limited to:

- Purchase of virtual currency using fiat currency
- Reassignment from one distributed ledger address to another controlled by a single party
- Receipt of virtual currency as a gift



Capital asset

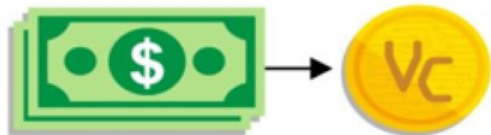
- Amount realized over basis
- Amount realized = value of property received

Not a capital asset

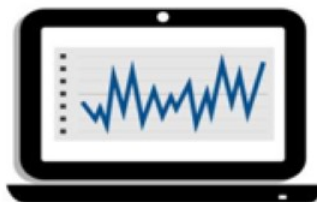
- Ordinary income
- Mining



Virtual Currency Transaction



1 Taxpayer buys virtual currency. The price paid in dollars is the cost basis.



2 Fair market value of the virtual currency fluctuates over time.



3 Taxpayer uses virtual currency to pay for goods, which may affect taxes if the transaction results in a capital gain or loss.



4 Taxpayer calculates capital gain or loss by subtracting the cost basis from the fair market value of the goods purchased.



5 Taxpayer reports capital gain or loss to IRS.



Online Resources

- www.irs.gov/virtualcurrency
- Notice 2014-21, found at www.irs.gov/2014n21, explains how general tax principles for property apply to virtual currency
- Revenue Ruling 2019-24, found at www.irs.gov/rr201924, explains the tax treatment of cryptocurrency hard forks and air drops



How do I navigate to virtual currency frequently asked questions?

- Go to **IRS.gov**
- Enter in Search box: **Virtual Currency FAQ**



- Link to Virtual Currency FAQ:
 - <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>



Frequently Asked Questions (FAQs)

- Q2. How is virtual currency treated for Federal income tax purposes?
- Q4. Will I recognize a gain or loss when I sell my virtual currency for real currency?
- Q9. Do I have income if I provide someone with a service and that person pays me with virtual currency?
- Q14. Will I recognize a gain or loss if I pay someone with virtual currency for providing me with a service?
- Q22. One of my cryptocurrencies went through a hard fork but I did not receive any new cryptocurrency. Do I have income?
- Q31. I received virtual currency as a bona fide gift. Do I have income?
- Q34. If I donate virtual currency to a charity, will I have to recognize income, gain, or loss?





FAQ #5

- ⊖ **Q5(a). The 2021 Form 1040 asks whether at any time during 2021, I received, sold, exchanged, or otherwise disposed of any financial interest in any virtual currency. During 2021, I purchased virtual currency with real currency and had no other virtual currency transactions during the year. How do I answer the question on the Form 1040? (added March 10, 2022)**

A5(a). If your only transactions involving virtual currency during 2021 were purchases of virtual currency with real currency, you are not required to answer “yes” to the Form 1040 question, and should, instead, check the “no” box.



Other Virtual Currency Guidance

- IRS Chief Counsel Advice (CCA) 202035011 (Issued 8/28/2020) – taxability of virtual currency in exchange for performing microtask
- IRS CCA 202114020 (Issued 4/9/2021) – taxability of Bitcoin Cash from Bitcoin hard fork
- IRS CCA 202124008 (Issued 6/18/21) – applicability of like-kind exchange under I.R.C. § 1031.





Questions

Thank you