

CRYPTOCURRENCY FUNDAMENTALS: Criminal and Civil Pitfalls & Reporting Requirements

Live Zoom Webinar Wednesday May 24th, 2023 **Time 12 pm CT- 1 pm CT**

Nathan MacPherson and Dan Pilla will conduct a Zoom conference addressing cryptocurrency. This is a very important session that will address the legal consequences of crypto, from two different angles.

First, Nathan will address the civil and criminal pitfalls of dealing in crypto, including the little-known and less-understood “money transmittal business” rules. These rules are tripping up otherwise honest people across the country. You need to know about these rules to better advise your clients and help keep them out of trouble with both federal and state government agencies.

Next, Dan will address the tax consequences of dealing in crypto, examining both the ordinary income, and capital gain tax aspects of crypto trades. He will also lay out specific crypto reporting requirements.

IMPORTANT DETAILS

Make sure you log in with your full name

Please let Jean know before hand if calling in and what your number is or she will not let you in. All will be muted once starts until discussion- use the chat box for a question. The hosts will unmute you.

Current TDI/TFI members who email to Jean the polling questions (4) by Thursday May 25th are eligible for 1 CE credit.

Send one email to jean@taxhelponline.com with:

Full Name for certificate

PTIN if have one

Answers to 4 polling questions

As Dan stated - THIS IS THE KIND OF MATERIAL THAT PUTS US ON THE CUTTING EDGE OF THE IRS DEFENSE INDUSTRY.

Thus, this webinar is a benefit for TFI/TFI current **members** only. Others in your firm who are not signed up as current members will not be let in or receive credit.

We will be recording and place the session in the members only area of the Taxpayers Defense Institute site for members to listen to later. Note: No CE credits will be available once up on site.

CRYPTOCURRENCY FUNDAMENTALS

Criminal and Civil Pitfalls Reporting Requirements

A. OVERVIEW

1. The use of cryptocurrency is at an all-time high

a. Five million monthly users in 2016, to over 400 million at the end of 2022

b. International Monetary Fund is working with central banks worldwide to create “Central Bank Digital Currencies” (CBDCs).

c. President Biden’s Treasury is developing a U.S. digital currency – See: “Executive Order on Ensuring Responsible Development of Digital Assets,” March 9, 2022

2. Cryptocurrency is on the IRS’s radar

a. 2020 Form 1040 asks:

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?

b. 2022 Form 1040 asks:

At any time during 2022, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.)

c. CI Chief Jim Lee announced IRS opened a new cyber crimes data unit – See: “Crypto Cases to Top CI’s ‘To-Do List’ in 2023,” October/November 2022 issue of *PTT*

d. The *2021 Infrastructure Investment and Jobs Act*, requires cryptocurrency exchanges to issue Form 1099-B

1. Look for more audits and reporting problems due to erroneous Form 1099-B

e. IRS is issuing “John Doe summonses” to crypto exchanges

3. Cryptocurrency is now covered by both criminal and civil laws, and transcends tax law

B. CRIMINAL LAW ISSUES

1. FinCen Registration

a. Distinction between acquiring cryptocurrency as an investment and selling to others in the course of business

1. A “money transmitting business” must register with the Treasury – *31 U.S.C. § 5330*

i. Failure to register is a crime independent of any other offenses – *18 U.S.C. § 1960(a)*

2. Factual distinction between cryptocurrency “investor” and a reseller

b. Criminal penalty for anyone who knowingly conducts, controls, manages, supervises, directs, or owns all or part of an “unlicensed money transmitting business” – *18 U.S.C. § 1960(a)*

1. Max punishment is a fine and five years in prison

2. “Knowingly” simply means you knew you were engaged in exchanging cryptocurrency

3. Definition of an “unlicensed money transmitting business”:

(A) The business is not licensed in the state of operation and such failure to license in that state is itself a misdemeanor or felony under state law

(i) If state law requires you to register, you must also register with the feds

(B) The business is not registered under *31 U.S.C. § 5330*

(i) Failure to register under federal law is a crime

(C) Or, the cryptocurrency transactions involve funds the defendant knows are related to unlawful activities. *18 U.S.C. § 1960(b)(1)*

(i) The “knowingly” element pertains to the source or use of the funds — that they are proceeds of crime or used to support crime

4. Courts have consistently held that: (a) that cryptocurrency is “money” or “currency” or “funds”, and (b) a “money transmitting business” is one in which one currency is exchanged for another

5. Prosecution may occur under federal and/or state law

6. Recent case example shows risks involving potential charges of bank fraud, wire fraud, conspiracy, money laundering, failure to file and tax evasion, and failure to register with FinCen and state agencies

2. Potential Tax Crimes

a. Evasion (IRC § 7201) and false returns (IRC § 7206)

3. Other Potential Crimes

a. Title 18 and Title 31 crimes

C. CIVIL TAX ISSUES

1. Crypto is “property” – IRS Notice 2014-21

a. Defined as “convertible” currency in which

1. Value is measured in real currency, or

2. Acts as a substitute for real currency

b. Not specifically addressed in the tax code

c. To be treated no differently than a share of stock or an automobile

2. Three common tax problems (misunderstandings) with taxability of virtual currency

a. Computing crypto gains

1. The gain in value is taxable as income upon sale

EXAMPLE: Citizen purchases Bitcoin for \$5 per coin and later sells for \$15. He realizes gain of \$10 per coin. The gain is taxed as long-term or short-term capital gain depending on the holding period.

2. Gain in value is taxable as income when trading crypto for crypto

EXAMPLE: Citizen holds 50 Bitcoin, worth \$1,000 each. The cost basis is \$100 each. All Bitcoin is traded for another digital currency without taking any cash.

The swap of the Bitcoin is treated as a sale. Whether gain is long-term or short-term is based on the holding period.

A. Capital gain is \$900 per Bitcoin (\$1,000 sale price less \$100 basis)

i. Gain is taxable in the year of the trade

B. Basis in the new crypto is the purchase price thereof

b. Purchasing goods or services with crypto

1. The trade of crypto for goods or services is considered a “sale”

EXAMPLE: Citizen trades two Bitcoin (FMV \$5,000 ea; basis \$2,000 ea) for a used car (purchase price \$10,000). Each Bitcoin is considered “sold” at FMV. The taxable capital gain is \$3,000 per Bitcoin (sale price less basis). The basis in the car is \$10,000 (the purchase price).

c. Selling goods or services in exchange for crypto

1. Receipt of crypto is income

EXAMPLE: You are in business as a CPA. Fee for services is \$5,000/yr. Client engages your services and pays you with a Bitcoin. The FMV of the coin as of the date paid is \$5,000. \$5,000 is income to you in the year received.

A. Income is measured by the FMV of the crypto as of the date received for payment of goods or services

2. Basis in the crypto received is equal to the FMV on the date of receipt (\$5,000)

EXAMPLE: Client pays for \$5,000 worth of services with one Bitcoin with FMV of \$5,000. Your income is \$5,000 (per the above example), to be reported in the year received. You now have basis in the Bitcoin equal to the income recognized on the trade (\$5,000).

3. Subsequent sale of the Bitcoin is subject to capital gain tax

EXAMPE: You later sell the Bitcoin (acquired in the above example) for \$7,500. At that time, you have a profit (capital gain) of \$2,500. On the other hand, if you sell for \$4,500, you have a capital loss of \$500. Gain or loss is reported in the year of the sale.

D. REPORTING CRYPTO TRANSACTIONS

1. The “Yes” box must be checked if, during the tax year, taxpayer either,
 - a. Received (as a reward, award, or payment for property or services); or
 - b. Sold, exchanged, gifted, or otherwise disposed of a digital asset (or any financial interest in any digital asset).

EXAMPLES: Taxpayer,

- Received digital assets as payment for property or services;
- Received digital assets as a result of a reward or award;
- Received new digital assets as a result of mining, staking, or similar activities;
- Received digital assets as a result of a “hard fork”;
- Disposed of digital assets in exchange for property or services;
- Disposed of a digital asset in exchange or trade for another digital asset;
- Sold a digital asset;
- Transferred digital assets for free (without receiving any consideration) as a bona fide gift; or
- Otherwise disposed of any other “financial interest” in a digital asset.

- c. “Financial interest” defined: -- IR-2022-61, March 18, 2022

Person is either, (a) the owner of record of a digital asset, (b) has an ownership stake in an account that holds one or more digital assets, including the rights and obligations to acquire a financial interest, or (c) owns a wallet that holds digital assets.

2. Who is NOT required to check the “Yes” box

- Merely holding a digital asset in a wallet or account without any trading activity;
- Transferring a digital asset from one wallet or account you own or control to another wallet or account that you own or control; or
- Purchasing digital assets using U.S. or other real currency, including through the use of electronic platforms such as PayPal and Venmo.

3. The question must be answered

4. Tax forms used for reporting

<u>Digital Asset Transaction</u>	<u>How to Report</u>
Received as compensation for services or because of Income reward or award	Wages or Other
Received because of a “hard fork”	Other Income
Received as payment for any property or services provided	Form 1040, Schedule C
Received through mining, staking, or similar activities	Form 1040, Schedule C for Businesses; or Other Income
Sold a digital asset	Form 1040 Schedule D, Form 8949
Exchanged for property or services	Form 1040 Schedule D, Form 8949
Exchanged or traded for another digital asset	Form 1040 Schedule D, Form 8949
Disposed of any other financial interest	Form 1040 Schedule D, Form 8949
Donated to charity	Form 1040 Schedule A, Form 8283
Disposed when held for sale to customers in a trade or business	Sale of Inventory, Part 1, Schedule C or other business tax return

E. Final Thoughts