



IRS Nationwide Tax Forum | 2022

The Fundamentals and Tax Treatment of Digital Assets
Wednesday, July 27th, 2022

Start Time: 2:00pm Eastern / 1:00pm Central
12:00 Noon Mountain / 11:00am Pacific

Note: You should be hearing music while waiting for webinar to start.

Having Technical Issues?

View the “Technical Issues” troubleshooting guide in the Materials drop-down menu on the left side of this page

Today our webinar will:

- Explain the key concepts of digital assets/virtual currency
- Describe published guidance and legal concepts governing digital asset/virtual currency taxation
- Summarize how digital asset/virtual currency transactions are reported to the IRS
- Explain the recordkeeping issues associated with digital assets/virtual currency

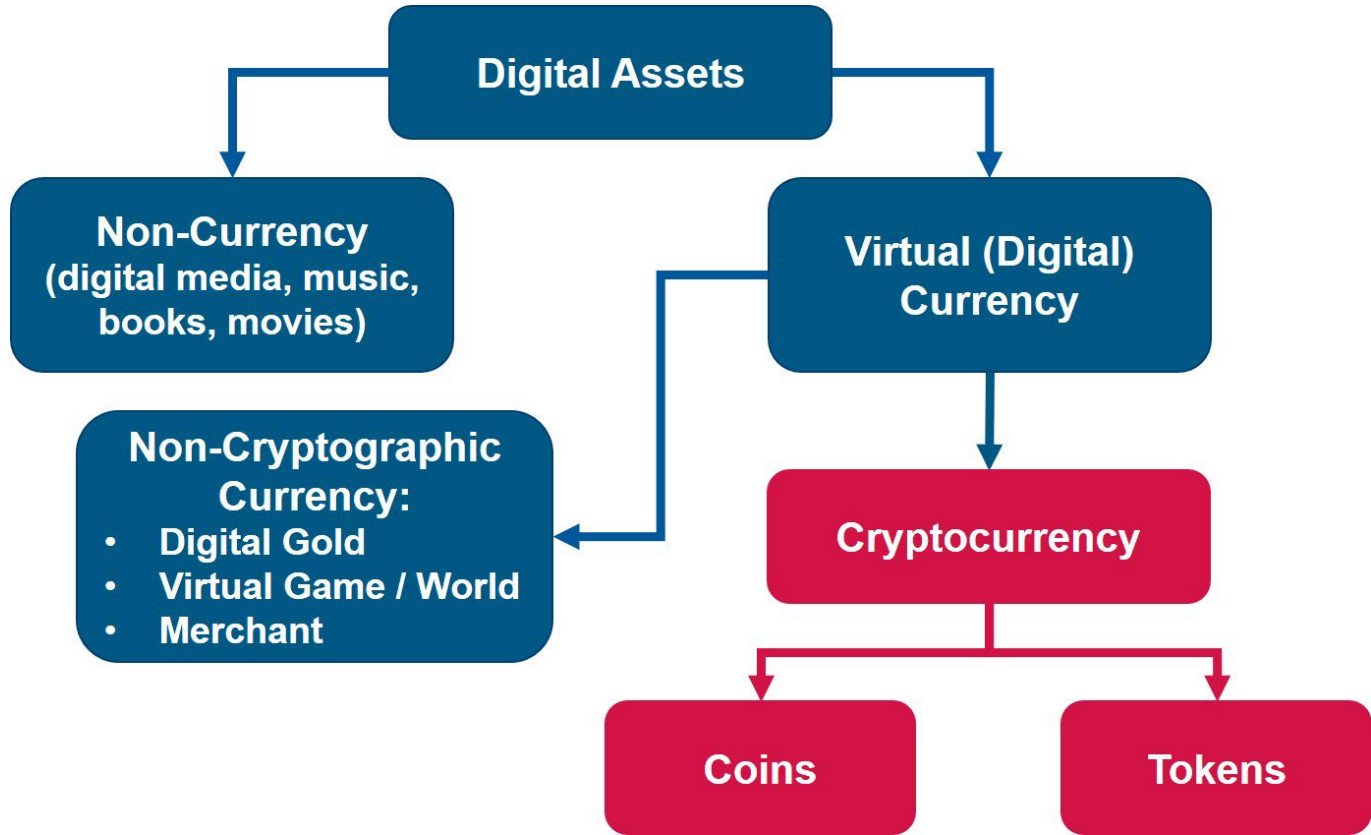


What is Virtual Currency?

A digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like “real” currency (i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance), but it does not have legal tender status in the U.S.



Digital Assets





Wallets, Keys, & Exchanges

- Wallet (custodial, software, hardware, or paper) – Stores private and public keys/addresses
- Public Key (Address) – Needed to give to the sender in order to receive digital assets
- Private Key – Known only to the recipient of the digital assets and needed to access those digital assets
- Digital Currency Exchanges – A third-party platform that custodies wallets/keys of users and allows for the trading of digital assets

How Virtual Cryptocurrency Operates



Someone initiates a cryptocurrency transaction, such as sending one unit of cryptocurrency to another individual.



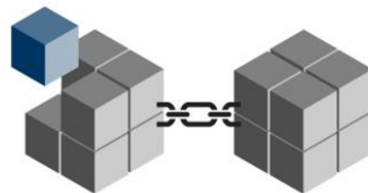
The transaction is broadcast to a peer-to-peer network of computers that support the blockchain.



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



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 cryptocurrency sent.



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 cryptocurrencies transact on different blockchains.



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

Following Virtual Currency

- Generally, digital asset transactions can be traced through the blockchain, tracing these assets can lead to an exchange or service provider to which ownership can be identified.
- Tracing digital assets can also lead to:
 - Counterparties
 - Services (reputable and illicit)
 - Additional Digital Assets





Mining vs. Staking

- Mining (Proof of Work Model) – Miners solve computational problems to validate transactions to add to the blockchain in exchange for digital assets.
- Staking (Proof of Stake Model) – Stakers commit already owned digital assets to validate blocks of transactions in exchange for additional staking rewards.



Ethereum

- What is Ethereum?
- A public, decentralized, and open-source blockchain with smart contract functionality
- What does that even mean?
- Public – transactions are transparent
- Decentralized – no single entity or group controls the nodes
- Open-source – the code is available for public review
- Smart contract functionality – code-based agreements may be written or deployed on top of the blockchain network



Bitcoin vs. Ethereum

- Both have digital asset transactions recorded on the blockchain and use keys and wallets.
- Both Bitcoin and Ether (Ethereum's token) can be traded through exchanges.
- Ethereum also serves as a platform to facilitate programmable contracts and applications. Payments in Ether are used to execute these contracts and applications.



Smart Contracts and NFTs

- Contract Addresses – Code-bearing addresses on a blockchain (such as Ethereum) which can issue and manage tokens
- Smart Contracts – Self-executing agreements written in code. Can be used to facilitate decentralized financial services or the creation of decentralized applications and NFTs
- NFTs – Unique tokens used to store ownership data on the blockchain for items such as images, videos, and audio. Can be created by anyone; bought and sold on specialized marketplaces in a peer-to-peer environment through either a fixed price or auction.



Non-Fungible Tokens – Definition

What is a Non-Fungible Token (NFT)?

Non-Fungible

- Unique

Token

- A digital asset built on a blockchain via a smart contract

$NF + T = \text{digital scarcity}$



Non-Fungible Tokens – Types of NFTs

General categories of NFT types:

- Profile picture projects (PFPs)
- Digital sports cards
- Digital art
- Blockchain gaming assets
- Metaverse assets (avatars, voxel art)
- Marketing from legacy businesses



Decentralized Finance – Basics

What is decentralized finance (DeFi)?

Decentralized

- No trusted third-party required to facilitate transactions
- Blockchain-based (primarily Ethereum)
- Interact with decentralized applications (DApps)

Finance

- Borrowing, lending, and trading of digital assets
- Staking, liquidity providing, yield farming, and token swapping



Published Guidance

- [IRS Notice 2014-21](#)
- [Revenue Ruling 2019-24](#)
- [Frequently Asked Questions](#)
- [Chief Counsel Advice \(CCA\) #202035011](#)
- [Chief Counsel Advice \(CCA\) #202114020](#)
- [Chief Counsel Advice \(CCA\) #202124008](#)
- [PLR 202019028](#)



Notice 2014-21 - Overview

Notice 2014-21

SECTION 1. PURPOSE

This notice describes how existing general tax principles apply to transactions using virtual currency. The notice provides this guidance in the form of answers to frequently asked questions.

SECTION 2. BACKGROUND

The Internal Revenue Service (IRS) is aware that "virtual currency" may be used to pay for goods or services, or held for investment. Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like "real" currency -- i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance -- but it does not have legal tender status in any jurisdiction.

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as "convertible" virtual currency. Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies. For a more comprehensive description of convertible virtual currencies to date, see Financial Crimes Enforcement Network (FinCEN) *Guidance on the Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (FIN-2013-G001, March 18, 2013).

SECTION 3. SCOPE

In general, the sale or exchange of convertible virtual currency, or the use of convertible virtual currency to pay for goods or services in a real-world economy transaction, has tax consequences that may result in a tax liability. This notice addresses only the U.S. tax consequences of such transactions in, or transactions that use, convertible virtual currencies not described in this notice. Section 4 refers only to convertible

- Describes how existing general tax principles apply to transactions using convertible virtual currency
- Provides guidance as answers to frequently asked questions

<https://www.irs.gov/pub/irs-drop/n-14-21.pdf>

Tax Treatment of Virtual Currency Transactions

Taxed as property, not currency

No foreign currency exchange gain/loss

When purchased with US dollars no income recognition

Basis if acquired as capital asset

Income recognition upon receipt

Payment for goods or services (basis is FMV of virtual currency received)

Value

Fair market value at date and time of receipt

Determining date and time of receipt: dominion and control over units or when recorded on a distributed ledger

Income recognition events

Sale of virtual currency

Exchange for other property (such as other virtual currency)

Character of Income

Capital Gains	Ordinary Income
<p>Trading activities Selling virtual currency* Exchanging virtual currency* Spending virtual currency</p> <p>*As an investor</p>	<p>Salary paid in virtual currency Bonus/rewards paid in virtual currency* Mining Selling virtual currency^ Exchanging virtual currency^</p> <p>^Dealer or in the trade or business of</p>

Revenue Ruling 2019-24 - Overview

Aids taxpayers in understanding their reporting obligations for hard forks and airdrops.

Rev. Rul. 2019-24

ISSUES

(1) Does a taxpayer have gross income under § 61 of the Internal Revenue Code (Code) as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency?

(2) Does a taxpayer have gross income under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency?

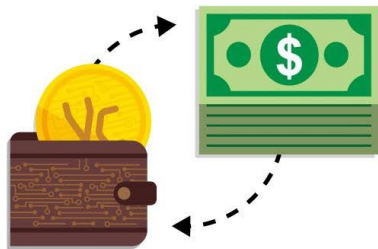
BACKGROUND

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value other than a representation of the United States dollar or a foreign currency. Foreign currency is the coin and paper money of a country other than the United States.

<https://www.irs.gov/pub/irs-drop/rr-19-24.pdf>

Tax Consequences

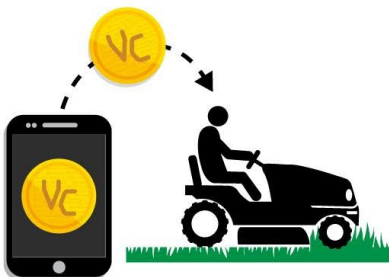
Transactions That Could Affect Taxable Income



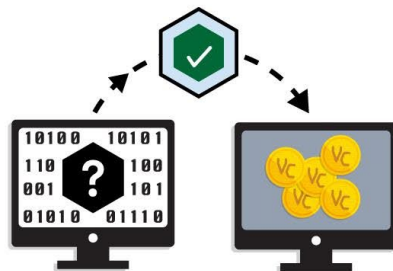
Selling virtual currency for U.S. dollars.



Exchanging one type of virtual currency for another.



Receiving virtual currency for services.

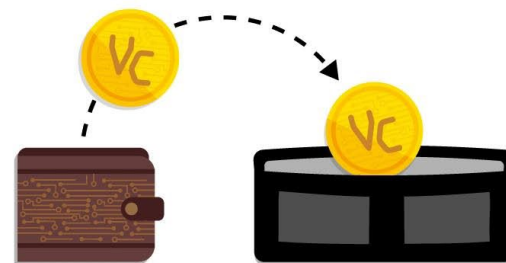


Mining virtual currency.

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.

Sale of Virtual Currency - Example

Mark Smith purchased 1,000 bitcoins for 10 cents each on October 20th, 2010. He sold all 1,000 bitcoins on April 21, 2021. What is Mark's tax implication?*

Note: As of April 21, 2021, one bitcoin was worth \$53,530.26.

Basis on date of acquisition - \$100 (1,000 x .10)

FVM on date of sale - \$53,530,260 (1,000 x \$53,530.26)

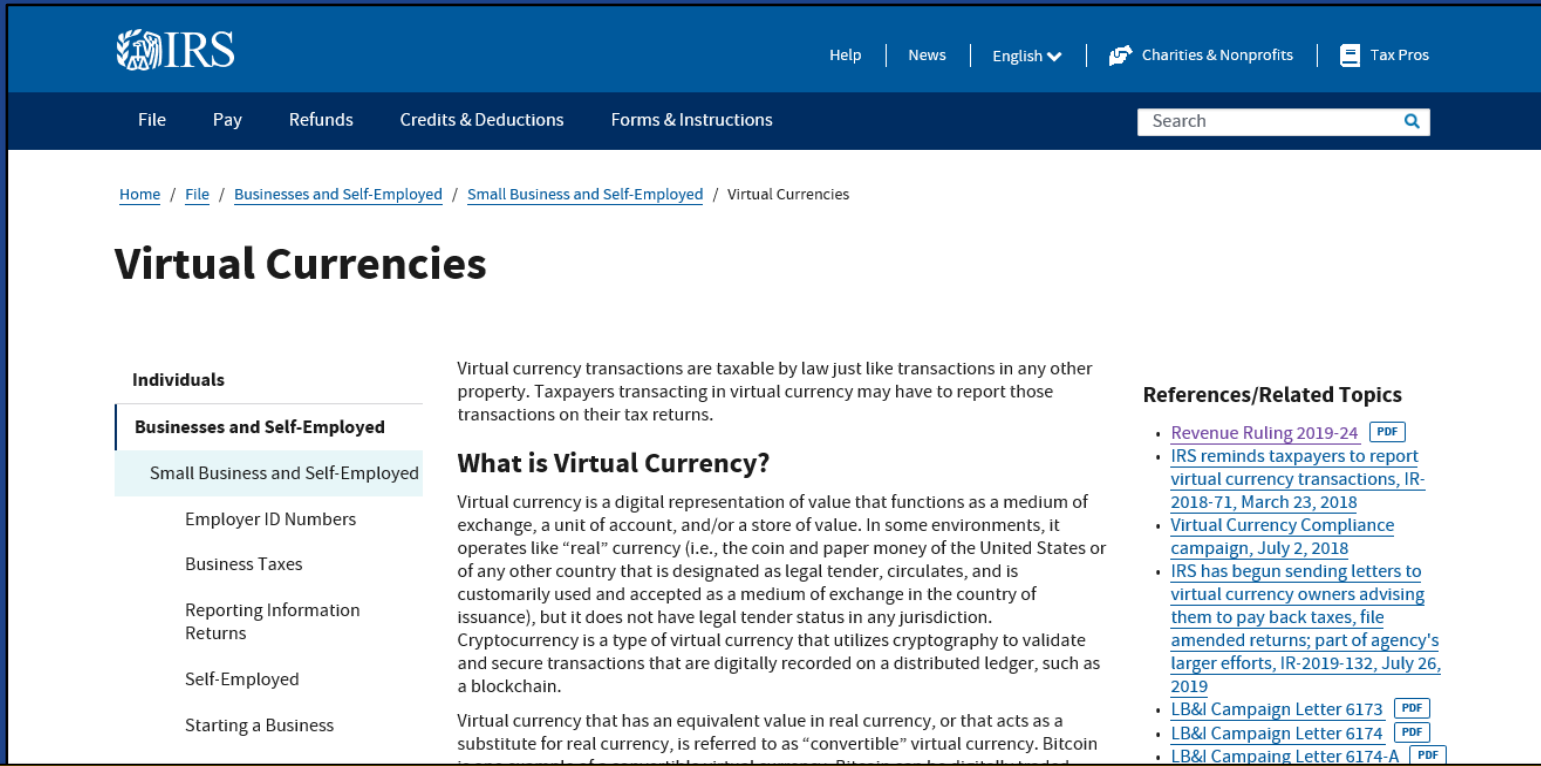
Long Term Capital Gain - \$53,530,160 (53,530,260 - \$100)

*Assuming

Not held for sale to customers in the ordinary course of a trade or business

Fees that transactions require are not being taken into account

Public Awareness - www.IRS.gov



The screenshot shows the IRS website's navigation bar with links for File, Pay, Refunds, Credits & Deductions, and Forms & Instructions. A search bar is located on the right. The breadcrumb trail reads: Home / File / Businesses and Self-Employed / Small Business and Self-Employed / Virtual Currencies.

Virtual Currencies

Individuals

Businesses and Self-Employed

- Small Business and Self-Employed
- Employer ID Numbers
- Business Taxes
- Reporting Information Returns
- Self-Employed
- Starting a Business

Virtual currency transactions are taxable by law just like transactions in any other property. Taxpayers transacting in virtual currency may have to report those transactions on their tax returns.

What is Virtual Currency?

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like “real” currency (i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance), but it does not have legal tender status in any jurisdiction. Cryptocurrency is a type of virtual currency that utilizes cryptography to validate and secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as “convertible” virtual currency. Bitcoin

References/Related Topics

- [Revenue Ruling 2019-24](#) PDF
- [IRS reminds taxpayers to report virtual currency transactions, IR-2018-71, March 23, 2018](#)
- [Virtual Currency Compliance campaign, July 2, 2018](#)
- [IRS has begun sending letters to virtual currency owners advising them to pay back taxes, file amended returns; part of agency's larger efforts, IR-2019-132, July 26, 2019](#)
- [LB&I Campaign Letter 6173](#) PDF
- [LB&I Campaign Letter 6174](#) PDF
- [LB&I Campaign Letter 6174-A](#) PDF

<https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies>

Required Reporting - 1040

Form 1040	Department of the Treasury—Internal Revenue Service (99)	2021	OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.
Filing Status	<input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Head of household (HOH) <input type="checkbox"/> 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.	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. <input type="checkbox"/> You <input type="checkbox"/> Spouse
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		
At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? <input type="checkbox"/> Yes <input type="checkbox"/> No				
Standard Deduction	<input type="checkbox"/> Someone else's dependent <input type="checkbox"/> You as a dependent <input type="checkbox"/> Your spouse as a dependent			
	<input type="checkbox"/> Spouse itemizes on a separate return or you were a dual-status alien			

<https://www.irs.gov/forms-pubs/about-form-1040>

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Required Reporting – Schedule D / 8949

Form 8949	Sales and Other Dispositions of Capital Assets		OMB No. 1545-0074					
Department of the Treasury Internal Revenue Service	<p>► Go to www.irs.gov/Form8949 for instructions and the latest information.</p> <p>► File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.</p>		<p>2021</p> <p>Attachment Sequence No. 12A</p>					
Name(s) shown on return		Social security number or taxpayer identification number						
<p>Before you check Box A, B, or C below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.</p>								
<p>Part I Short-Term. Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). For long-term transactions, see page 2.</p> <p>Note: You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren't required to report these transactions on Form 8949 (see instructions).</p>								
<p>You must check Box A, B, or C below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.</p>								
<p><input type="checkbox"/> (A) Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see Note above)</p> <p><input type="checkbox"/> (B) Short-term transactions reported on Form(s) 1099-B showing basis wasn't reported to the IRS</p> <p><input checked="" type="checkbox"/> (C) Short-term transactions not reported to you on Form 1099-B</p>								
1	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the Note below and see Column (a) in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions.		(h) Gain or (loss). Subtract column (e) from column (d) and combine the result with column (g)
	1.50074550 ETH	06/07/2017	09/06/2017	503.31	391.06			112.24
	0.01838750 BTC	06/07/2017	09/06/2017	85.24	51.55			33.69
	0.06934928 BTC	06/07/2017	09/06/2017	321.48	194.41			127.07
								48
								31)

<https://www.irs.gov/pub/irs-pdf/f8949.pdf>

Required Reporting – Schedule C

2022

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SCHEDULE C (Form 1040) Department of the Treasury Internal Revenue Service (99)	Profit or Loss From Business (Sole Proprietorship) ▶ Go to www.irs.gov/ScheduleC for instructions and the latest information. ▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships must generally file Form 1065.	OMB No. 1545-0074 2021 Attachment Sequence No. 09
Name of proprietor		Social security number (SSN)
A Principal business or profession, including product or service (see instructions) CRYPTOCURRENCY MINING		B Enter code from instructions ▶ 5 4 1 5 1 0
C Business name. If no separate business name, leave blank.		D Employer ID number (EIN) (see instr.)
E Business address (including suite or room no.) ▶ City, town or post office, state, and ZIP code		
F Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶		
G Did you “materially participate” in the operation of this business during 2021? If “No,” see instructions for limit on losses		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
H If you started or acquired this business during 2021, check here		<input type="checkbox"/>
I Did you make any payments in 2021 that would require you to file Form(s) 1099? See instructions		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
J If		<input type="checkbox"/> No

<https://www.irs.gov/pub/irs-pdf/f1040sc.pdf>

Required Reporting – Schedule 1

2022

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SCHEDULE 1 (Form 1040)		Additional Income and Adjustments to Income		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service		▶ Attach to Form 1040, 1040-SR, or 1040-NR. ▶ Go to www.irs.gov/Form1040 for instructions and the latest information.		2021 Attachment Sequence No. 01	
Name(s) shown on Form 1040, 1040-SR, or 1040-NR				Your social security number	
Part I Additional Income					
1	Taxable refunds, credits, or offsets of state and local income taxes	1			
2a	Alimony received	2a			
o	Section 461(l) excess business loss adjustment	8o			
p	Taxable distributions from an ABL account (see instructions)	8p			
z	Other income. List type and amount ▶ CRYPTOCURRENCY AIRDROPS	8z			
				5,000	
9	Total other income. Add lines 8a through 8z	9			
10	Combine lines 1 through 7 and 9. Enter here and on Form 1040, 1040-SR, or 1040-NR line 8	10			

<https://www.irs.gov/pub/irs-pdf/f1040s1.pdf>



Questions to Ask/Documents to Review

- Do they own digital assets? What type? When did they purchase them? How did they purchase them? How frequent are transactions?
- How do they convert digital assets to fiat currency and vice versa? What financial institutions and exchanges are used?
- What is the value of their digital assets? What is the nature of their use of digital assets? Do they send/receive digital assets as payment for goods/services?
- You may notice their involvement with digital assets through bank statements or credit card statements. They can then follow-up by providing you with reports from any exchanges.

Recordkeeping Considerations



<https://www.irs.gov/newsroom/the-first-step-of-good-tax-planning-is-good-recordkeeping>

Hot Topics

- Below are key search terms that may be used to research various popular topics on www.irs.gov

Topic	Suggested Search Term
Online Tools	Tools; voice bot; chat bot
Payment Options	Pay; payments
Small Business News and Resources	Small business news
Tax Professional News and Resources	Tax pro news
Tax Scams	Scams
Virtual Currency	Bitcoin; virtual currency
Work Opportunity Tax Credit (WOTC)	Wotc; tax credit
1099-K	Payment cards; third party payments