UHY EXECUTIVE BRIEFING

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Tax Considerations For Cryptocurrency

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WEBINAR AGENDA

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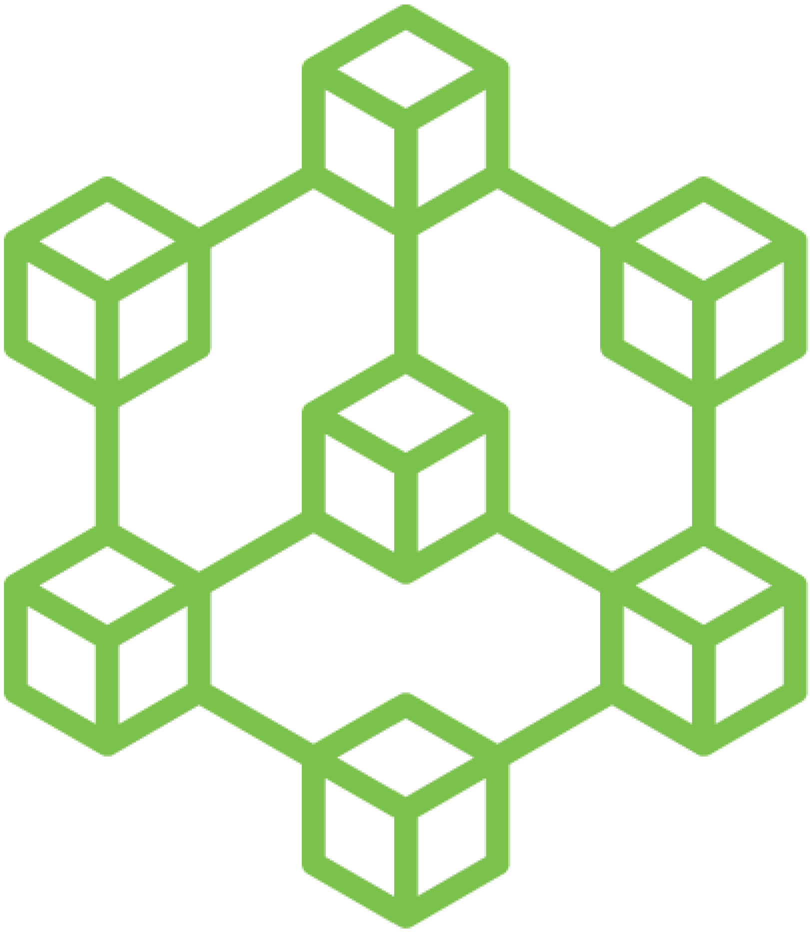
- Background
- Types of Coins
- Tax Treatment

BLOCKCHAIN

A cryptocurrency's block chain is the master ledger that records and stores all prior transactions and activity, validating ownership of all units of the currency at any given point in time.

A cryptocurrency transaction technically isn't finalized until it's added to the block chain, which usually occurs within minutes. Once the transaction is finalized, it's usually irreversible.



US TAX TREATMENT FOR CRYPTOCURRENCIES

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March 25, 2014 IRS issued a notice (2014-21) providing answers for frequently asked questions on virtual currency. These FAQs provide basic information on US Federal Tax implications of transactions in, or transactions that use, virtual currency.

In most cases cryptos operate as real currency, and is designated as legal tender and can be exchanged for goods/services provided, however it does not have a legal tender status in any jurisdiction.

Taxation

- Bitcoin is a personal property, a convertible virtual currency, and so is taxed as a capital asset
- Gains made from converting Bitcoins into a fiat currency are subject to capital gains tax
- Purchases of goods or services with Bitcoins must also account for gains
- Bitcoins and other alt-coins obtained from mining are recognized as income at their fair value on the date the virtual currency was received
- Mining equipment can be deducted as a business expense

POLLING QUESTION

How many types of cryptocurrency currently exist?

- 180
- 1,800
- 18,000
- 180,000

QUESTIONS & ANSWERS #1-2

Q-1: How is virtual currency treated for federal tax purposes?

Q-2: Is virtual currency treated as currency for purposes of determining whether a transaction results in foreign currency gain or loss under U.S. federal tax laws?

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QUESTION & ANSWER #3

Q-3: Must a taxpayer who receives virtual currency as payment for goods or services include in computing gross income the fair market value of the virtual currency?

QUESTIONS & ANSWERS #4-5

Q-4: What is the basis of virtual currency received as payment for goods or services in Q&A-3?

Q-5: How is the fair market value determined?

QUESTIONS & ANSWER #6

Q-6: Does a taxpayer have gain or loss upon an exchange of virtual currency for other property?

QUESTION & ANSWER #7

Q-7: What type of gain or loss does a taxpayer realize on the sale or exchange of virtual currency?

QUESTION & ANSWER #8

Q-8: Does a taxpayer who "mines" virtual currency (for example, uses computer resources to validate Bitcoin transactions and maintain the public transaction ledger) realize gross income upon receipt of the virtual currency resulting from those activities?

QUESTIONS & ANSWERS #9-10

Q-9: Does virtual currency received by an independent contractor for performing services constitute self-employment income?

Q-10: Does virtual currency paid by an employer as remuneration for services constitute wages for employment tax purposes?

QUESTIONS & ANSWER #11

Q-11: Is a payment made using virtual currency subject to information reporting?

QUESTION AND ANSWER #12

Q-12: Will taxpayers be subject to penalties for having treated a virtual currency transaction in a manner that is inconsistent with this notice prior to March 25, 2014?

POLLING QUESTION

Bitcoin was the first in the cryptocurrency ecosystem. What year was bitcoin developed?

- 2009
- 2010
- 2014
- 2015

TAX CUT & JOBS ACT

The exchange of one virtual currency for another virtual currency does not qualify for non-taxable like-kind exchange treatment. The Tax Cuts and Jobs Act has eliminated the use of like-kind exchanges for all property other than real-estate.

INFRASTRUCTURE INVESTMENT & JOBS ACT

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- Signed into law by President Biden on November 15, 2021
- Cryptocurrency to be treated as a covered security subject to 1099-B reporting (effective for the 2023 tax year).
- Exchanges must share cost basis information during transfers.
- Businesses and financial institutions- Must report transactions greater than $10,000 (returns and statements filed after December 31, 2023)

SIMPLE AGREEMENTS FOR FUTURE TOKENS (SAFTS)

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SAFTs are investment contracts. The contract is a promise to deliver tokens in the future.

SAFTs are treated as forward contracts for tax purposes.

Taxation to the issuer of SAFTs occurs upon the delivery of tokens. Until such time the transaction is treated as an open contract.

FOUNDER/ADVISOR TOKENS

Tokens issued to founders generally have the same tax result as receiving equity. The tokens distributed to the founders generally do not have an established fair market value.

Tokens distributed in exchange for sweat equity is income to the extent of the fair market value of the token. Tokens received in connection with the performance of services should be eligible for a section 83(b) election as the tokens are considered property.

FORKING

Forked tokens or coins have no clear tax treatment. The Internal Revenue Service may treat the forked token or coin as a dividend, or as a stock-split. However, in crypto world the transfer of property is a taxable event. The income from the receipt of the property would likely be taxed as ordinary income.

REV RULE. 2019-24

Addresses the taxation of hard forks and airdrops.

- **Hard fork**: occurs when a cryptocurrency on a distributed ledger undergoes a protocol change which results in a change to the existing ledger, and possibly the creation of a new cryptocurrency in addition to the existing.
- **Airdrop**: A means of distributing units of a cryptocurrency to the distributed ledger address of taxpayers.

Taxable: Hard fork followed by an airdrop, assuming dominion and control over the cryptocurrency.

Nontaxable: Hard fork without airdrop.

EXAMPLE - HARD FORK

Situation 1:

A holds 50 units of Crypto M, a cryptocurrency. On Date 1, the distributed ledger for Crypto M experiences a hard fork, resulting in the creation of Crypto N. Crypto N is not airdropped or otherwise transferred to an account owned or controlled by A.

IRS Analysis:

A did not receive units of the new cryptocurrency, Crypto N, from the hard fork; therefore, A does not have an accession to wealth and does not have gross income under § 61 as a result of the hard fork.

EXAMPLE - HARD FORK W/ AIRDROP

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Situation 2:

B holds 50 units of Crypto R, a cryptocurrency. On Date 2, the distributed ledger for Crypto R experiences a hard fork, resulting in the creation of Crypto S. On that date, 25 units of Crypto S are airdropped to B's distributed ledger address and B has the ability to dispose of Crypto S immediately following the airdrop. B now holds 50 units of Crypto R and 25 units of Crypto S. The airdrop of Crypto S is recorded on the distributed ledger on Date 2 at Time 1 and, at that date and time, the fair market value of B's 25 units of Crypto S is $50. B receives the Crypto S solely because B owns Crypto R at the time of the hard fork. After the airdrop, transactions involving Crypto S are recorded on the new distributed ledger and transactions involving Crypto R continue to be recorded on the legacy distributed ledger.

IRS Analysis:

B received a new asset, Crypto S, in the airdrop following the hard fork; therefore, B has an accession to wealth and has ordinary income in the taxable year in which the Crypto S is received. See §§ 61 and 451. B has dominion and control of Crypto S at the time of the airdrop, when it is recorded on the distributed ledger, because B immediately has the ability to dispose of Crypto S . The amount included in gross income is $50, the fair market value of B's 25 units of Crypto S when the airdrop is recorded on the distributed ledger. B's basis in Crypto S is $50, the amount of income recognized. See §§ 61, 1011, and 1.61-2(d)(2)(i).

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COMMON TERMS TO UNDERSTAND

Term	Definition
Airdrops	A crypto airdrop is a promotional event for a new blockchain-based service. In an airdrop, participants are given free crypto coins or tokens by a new service. Those looking to participate in an airdrop require a crypto wallet to do so. An airdrop is a taxable event to the extent that the recipient has dominion and control over the crypto wallet.
Hardfork	A hard fork (or hardfork), as it relates to blockchain technology, is a radical change to a network's protocol that makes previously invalid blocks and transactions valid, or vice-versa. A hard fork requires all nodes or users to upgrade to the latest version of the protocol software.
Softfork	In blockchain technology, a soft fork is a change to the software protocol where only previously valid transaction blocks are made invalid. Because old nodes will recognize the new blocks as valid, a soft fork is backwards-compatible.
Halving	A Bitcoin halving is when the payout for mining a new block is halved, and this happens after every 210,000 blocks (approximately four years). The first of which happened in 2012, and the next will occur in 2024.
Available Cryptocurrencies	There are 18,465 total cryptocurrencies · The total market cap of all cryptocurrencies is $2.023 trillion.

COMMON TERMS TO UNDERSTAND (CONTINUED)

Term	Definition
Cryptocurrency Mining	The competitive process that verifies and adds new transactions to the blockchain for a cryptocurrency that uses the proof-of-work (PoW) method. The miner that wins the competition is rewarded with some amount of the currency and/or transaction fees.
Proof-of-Work	Proof of work (PoW) is a form of adding new blocks of transactions to a cryptocurrency's blockchain. The work, in this case, is generating a hash (a long string of characters) that matches the target hash for the current block. The crypto miner who does this wins the right to add that block to the blockchain and receive rewards. Cryptocurrency started with proof of work since it's the consensus mechanism used by the first cryptocurrency. It's well-known for its security but also for inefficiency and a heavy environmental impact. By understanding proof of work, you'll have a better understanding of the coins that use it. This can also help you choose where to put your money when investing in crypto.
Proof-of-stake	Proof of stake is a type of consensus mechanism used to validate cryptocurrency transactions. With this system, owners of the cryptocurrency can stake their coins, which gives them the right to check new blocks of transactions and add them to the blockchain. This method is an alternative to proof of work, the first consensus mechanism developed for cryptocurrencies. Since proof of stake is much more energy-efficient, it has gotten more popular as attention has turned to how crypto mining affects the planet. Understanding proof of stake is important for those investing in cryptocurrency.

POLLING QUESTION

Bitcoin is the most popular form of cryptocurrency. What is the next largest?

- Terra
- Dogecoin
- Tether
- Ethereum

THANK YOU!

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