

# 38th TEI-SJSU High Tech Tax Institute

## Crypto Opportunities and Compliance Considerations

Presented by

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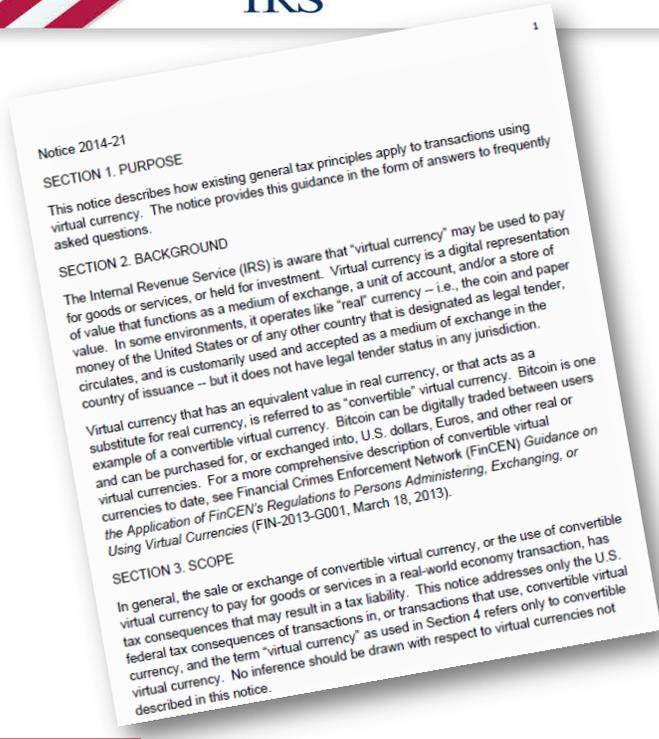
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## Overview of Virtual Currency Taxation



## Notice 2014-21



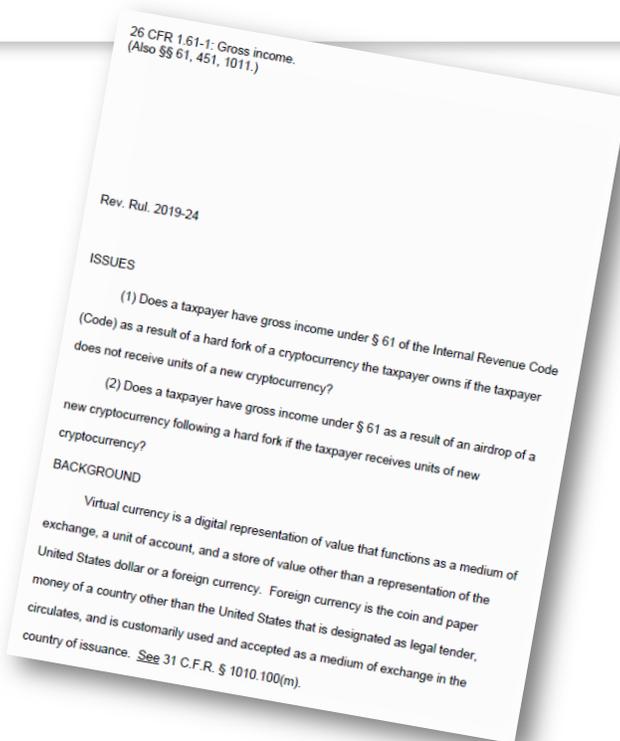
**Describes how existing general tax principles apply to transactions using virtual currency.**

**Provides guidance as answers to frequently asked questions.**



## Revenue Ruling 2019-24

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





## Frequently Asked Questions (FAQs)

File Pay Refunds Credits & Deductions Forms & Instructions Search

### Frequently Asked Questions on Virtual Currency Transactions

English | Español | 中文(简体) | 中文(繁體) | 한국어 | Русский | Tiếng Việt | Kreyòl ayisyen

- Individuals
- Businesses and Self-Employed
- Charities and Nonprofits
- International Taxpayers
  - Individuals - International
  - Businesses - International
- Governmental Liaisons
- Federal State Local Governments
- Indian Tribal Governments
- Tax Exempt Bonds

In 2014, the IRS issued [Notice 2014-21, 2014-16 I.R.B. 938](#) [\[PDF\]](#), explaining that virtual currency is treated as property for Federal income tax purposes and providing examples of how longstanding tax principles applicable to transactions involving property apply to virtual currency. The frequently asked questions ("FAQs") below expand upon the examples provided in Notice 2014-21 and apply those same longstanding tax principles to additional situations.

Comments on these FAQs may be submitted electronically via email to [Notice.Comments@irs.counsel.treas.gov](mailto:Notice.Comments@irs.counsel.treas.gov). The email should include "FAQs on Virtual Currency" in the subject line. All comments submitted by the public will be available for public inspection and copying in their entirety.

**Note:** Except as otherwise noted, these FAQs apply only to taxpayers who hold virtual currency as a capital asset. For more information on the definition of a capital asset, examples of what is and is not a capital asset, and the tax treatment of property transactions generally, see [Publication 544, Sales and Other Dispositions of Assets](#).

**References/Related Topics**

- [Virtual Currencies](#)
- [IRS Notice 2014-21, IRB 2014-16](#)
- [Rev. Rul. 2019-24](#) [\[PDF\]](#)

**Q1. What is virtual currency?**

**Q2. How is virtual currency treated for Federal income tax purposes?**



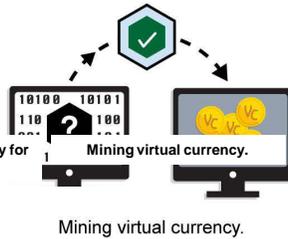
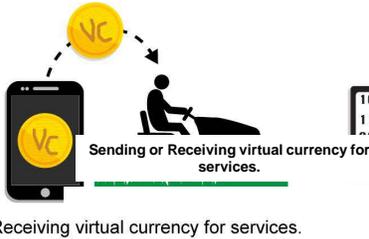
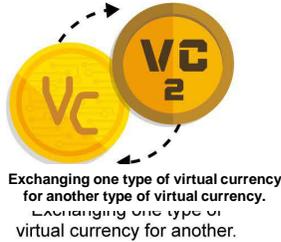
## Other Virtual Currency Guidance

- [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.

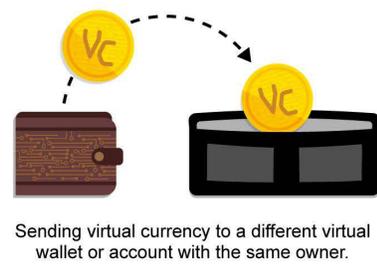


# Tax Consequences

## Transactions That Could Affect Taxable Income



## Transactions That Do Not Affect Taxable Income



Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

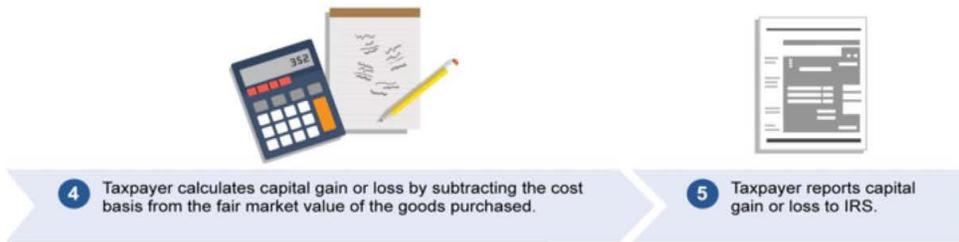


# Public Awareness [www.irs.gov](http://www.irs.gov)

The screenshot shows the IRS website's 'Digital Assets' page. The navigation bar includes 'File', 'Pay', 'Refunds', 'Credits & Deductions', and 'Forms & Instructions'. The main content area is titled 'Digital Assets' and includes a language selector (English, Español, etc.). Under 'Businesses and Self-Employed', there are links for 'Employer ID Numbers', 'Business Taxes', 'Reporting Information Returns', 'Self-Employed', 'Starting a Business', and 'Operating a Business'. The 'What Are Digital Assets' section explains that digital assets are taxable and provides a list of examples like Bitcoin, Ether, and NFTs. A 'Related Topics' section lists several IRS notices and campaigns. A yellow banner at the bottom contains the URL: <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets>



# Virtual Currency Transaction



Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188



# Required Reporting – 2021 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.

**U.S. Individual Income Tax Return**

**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. 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  You  Spouse

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

**Standard Deduction**  Spouse itemizes on a separate return or you were a dual-status alien

**Age/Blindness** You:  Were born before January 2, 1957  Are blind Spouse:  Was born before January 2, 1957  Is blind

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



# Required Reporting – 2022 1040

Form **1040** Department of the Treasury—Internal Revenue Service **2022** U.S. Individual Income Tax Return 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. **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  You  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



# 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 **2021** Attachment Sequence No. 12A  
 Name(s) shown on return Social security number or taxpayer identification number

Go to [www.irs.gov/Form8949](http://www.irs.gov/Form8949) for instructions and the latest information.  
 File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.

**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.  
**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).

**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.

(A) Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see Note above)  
 (B) Short-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS  
 (C) Short-term transactions not reported to you on Form 1099-B

| 1 | (a)<br>Description of property<br>(Example: 100 sh. XYZ Co.) | (b)<br>Date acquired<br>(Mo., day, yr.) | (c)<br>Date sold or disposed of<br>(Mo., day, yr.) | (d)<br>Proceeds<br>(sales price)<br>(see instructions) | (e)<br>Cost or other basis.<br>See the Note below<br>and see Column (e)<br>in the separate<br>instructions | Adjustment, if any, to gain or loss.<br>If you enter an amount in column (g),<br>enter a code in column (f).<br>See the separate instructions. | (f)<br>Code(s) from<br>instructions | (g)<br>Amount of<br>adjustment | (h)<br>Gain or (loss).<br>Subtract column (e)<br>from column (d) and<br>combine the result<br>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                         |   |
|   | 0.10000000 ETH   | 06/07/2017                              | 09/06/2017   | 33.54  | 26.06  |  |                                     | 7.48                           |   |
|   | 1.29964208 ETH   | 09/05/2017                              | 09/12/2017   | 358.49   | 409.80   |  |                                     | (51.31)                        |   |



# Required Reporting – Schedule C

|  |  |   |  |   |  |
|--|--|---|--|---|--|
| <b>SCHEDULE C</b><br><b>(Form 1040)</b>  |  | <b>Profit or Loss From Business</b><br>(Sole Proprietorship)  |  | OMB No. 1545-0074   |  |
| Department of the Treasury<br>Internal Revenue Service (99)  |  | ▶ Go to <a href="http://www.irs.gov/ScheduleC">www.irs.gov/ScheduleC</a> for instructions and the latest information. |  | <b>2021</b>   |  |
|  |  | ▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships must generally file Form 1065.                         |  | Attachment<br>Sequence No. <b>09</b>                                |  |
| Name of proprietor   |  |   |  | Social security number (SSN)  |  |
| A Principal business or profession, including product or service (see instructions)  |  |   |  | <b>B Enter code from instructions</b>                               |  |
| <b>CRYPTOCURRENCY MINING</b>   |  |   |  | ▶ <b>5 4 1 5 1 0</b>  |  |
| C Business name. If no separate business name, leave blank.  |  |   |  | <b>D Employer ID number (EIN)</b> (see instr.)                      |  |
| E Business address (including suite or room no.) ▶<br>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 "Yes," did you or will you file required Form(s) 1099?  |  |   |  | <input type="checkbox"/> Yes <input type="checkbox"/> No            |  |



# Required Reporting – Schedule 1

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

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F Schedule 1 (Form 1040) 2021



# Recordkeeping Considerations



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

## Certain Crypto Tax Issues

- A. Information Reporting – Section 6045 and 6050
- B. Compensation
- C. Initial Coin/Token Offerings
- D. Selected Funds Issues
- E. Crypto and Charities
- F. DAOs

# Information Reporting

- General Reporting
  - Rev. Proc. 2014-21—crypto/virtual currency is property.
  - If you would have information reporting for cash, you have it if you use crypto (e.g., wages =W-2 independent contractor receives Form 1099). Notice 2021-14 Q&As 11-13.
  - See Q-13: Is a person who, in the course of a trade or business, makes a payment using virtual currency worth \$600 or more to an independent contractor for performing services required to file an information return with the IRS? A-13: Generally, a person who, in the course of a trade or business, makes a payment of \$600 or more in a taxable year to an independent contractor for the performance of services is required to report that payment to the IRS and to the payee on Form 1099-MISC, Miscellaneous Income. Payments of virtual currency required to be reported on Form 1099-MISC should be reported using the fair market value of the virtual currency in U.S. dollars as of the date of payment. The payment recipient may have income even if the recipient does not receive a Form 1099-MISC.
  - If crypto has appreciated and is used to make a payment, the net deduction will be equal to tax basis due to gain being income. Use bitcoin with basis of \$10 and value of \$20 to pay director fee of \$20. Treated as though bitcoin was sold for \$20 and proceeds used to pay \$20. Net result is \$10 of gain and a \$20 deduction.

## Information Reporting con't

- Broker Reporting
  - Who is a digital asset broker? New Code section 6045(c)(1)(D) provides the following definition: “any person” who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.
  - First time “digital asset” mentioned in the Code.
  - Definition initially feared as being very broad.
  - Excellent Tax Notes article on legislative history: [How the Definition of Digital Asset Brokers Was Brokered](#), 9/13/22. Clear statute is much broader than what many legislatures had in mind.
  - Proposed legislative fixes (likely to be in regulations (hopefully)) offers two rules of construction stating the activities that do not make someone a broker:
    - (1) validating distributed ledger transactions, without providing other functions or services; or
    - (2) selling hardware or software for which the sole function is to permit persons to control private keys which are used for accessing digital assets on a distributed ledger.
  - If in a position to know the amount of the payment and you are facilitating a payment, then further analysis needed to determine if you are a broker for this purpose.

# Compensation

- Tokens have been used to provide incentive compensation to service providers and independent contractors.
  - Same issues as using equity compensation to employee.
  - Section 83(b) election advisable if award is subject to vesting.
  - Similar valuation issues.
  - Property—infant NRC20 token.
  - Wage withholding required in the case of employees. Difficult to implement since there is no cash in the transaction.
  - Information reporting required as discussed above.
  - Options to purchase crypto—409A applicable.
  - Phantom awards.

# Initial Coin/Token Offerings

- Equity: some tokens confer voting rights, the right to participate in dividends and proceeds in liquidation.
  - It may be difficult to conclude the token is “stock” for most income tax purposes (e.g., Sections 1032 or 368) with any meaningful level of confidence unless you can get comfort the token is stock for state law purposes.
  - Sometimes a token is clearly tied to stock that has been authorized under the corporate charter.
- Debt: Sometimes tokens represent the right to receive a fixed amount at a set time with an interest factor.
- Goods or Services: Many tokens (so called utility tokens) represent the right to participate in some “platform” being developed by the issuer. The platform may be something SaaS-like.
  - Business reason: avoids equity dilution.
  - Under Rev. Proc. 2014-21 a token is property. Sale of the token generates taxable income to issuer. The question is when is the income taxable—upon receipt of cash? delivery of token? Issuers will try to match expenses to the income.
    - Prepaid forward.
    - SAFT – similar to a SAFE except for tokens.
  - Holder has income if they sell or use after token has appreciated.

## Selected Funds Issues

- ECI/UBTI Covenants
  - Trading—Section 864(b)(2) safe harbor trading stocks, commodities and certain derivatives for own account.
    - The Commodity Futures Trading Commission has determined that bitcoin is a commodity, and bitcoin futures contracts trade on the Chicago Mercantile Exchange.
    - Common view is that most tokens/crypto are not securities. So, unless regulated as commodity may not be fit within safe harbor for trading.
    - If passive, then most funds and investors are comfortable ownership does not create ECI or UBTI.
      - What about air drops, mining, staking?
      - Pay to manager rather than fund to offset fees—like management fee offset in fund.
      - Blocker.
    - Exchange traded funds taxed as partnership and qualifying income for PTP purposes.
    - UBTI analysis is less nuanced because all gains are exempt unless debt-financed income.
      - Crypto lending and analogy to securities lending.

## Crypto and Charities

- Letter Ruling 202019028
  - Stated purpose was to educate public on issues involving crypto and facilitate the use of crypto.
  - Ruling denied: The IRS explained that some sort of educational instruction must be present for a nonprofit's purpose to be deemed educational within the meaning of Section 501(c)(3) of the Code. Drawing from various other IRS authorities, the IRS clarified that such instruction can be devoted to individual skills training or public education surrounding relevant issues. Acceptable forms of instruction include workshops, clinics, lessons, seminars, panel discussions, and lectures.
  - Distinguish Brink: Brink Technology, Inc., a bitcoin developer fund that provided grants to developers who work on its open-source bitcoin protocols obtained ruling in 2021.
- Crypto Donations and Foundations

## DAOs

- A decentralized autonomous organization (DAO) is a group managed by individuals who collectively vote to decide on organizational proposals.
- Typically, each member's voting power is determined by their percentage interest calculated by dividing the digital assets contributed by a member by the total amount of digital assets in the DAO.
- A DAO usually operates without the need for a board of directors or other governing body. Attempt to operate platform to gather individuals and resources to achieve a common goal.
- Participants can earn additional crypto based on success—air drop, etc.
- Tax characterization partnership: Code Sections 721 and 731.

## Case Discussion: Jarrett v. United States

## Jarrett v. United States

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- *Jarrett v. United States*, No. 21-cv-00419 (M.D. Tenn. filed 2021)
- Income tax suit: Amount in controversy \$3,793
  - IRS issued refund on January 28, 2022 for full amount + interest.
  - Jarretts did not cash the check; instead sought to “vindicat[e] their rights in court.” Amended their complaint to seek injunctive and declaratory relief.
- Issue: Are “Tezos tokens” that the Jarretts received from staking cryptocurrency taxable income when received?
  - Taxpayers: No, these tokens only give rise to taxable income when sold or exchanged.

## Jarrett v. United States – Background

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- Jarrets held Tezos tokens. Like many other cryptocurrencies, Tezos public blockchain is built via proof-of-stake (“PoS”) process.
  - Holders can employ their Tezos tokens and computing power to validate transactions that use Tezos tokens (“staking”).
  - This process creates new blocks on Tezos public blockchain, resulting in the creation of new Tezos tokens.
  - Joshua Jarrett received 8,876 Tezos tokens through PoS in 2019.



## Jarrett v. United States – Background (con'td)

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- Consensus mechanisms:
  - Blockchain technology provides ability to validate transactions and record ownership in a decentralized manner.
  - Users who participate in validation confirm the authenticity of transactions in a block and compete for the right to add the authenticated block to the public blockchain ledger.
  - Winner gets a reward consisting of (1) fees from transacting parties and/or (2) newly minted tokens.
- PoS: Network is maintained by staking existing tokens. Tokens cannot be used while being staked, and are at some risk in the sense that it's possible to “cheat” or bypass the validation work
  - Stakers can delegate validation to a third party.

## Jarrett v. United States – Timeline

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| Event  | Date               |
|--|--------------------|
| Jarrett Form 2019 1040X with Brief Filed                     | July 31, 2020      |
| Complaint filed in M.D. Tenn.                                | May 26, 2021       |
| IRS pays refund claim  | January 28, 2022   |
| USA moves to dismiss for lack of subject matter jurisdiction | February 28, 2022  |
| Case dismissed   | September 30, 2022 |

## Jarrett v. United States – Relevant law

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- Section 61: Gross income means all income from whatever sources derived, unless excluded by law.
- *Glenshaw Glass v. Commissioner*, 348 U.S. 426, 431 (1955): Gross income includes all “undeniable accessions to wealth, clearly realized and over which the taxpayers have complete dominion.”
- Section 83: Property received *in exchange for services* is income when that property is transferrable or no longer subject to a substantial risk of forfeiture.
- Notice 2014-21:
  - “When a taxpayer successfully ‘mines’ virtual currency, the fair market value of the virtual currency as of the date of receipt is includable in gross income.”
  - Does not address staking rewards.

## Jarrett v. United States – Jarrett Arguments

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- Tezos tokens obtained through PoS are self-created property and therefore are not income. Similar to a farmer growing crops, the wealth is not increased.
  - *Cf. Morris v. Commissioner*, 9 B.T.A 1273 (1928) (Farmers’ products that are consumed by his family are not gross income).
- To the extent that self-created property is an “accession to wealth,” it has not been “realized.”
- If PoS rewards are income, they are imputed income.
  - Taxpayer gains something from services that it provides itself. (E.g., I mow my lawn, instead of earning income, paying tax, and using the net proceeds to pay someone to do the same thing).

## Jarrett v. United States – Other Arguments in Favor of Non-Recognition

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- There is no accession to wealth because increasing the token supply dilutes the value of the token.
  - Cf. *Esiner v. Macomber*, 252 U.S. 1920 (proportional stock dividend is nontaxable; see Section 305).
- Even if there is an accession to wealth, inclusion at FMV is wrong because the “market value” of the token overstates what the token is actually worth.
  - Need to take into account deflationary effects that arise from additional tokens being created, which takes time.
- PoS is environmentally friendly, unlike (sometimes) PoW...

## Jarrett v. United States – Counterarguments

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- PoS tokens are not self-created property; they are received from a third party in exchange for investing both capital and services.
  - See Section 83.
  - Farmers and manufacturers are subject to statutory and regulatory exceptions that provide for taxation on sale or based on inventory, depending on method of accounting. Treas. Reg. 1.61-3, -4. No such exception exists here.
  - Further, validators do not “create” the tokens; tokens are created by blockchain protocol.
  - Validators do not own the blockchain but simply provide services to the larger blockchain community.
  - NYSBA: “[W]hile the taxpayer’s actions led to its receipt of the staking rewards, the staking rewards were not created by the taxpayer’s actions (which simply involve validating transactions involving other units of the same cryptocurrency).”
- PoS tokens are “clearly realized.”
  - *Cottage Savings v. Commissioner*, 499 U.S. 554 (1991) (property exchanged for “materially different” property is a realization event).
- Because PoS tokens are received in exchange for services, they are not imputed income.

## Jarrett v. United States – Policy Concerns

- If PoS tokens are not taxable until sold, then they would be ordinary income.
  - For individuals, *entire appreciation* subject to tax at 37 percent.
- If PoS tokens are taxable on receipt, then that is ordinary income, but any subsequent appreciation will be a capital gain, because crypto is property under Notice 2014-21.
- Quite possible that the Jarretts would be better off under the government’s position.

## Jarrett v. United States – Policy Concerns (cont’d)

| Recognition at PoS Event (government position) |                |                 | Recognition at Sale (Jarrett position) |                |                 |
|--|----------------|-----------------|--|----------------|-----------------|
| Event  | Taxable income | Tax             | Event                                  | Taxable income | Tax             |
| 2019 income event                              | \$9,407        | \$3,293 (35%)   | 2019 token issuance                    |                |                 |
| 2021 token sale                                | \$31,245       | \$7,436 (23.8%) | 2021 token sale                        | \$40,652       | \$14,228 (35%)  |
| Discount to 2019 (5%)                          |                | \$6,745         | Discount to 2019 (5%)                  |                | \$12,905        |
|  |                |                 |  |                |                 |
| <b>Total tax paid</b>                          |                | <b>\$10,038</b> | <b>Total tax paid</b>                  |                | <b>\$12,905</b> |

See Omri Marian, *Law, Policy, and the Taxation of Block Roads*, 175 *Tax Notes* 1493 (June 6, 2022)

## Jarrett v. United States – Policy Concerns (cont'd)

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- Corporate taxpayers don't get preferential rate for capital gains, so may be better off under deferral system.
- Participants plan to avoid realization events.
  - Hold until death, section 1014 basis step-up
  - Borrow against appreciation
  - Like-kind exchange treatment (would require a change in law)
  - Tax evasion
- Further reading:
  - Amanda Parsons, *May I Pay More? Lessons from Jarrett for Blockchain Tax Policy*, 176 *Tax Notes* 2063 (Sept. 26, 2022)

## Jarrett v. United States – September 30 Order

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- Article III of the Constitution limits subject matter jurisdiction to “cases” and “controversies.” There’s no live controversy here.
- Tender of full payment moots the refund claim, and plaintiffs cannot reject to maintain subject matter jurisdiction in a refund suit.
- Declaratory Judgment Act (28 U.S.C. § 2201(a)) specifically excepts declaratory relief with respect to federal taxes.
- “The Court finds no reasonable expectation that Plaintiffs will be subject to the same action again.... This particular issue is not capable of repetition as any subsequent claim for refund would necessarily apply to a different tax year.”
  - Controversy was limited to whether Jarretts overpaid their federal income taxes in 2019; not whether creation of Tezos tokens is taxable income.
- Does not reach substantive issue.

# Business Challenges Involving Virtual Currency



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## Selected Countries Development in Digital Asset

- US – President Biden’s Executive Order
- Singapore, EU, El Salvador, Ukraine
- India:
  - India’s Union Budget of 2022 introduced specific proposals to tax virtual digital assets (VDAs), including cryptocurrencies.
  - Tax on Income From VDAs; Withholding Tax on VDAs
- UK:
  - HMRC working alongside leading crypto exchange platforms to gather information
  - Capital gains tax usually applies on any profits realized for individual holding it as personal investment
  - Business to include cryptocurrency received in payment for goods or services as income
- OECD proposal:
  - Crypto Asset Reporting Framework (CARF)

## US - Proposed Legislation

- H.R. 6582, Virtual Currency Tax Fairness Act of 2022
  - Exclude up to \$200 of gain from disposition of virtual currency in a personal transaction.
- S. 4356, Lummis-Gillibrand Responsible Financial Innovation Act
  - Gross income shall not include gain or loss from sale of exchange of virtual currency in a personal transaction; the amount of gain or loss excluded from gross income shall not exceed \$200
  - Amending Sec 6045(c)(1)(D) broker definition; Information Reporting Effective after December 31, 2025
  - Decentralized Autonomous Organizations (DAO) shall be a business entity which is not a disregarded entity
  - Staking income is not recognized as income until disposed of
  - No qualified appraisal needed for charitable contribution greater than \$5,000 of digital assets which are traded on established financial markets.
- S. 4608, Virtual Currency Tax Fairness Act (Toomey and Sinema)
  - Gain, up to \$50, from sale or exchange of virtual currency in a personal transaction is excluded from gross income.

## Business Challenges Involving Virtual Currency

- Guidance needed from IRS and/or other authorities
  - FASB – Fair Value Measurement.
  - SEC - Investment Securities, Crypto Exchanges
  - IRS (income tax, employment tax, etc)
  - States (income tax, sales / use tax, etc)
- Legal, Tax and Accounting Professional Support
  - CPAs getting client tax info for tax reporting purposes
  - Accountants getting client data for accounting/ bookkeeping purposes
  - Attorneys advising clients involving digital assets
- Tools needed to get data organized for reporting purposes
  - Accounting Software
  - Basis Tracking Software
  - Tax Software

## Potential Tax Issues Involving Virtual Currency for 2022 Filing

- Timing for recognition of loss
- Types of loss sustained
  - Abandonment/ Worthlessness
  - Theft Loss
  - Capital Loss
- Lending
- Mining/ Staking
- Investing through Funds or Other Investment Vehicles
- Proper Tracking and Documentation for Basis of Cryptocurrency Sold / Disposed Of

