Blockchain and Cryptocurrency

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BIO

- Alex Tran
  - **Alex Tran CPA**, Tax Manager at Seidel Schroeder, graduated from Texas A&M University in 2015 with a BBA in Accounting and an MS in Accounting in 2016. Alex has practiced in public accounting for over 6 years. He specializes in income tax planning and services for high-net-worth individuals, small to medium businesses, and individuals with cryptocurrency assets. Alex and his wife Magie have one daughter and enjoy food.

- Bradley Terry
  - **Bradley Terry,** IT Manager for Seidel Schroeder, graduated from Sam Houston State University with a Bachelor of Business Administration with a concentration in Finance in 2015. He has over 9 years of experience in the technology industry, and specializes in technology management, cybersecurity, and IT automation. Bradley and his wife have one son and enjoy traveling.

AGENDA

- Blockchain
- Cryptocurrency
- Crypto Tax and Accounting
- Q/A

Disclaimer

This presentation is for educational purposes only. Under no circumstances should information herein be construed as investment or legal advice. Purchasing cryptocurrencies come with several risks, including highly volatile market prices. Participants should consult with and rely on their own advisors as to implications and risks related to blockchain technology and cryptocurrencies.

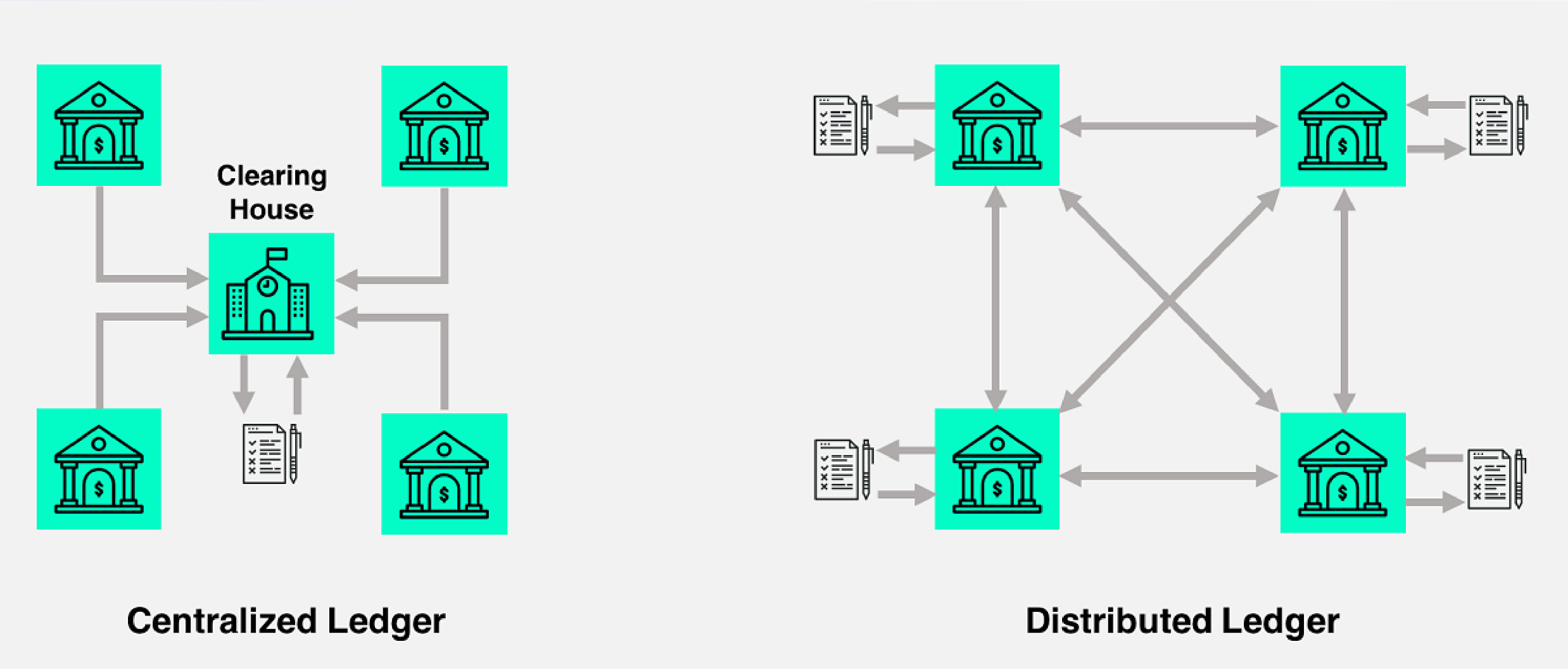
What is the Blockchain?

- Distributed database shared amongst the nodes of a computer network.
  - A "node" is a device or data point on a larger network (Computer, Server, Printer, etc.)
- Shared database for maintaining a secure and decentralized record of transactions.
- Collects information and groups them in "blocks" that when filled, form a chain of data. This data structure makes an irreversible timeline of data.

Decentralized Blockchains

- Digital currencies such as Bitcoin are built on a Blockchain.
- These data chains are decentralized so that no single person or group has control.
- Decentralized Blockchains contain data that is irreversible, allowing transactions to be permanently recorded and viewed by anyone.

Distributed Ledger



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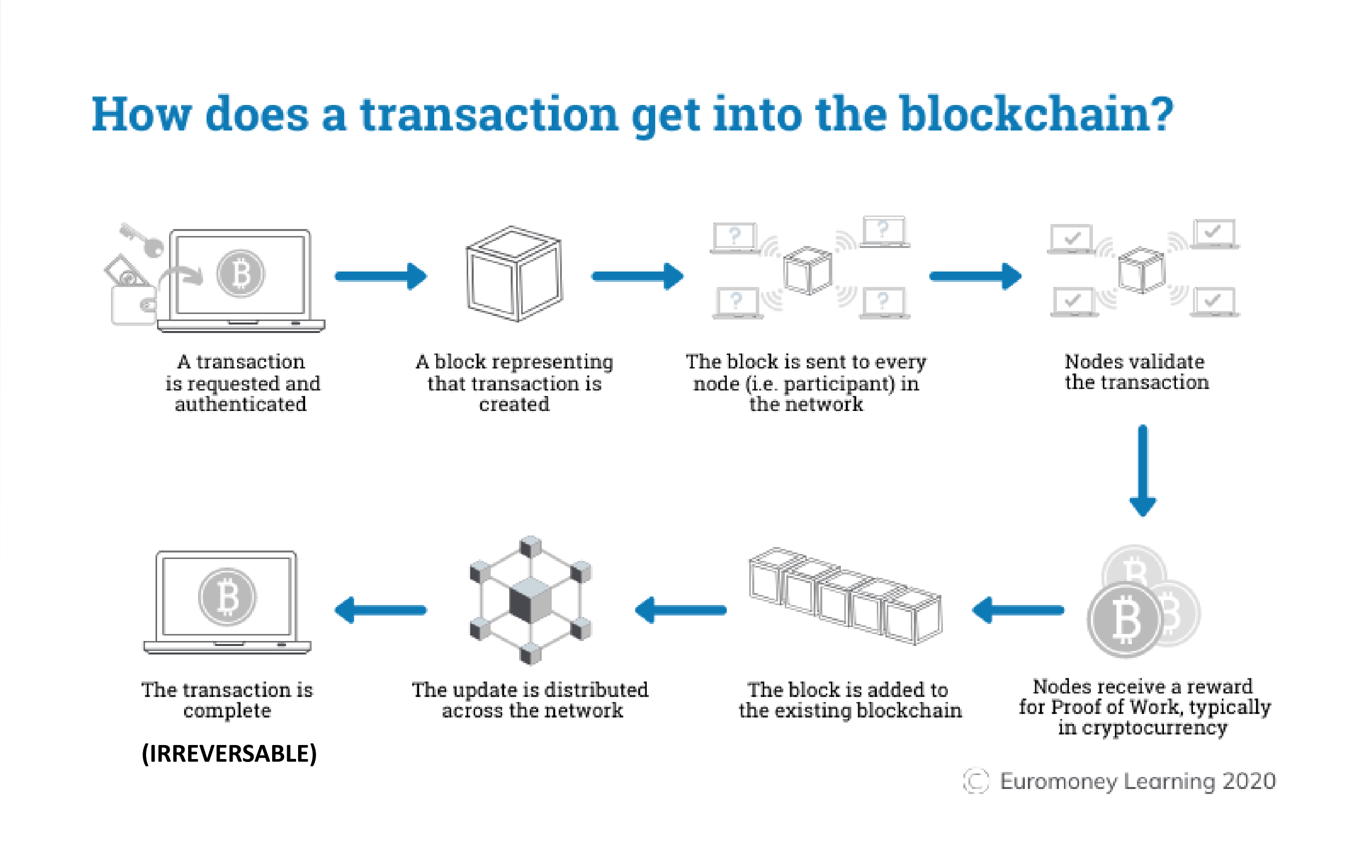
How do Blockchains work?



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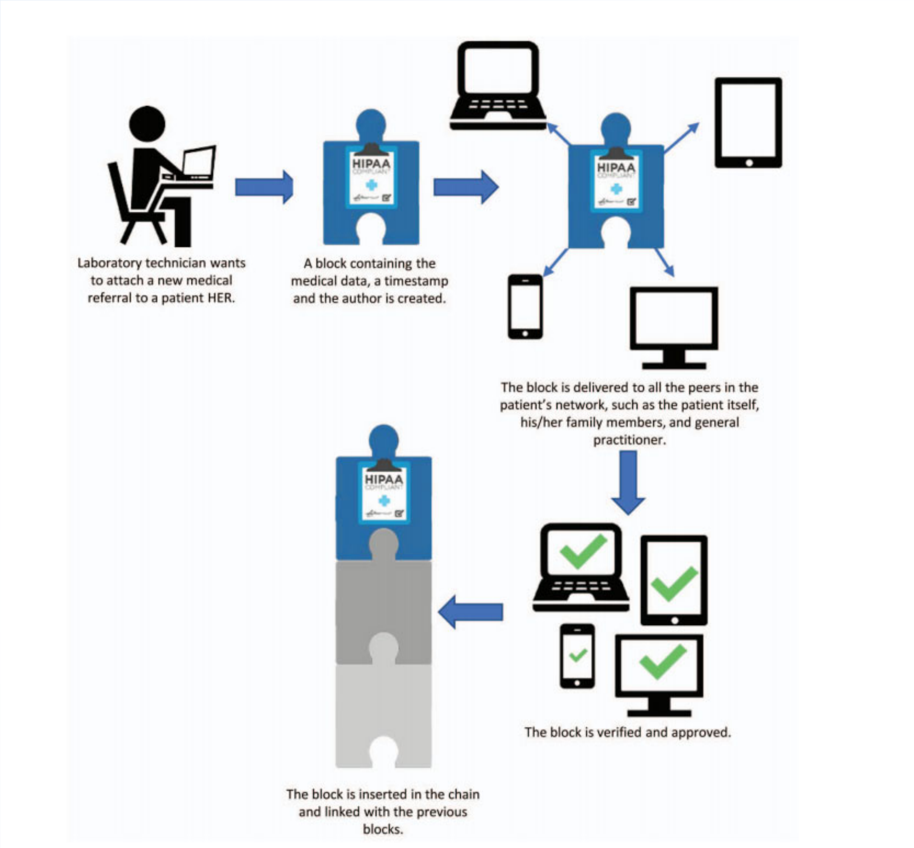
Blockchain: Real World Example



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What is Cryptocurrency?

- Digital or virtual currency that uses cryptography to secure transactions.
  - Cryptography is the art of “Writing or solving codes”
- Peer to peer digital payment system using the Blockchain to record transactions.
- More than 18,000 Cryptocurrencies exist today.

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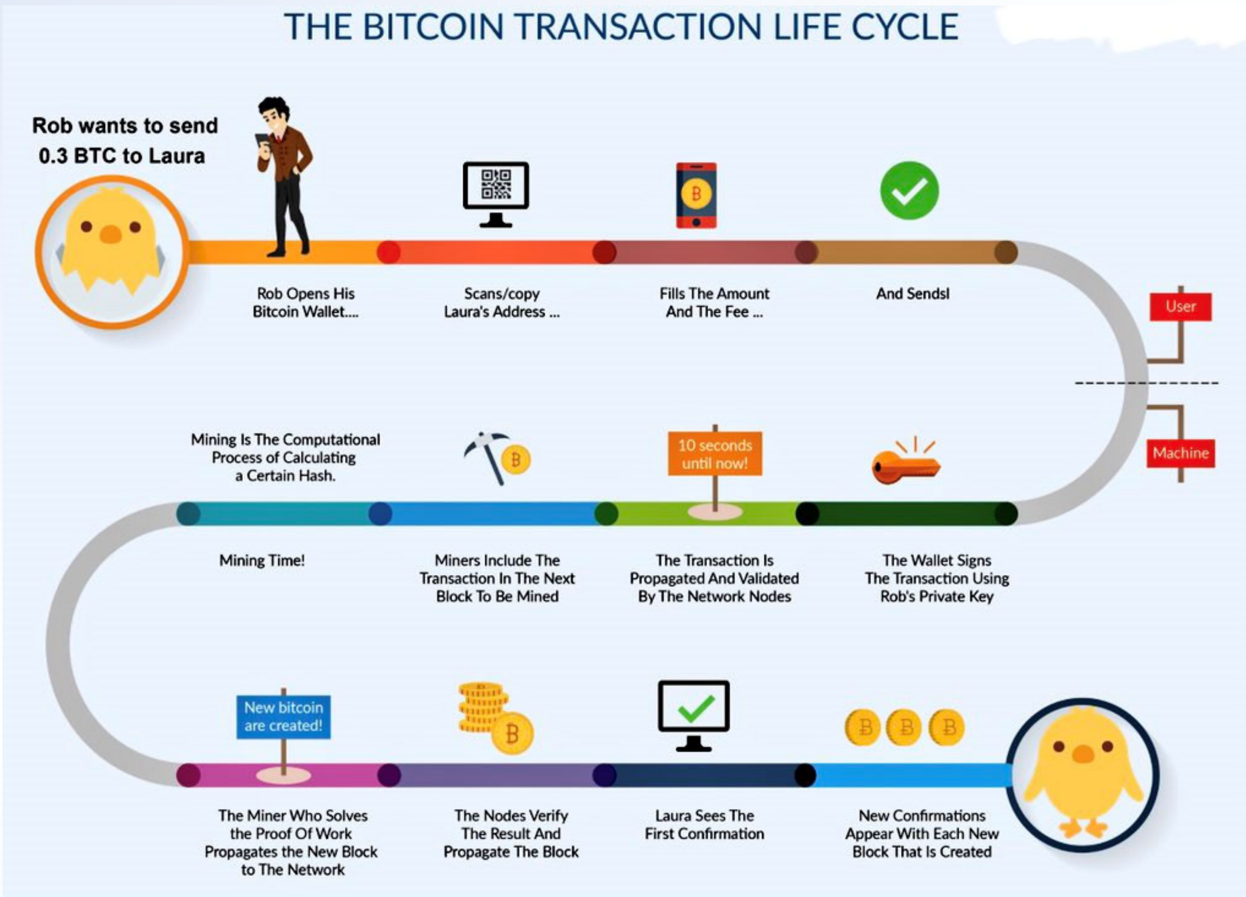
How do Cryptocurrencies work?



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Cryptocurrency: Security

- In order to access Crypto funds on the blockchain, a person or organization relies on their "Private Keys", or a series of words.
  - Individual
  - Exchange
  - Organization
- Some of the largest hacks to date were the result of an exchange's "private keys" becoming compromised resulting in the loss of funds (Crypto) for individuals using that exchange.

Cryptocurrency: Security Best Practices

- Hardware Wallet (Cold Storage)
  - Restrain from holding assets on any exchange where you do NOT have access to your private keys
  - Keep assets on a hardware wallet where you hold your private keys and require a human verification to buy, sell, or transfer assets.
- Private Keys
  - Stored “offline” in a safe location
  - Not shared with ANYONE

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Major Exchanges

- Coinbase
- Robinhood
- Binance
- Gemini
- FTX
- Crypto.com
- Kraken

Cryptocurrency: Tax and Accounting

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What we know…

- U.S. lawmakers and government agencies are interested
  - Treasury Secretary Janet Yellen says “the absence of appropriate oversight presents risks to users and the broader [cryptocurrency] system.”
  - Powell compared [stablecoins] to money market funds or bank deposits, which have a strong regulatory framework in the United States.
  - Gensler, in his comments on June 13th, said most crypto exchanges list hundreds of tokens, and “it’s highly unlikely that all of them, 100% are not securities.”

- Minimizing crime and tax evasion a priority for lawmakers
  - IRS investigators seized $3.5 billion worth of cryptocurrencies tied to financial crimes during fiscal year 2021
  - Depending on the severity of the evasion, you can face up to $100,000 in fines ($500,000 for corporations) or up to 5 years in prison.

- Guidance is unclear

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IS IT A TAXABLE EVENT?

<u>TAXABLE EVENT</u>

– Selling Crypto
– Trading Crypto-for-Crypto
– Using or Accepting Crypto for Goods and Services

<u>NON-TAXABLE EVENT</u>

– Buying and Holding Crypto
– Crypto Transfers

Cryptocurrency Tax Guidance

- Cryptocurrencies are treated as property under federal U.S. tax rules.
- Investors can be liable for capital gains tax whenever they sell a cryptocurrency. The amount paid depends on how long they have held the coin and the market value at the time of the transaction.

Purchase Crypto:	$10,000
Sold Crypto:	$12,000
Taxable Gain:	$2,000

- Investors that purchase and sell frequently must track the gain or loss for each transaction. This can be cumbersome and difficult to track.

Cryptocurrency Tax Guidance

- You MUST consider the characterization of digital assets for tax purposes and MUST consider the facts and circumstances as well as the means in which the taxpayer uses the digital assets.

- If an investor intends to hold digital assets as investments or treasury reserve assets and not use them in their trade or business, they are likely considered a capital asset and any gains or losses realized upon sale or exchange are likely to be capital gains and losses.

- If an investor is actively trading or using digital assets in their trade or business, it may be ordinary income.

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Cryptocurrency Tax Guidance

- For tax purposes, the use of virtual currency is considered a barter transaction, an exchange of property for property.
- Fair value must be established at the time of receipt, and basis must be documented.
- Making a payment in digital assets triggers gain or loss recognition, so it is important to track cryptocurrency very carefully.

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Cryptocurrency Tax Guidance

Wash Sales

The Internal Revenue Service allows taxpayers to use losses in stocks and other investments, including crypto, to offset gains. If your losses exceed your total gains for the year, you can deduct up to $3,000 against your ordinary income. Losses beyond $3,000 can be carried forward every year until death to offset gains in future years.

The wash-sale rule is an Internal Revenue Service (IRS) regulation that prevents a taxpayer from taking a tax deduction for a security sold in a wash sale. The rule defines a wash sale as one that occurs when an individual sells or trades a security at a loss and, within 30 days **before** or **after** this sale, buys a "substantially identical" stock or security, or acquires a contract or option to do so.

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Cryptocurrency Tax Guidance

Does Wash Sales Apply to Cryptocurrency?

- The IRS currently defines cryptocurrency assets as property, not securities. Therefore, currently the wash rule doesn't technically apply to crypto assets. Many investors take advantage of this loophole when crypto tax loss harvesting, or strategically selling assets at a loss in order to lower their total capital gains.

- The IRS could however, turn to another part of the tax code that requires transactions to have "economic substance" to be eligible for tax benefits. In other words, you must expose yourself to some kind of market risk before rebuying the same coin.

- Additionally, the regulatory landscape for crypto is always changing. It's possible that crypto wash trading could be explicitly disallowed next year—or next week.

- In fact, in 2021, the Biden administration's Build Back Better bill and a House Ways and Means Committee proposal included language applying wash sale rules to digital assets. Although the Build Back Better bill stalled in Congress, these developments underline the government's interest in the matter.

- The most conservative approach is to wait 30 days before or after, just like you would with stocks before rebuying. Some accountants and advisors will argue that the market volatility exposes you to risk in a shorter time frame. It's to each person's risk tolerance if they are willing to wait 30 days or 30 seconds.

Cryptocurrency Tax Guidance

New Cryptocurrency Information Reporting Regime Required on Form 1099 and Form 8300

- On November 15, 2021, President Biden signed the Infrastructure Investment and Jobs Act (the "Infrastructure Bill"), which significantly expands tax information reporting for certain cryptocurrency transactions.

Form 1099

- The Infrastructure Bill includes an information reporting requirement for cryptocurrency asset exchanges and custodians on an IRS Form 1099. Beginning with the 2023 tax year, they will be required to collect taxpayer identifying information from their customers, so that they can properly issue Forms 1099 at the end of each tax year. Specifically, the following type of information will be required to be reported:
  - name, address, and phone number of each customer;
  - the gross proceeds from any sale of digital assets; and
  - capital gains or losses and whether such capital gains or losses were short term (held for one year or less) or long term (held for more than one year).

Form 8300

- Currently required for a receipt of cash over $10,000, will now be required for a receipt of Crypto over $10,000, and must be filed within 10 days of such receipt.

The effective date of these changes will apply to any information return required to be filed after December 31, 2023.

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Cryptocurrency Tax Guidance

IRS Virtual Currency webpage

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

IRS Notice 2014-21

Virtual currency treated as property for tax purposes

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

IRS Revenue Ruling 2019-24

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

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U.S. GAAP Accounting Rules

- There is not currently explicit U.S. GAAP guidance for accounting for cryptocurrencies
  - Financial Accounting Standards Board added "Accounting for and Disclosure of Digital Assets" to its technical agenda in May 2022

- Most cryptocurrencies are accounted for as an indefinite-lived intangible assets
  - Carried at cost less impairment
  - Impairment is recorded on the income statement and not reversed if fair value recovers

  - However, investment companies under ASC 946 would treat cryptocurrencies held as an investment as they would other investments recorded at fair value

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Social Impact

- Many in undeveloped or underdeveloped countries have no access to a bank
- Over 3 billion people do not have a bank account
- 2/3rds of these people now have mobile-phones
- With crypto currency the unbanked can have a bank account without access to a bank
- Cross border money fees and foreign currency exchange rates will no longer be necessary
- Crypto can be spent anywhere, any time, and is never unavailable (unless you don't have internet access, forget your password or are without power.)

Q/A

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