



2020 Tax Expo
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Cryptocurrencies
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Biography



Kevin Sweeney is an experienced civil and criminal tax controversy attorney focused on high-stakes IRS audits, voluntary disclosures, civil tax litigation, white-collar criminal defense, and whistleblower matters.

Kevin counsels companies and individuals on tax compliance matters and defends them in IRS audits and civil tax litigation. He draws on his experience at the U.S. Department of Justice's Tax Division (DOJ). Kevin's skill set is particularly suited for complex tax issues and sensitive tax matters where penalty, fraud, or criminal issues could arise.

Kevin is also a seasoned white-collar criminal defense attorney with a focus on criminal tax cases. As a former federal prosecutor, he has investigated and litigated dozens of federal white-collar criminal cases in United States District Courts throughout the country. Cases Kevin has litigated have been covered by Fortune, Bloomberg, and The Financial Times.

Kevin formerly served as a trial attorney with the U.S. Department of Justice Tax Division, where he was twice honored with the Department's Outstanding Attorney Award. During his tenure, he led many of its most significant cases including of offshore banking cases against Swiss banks BSI SA, Union Bancaire Privée (UBP) SA, and Edmond de Rothschild SA.

Kevin frequently speaks and writes on civil and criminal tax controversy and litigation matters and is often quoted by national media outlets including the Wall Street Journal, CNBC and CNN. He is admitted to practice law in New York, New Jersey, and Pennsylvania

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Origin of Cryptocurrency



- **Cypherpunk movement**
 - Goal of creating a digital currency unaffected by desires of politicians and regulators
 - Early attempts failed to solve double spending problem
- **Bitcoin is born**
 - Satoshi Nakamoto white-paper published in 2008
 - First coin is generated several months later in 2009
 - Valued in 2010 when 10,000 BTC exchanged for 2 pizzas
- **Wild, wild west of crypto (2011-2016)**
 - Rival cryptocurrencies emerge
 - Exchanges emerge and shut down
 - Huge market valuations and fluctuations
 - Privacy features exploited by participants in unlawful activities
- **Crypto enters mainstream**
 - Bitcoin hits \$10,000 in 2017
 - \$300 billion and over 2,000 types of cryptocurrencies today

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What is Cryptocurrency?



- **Digital representation of value**
 - Designed to work as medium of exchange and store of value
- **Unit of account**
 - Virtual coin
 - Represented by electronic files
- **Files are secured with cryptography**
 - Method for creating and protecting information/communications with codes
- **Each virtual coin is represented by an encryption key pair**
 - Public key – cryptographic code that allows users to receive coins
 - Private key – cryptographic code that allows users to control coins

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What is the Blockchain?



- **Digital ledger that records peer-to-peer crypto transactions**
 - Groups of transactions are recorded in units called blocks
 - New blocks are sequentially added to form chain
 - Blockchain is immutable
- **Decentralized**
 - Kept in an publically shared and synchronized electronic database
 - Not:
 - Controlled by central administrator
 - Subject to manipulation by sovereign or regulators
 - Dependent on intermediaries such as banks
- **Pseudo-anonymous**
 - Transparency of transactional history instills trust in the system
 - Encryption protects the privacy of transaction participants

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Role of Crypto Miners



- **Network of independent persons who validate and create crypto**
 - Use powerful computing power to run computer software (nodes)
 - Sometimes groups of miners pool computing power (mining pools)
- **Validate transfers of crypto by consensus**
 - Transactions broadcasted to network of miners
 - Nodes collect transactions into blocks
 - Attempt to solve math puzzle called proof of work (POW) for each block
 - Each puzzle is based on blocks already in place (immutable)
 - Checked against other pending transactions to ensure no double spending
- **Create new coins**
 - Miners are incentivized to solve POW with standardized awards of new BTC
 - One new block is created and timestamped every 10 minutes
 - Only one miner will solve each POW

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Crypto Wallets

- **Devices that allow users to store and/or transact crypto**
 - Physical wallets
 - Digital wallets
- **Cold vs. hot storage**
- **Personal vs. exchange-based wallets**
- **Multiple Wallets**
 - Coin compatibility
 - Security

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Cryptocurrency Transactions

- **Methods of acquiring crypto**
 - Mining
 - ATMs
 - Initial Coin Offerings (ICOs)
 - Security vs. Utility tokens
 - Hardforks/Air Drops
- **Acquiring from other Users**
 - Exchanging Cryptocurrency and property (i.e. Barter)
 - Exchanging Cryptocurrency and Sovereign (fiat) currency
 - Exchanging Cryptocurrency and Cryptocurrency

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Cryptocurrency Marketplace



- **Peer-to-Peer transactions**
 - Particular coins transferred directly from one person to another
 - Wallet permits private key holder to transfer coin to other wallets
 - Transaction is recorded in blockchain
 - New private key is generated and provided to recipient of coin transfer
- **Crypto exchanges**
 - Decentralized v. centralized
 - Non-custodial vs. custodial
 - Most centralized, custodial exchanges operate off-blockchain (Coinbase)
 - Off-blockchain crypto transactions are not pseudo-anonymous

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Why Does Crypto Have Value?



- **Limited supply**
 - Only 21 million bitcoins will be created
- **Divisibility**
 - Divisible by .00000001 (known as a Satoshi)
 - 100 million in each Bitcoin
- **Easily transacted**
 - Portable and easy to buy and sell
- **Secure**
 - Immutable and transparent
- **Non-consumable**

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IRS Notice 2014-21 – General Principles



- **IRS considers crypto to be property**
 - Not currency
 - Does not indicate what type of property (ie. intangible, security, commodity)
 - General principles apply
- **Any transaction has potential to trigger gain or loss**
 - Gain or loss calculated based on FMV of crypto on date of payment or receipt
 - May be long-term or short-term
 - Treatment of gain or loss depends on whether held as capital asset
 - No *de minimis* exception

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Computing Gain or Loss



- **Specific identification is only basis method for general property**
 - Practical issue
 - Small fractions of coins (especially miners)/multiple wallets
 - Legal issues
 - Specifically identifying fungible crypto
 - How to determine FMV of transactions
- **IRS October 9, 2019 FAQ – Identification**
 - Can confirm on-blockchain transactions using transaction information (key, address)
 - Also permitted taxpayers to use wallet records showing all transactions for all units of a specific virtual currency
 - Similar to adequate identification rules
 - Otherwise FIFO is permissible
- **IRS October 9, 2019 FAQ - FMV**
 - If peer-to-peer, use blockchain explorer to determine value at date/time of transaction
 - If occurs on crypto exchange, then use exchange data at date/time of transaction
 - If no published value but for property/serve then FMV of property/services

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Non-Income Producing Transactions

- **Transfer among a taxpayer's wallets**
- **Charitable contributions**
 - >1 year - deduction is equal to FMV at time of donation
 - <1 - lesser of donor's basis or FMV
 - File Form 8283 Noncash Charitable Contributions (>\$500)
- **Gifts**
 - Gift receiver inherits modified holding period of gift giver (if substantiated)
 - If no substantiation, basis of zero

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Mining Income

- **Bitcoin awards**
 - Reportable as ordinary income
 - Hobby vs. Business
 - SE tax consequences
- **Gains from mined bitcoin**
 - Ordinary income amount as basis
- **Mining pools (often limited information)**
 - Partnership?
 - Rental income?
- **Typical expenses (can generate gains when purchased with crypto)**
 - Mining equipment
 - Internet Fees
 - Utilities (electricity)

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Businesses Accepting Crypto



- **Receipt of cryptocurrency as payment**
 - Report FMV of crypto when received as ordinary
 - If held and sold, report gain or loss on disposition
- **Cryptocurrency for services**
 - Self employment and other employment tax considerations
 - Cryptocurrency payments valued on date of payment/receipt:
 - Remuneration for services: Form W-2
 - For contractors: Forms 1099 and 1042
 - Cryptocurrency payments and back-up withholding/TIN requirement
- **Third Party Settlement Organizations**
 - Third party that contracts with a substantial number of unrelated merchants to settle payments between the merchants and customers
 - Issue Forms 1099-K
 - \$20,000 of gross proceeds; and
 - More than 200 transactions
 - Application to crypto exchanges? Form 1099-B more appropriate?

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Reporting Hard Forks



- **Rev. Rul. 2019-24 (October 9, 2019)**
- **Scenario 1**
 - Taxpayer receives no airdrop following hard fork
 - No gross income as a result of a hard fork
- **Scenario 2**
 - Taxpayer receives airdrop following hard fork
 - Ordinary income from hard fork generating airdrop
 - Income recognized when airdropped crypto received into wallet
 - FMV of new crypto at time of receipt

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Many Questions Still Remain



- **Like-Kind Coin-for-Coin Exchanges**
 - Gold/Silver bullion cases
- **Theft or Casualty Loss**
 - Lost private key or password
 - Shady exchange losses
- **Wash Sales**
 - Security?
- **Mark-to-Market**
 - Security/commodity?
- **Straddle Rules?**
 - Personal property that is actively traded?
- **Gains subject to 3.8% net investment income tax/ICOs**


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Foreign Information Reporting




- **FBAR/Form 8938 requirements for foreign wallets?**
 - Alleged FinCEN/IRS statements indicating no requirement
 - Analogies to gold
- **Personal wallets provided by foreign companies**
 - Probably not reportable
 - Analogous to holding gold in a safe deposit box
- **Foreign exchange-based wallets**
 - Perhaps
 - Argument could be made it is analogous to gold fund shares in foreign account

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IRS Crypto Initiatives



- **Civil Initiatives**
 - IR-2018-71 - March 2018
 - Reminded taxpayers of Notice 2014-21
 - Penalties may apply
 - LB&I campaign announced - July 2018
 - Addresses virtual currency compliance through outreach and examinations
- **Criminal task forces**
 - IRS-CI International Tax Enforcement Group
 - Joint Chiefs of Global Tax Enforcement (J-5)
 - UK, Australia, Netherlands, Canada
- **Revised Schedule 1 to Form 1040 for 2019**
 - “At any time during 2019, did you receive, sell, send, exchange or otherwise acquire any financial interest in any virtual currency?”

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IRS Data Mining



- **Coinbase John Doe summons**
 - Despite Coinbase boasting of thousands of US clients, only 802 reported tax
 - Notified 13,000 customers in February 2018 that IRS is getting records
- **Bitfinex FATCA announcement**
 - Announced that it will be performing FATCA due diligence procedures
 - Asked clients to certify U.S. status
- **Targeted IRS notices (6173, 6174, 6174-A)**
 - 6174 – Educate and remind taxpayers of their obligation to report
 - 6173 - File tax returns or certify compliance under penalties of perjury
- **Form 1099-K information reporting**
 - CP2000

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Criminal Schemes


- **Repatriation of undeclared offshore funds**
- **Tumblers**
- **False exchange account information**
- **Schemes to divert business receipts to unreported crypto wallet**
- **Evasion of payment**
 - Conversion of seizable assets into crypto
- **False invoice schemes**
 - Internal wallet transfers disguised as business expenses
 -
- **Industry professionals/primary source of income**
 - Miners/ICO issuers

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Addressing Historical Noncompliance


- **Qualified amended returns**
 - Takes the place of original tax return
 - Eliminates accuracy-related penalty exposure
- **Voluntary disclosure**
 - New program provides little penalty benefits
 - Generally six years of amended returns
 - Generally 75% fraud penalty for highest year
 - Generally only appropriate for taxpayers with significant criminal exposure
- **Quiet disclosure**
 - Sole option for Coinbase John Doe summons class members
 - New IRS guidance indicates appropriate for some taxpayers
 - Lack of clear guidance from IRS provides ammunition for reasonable cause

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Questions?



Thank You!