TAX YEAR
2021

Virtual Currency (Cryptocurrency)

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NEWDAY ADVISORY
VENTURE FINANCIAL GROUP

Virtual Currency (Cryptocurrency)

Currency is money in any form when in use or circulation as a medium of exchange. When a currency is legally recognized by a government to be valid for meeting a financial obligation, it is called legal tender. Coins and banknotes are usually defined as legal tender in most countries. Legal tender is backed by a central government, and the government controls the supply.

Virtual currency is not legal tender and it is not backed by a central government or bank. It is decentralized and is global. It 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 U.S. dollar or a foreign currency. Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of cryptocurrency are generally referred to as coins or tokens.

Fair Market Value (FMV)

For federal income tax purposes, transactions using virtual currency must be reported in U.S. dollars. You will be required to determine the FMV as of the date of payment or receipt of the virtual currency.

Virtual Currency Income Received

Barter income. When you barter with someone you are exchanging one good or service for another without the payment of money. Barter exchanges are common in virtual currency exchanges. The FMV of virtual currency received in a barter exchange is subject to income tax as if it was U.S. dollars. When virtual currency is received in the course of a trade or business, the FMV of the virtual currency must be included in business income in the year of receipt and is subject to self-employment tax.

Example: *Jill has a cleaning business and cleans George's house for a year in exchange for one bitcoin. The FMV of the bitcoin when received is $15,000. Jill recognizes $15,000 as business income on her tax return even though she did not receive any U.S. dollars.*

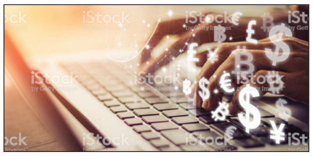
Employees. The FMV of virtual currency paid as wages is subject to federal income tax withholding, FICA tax, and unemployment taxes. It also must be reported on Form W-2, *Wage and Tax Statement.*

Virtual Currency Used to Purchase Goods or Services

For federal income tax purposes, the main difference between using virtual currency to purchase goods or services versus the U.S. dollar is that virtual currency is treated as property. The tax basis of the U.S. dollar is its face value. When a product or service is purchased using the U.S. dollar, there is no gain or loss on the exchange of that U.S. dollar for the product or service. In contrast, the tax basis of virtual currency is the cost to acquire it. When a product or service is purchased using virtual currency, gain or loss is the difference between the fair market value of the product or service and the cost basis in the virtual currency that is exchanged for that product or service.

Example #1: *Brad uses two U.S. dollars to purchase a cup of coffee. Since Brad's tax basis in those two U.S. dollars is their face value ($2), and the fair market value of the cup of coffee is $2, there is no gain or loss on the transaction.*

Example #2: *Brad uses virtual currency to purchase a cup of coffee that is worth $2. Brad had previously acquired the virtual currency at an ATM machine by exchanging one U.S. dollar for the virtual currency. Brad has a $1 taxable gain on the purchase of the coffee, the difference between the fair market value of the coffee ($2) and the tax basis in the virtual currency ($1).*



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Mining Virtual Currency

Miners. Mining is a process through which blockchain transactions are verified and accepted by adding such transactions to a blockchain ledger. Miners use computers to solve mathematical equations that are part of the encryption process. The first miner who solves the transaction and validates it receives a digital token of virtual currency as a reward.

Gross income is realized upon the receipt of the digital token. The FMV of the virtual currency as of the date of receipt is includible in gross income. If you are in the trade of business of mining, the gross income is net earnings from self-employment and subject to self-employment tax.

Hard fork. A hard fork occurs when a virtual currency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new virtual currency on a new distributed ledger in addition to the legacy virtual currency on the legacy distributed ledger. Following a hard fork, transactions involving the new virtual currency are recorded on the new distributed ledger and transactions involving the legacy virtual currency continue to be recorded on the legacy distributed ledger.

Airdrop. An airdrop is a means of distributing units of a virtual currency to the distributed ledger addresses of multiple taxpayers. A hard fork followed by an airdrop results in the distribution of units of the new virtual currency to addresses containing the legacy virtual currency. However, a hard fork is not always followed by an airdrop.

Constructive receipt. You generally have constructive receipt of virtual currency from an airdrop on the date and at the time it is recorded on the distributed ledger. However, you may constructively receive virtual currency prior to the airdrop being recorded on the distributed ledger if you are able to exercise dominion and control over the virtual currency. Likewise, you do not have receipt of virtual currency when the airdrop is recorded on the distributed ledger if you are not able to exercise dominion and control over it For example, you do not have dominion and control if the address to which the cryptocurrency is airdropped is contained in a wallet managed through a virtual currency exchange which does not support the newly-created virtual currency such that the airdropped virtual currency is not immediately credited to your account. If you later acquire the ability to transfer, sell, exchange, or otherwise dispose of the virtual currency, you have constructive receipt at that time.

Tax Reporting for Virtual Currency Purchases and Exchanges

If you purchase or exchange virtual currency, it is treated as the sale or exchange of property. If held as a capital asset and disposed of, a transaction involving virtual currency is reported on Form 8949, *Sales and Other Dispositions of Capital Assets,* and Schedule D (Form 1040), *Capital Gains and Losses.* There is a box to check on Form 1040 if you engaged in any transaction involving virtual currency during the tax year, even if it was not disposed of.

To report transactions involving virtual currency, your tax preparer will need information from you including the date acquired, date sold/exchanged, purchase price, sales price, number of units exchanged, and a description of the property.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 72.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.