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The Crypto Tax Man Cometh

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Congressional Proposal Making Waves and Creating Uncertainty with Crypto-Currency Reporting

Cryptocurrency investors, blockchain innovators, miners and digital asset intermediaries need to be aware of draft legislation being considered by Congress. As part of the negotiations over an infrastructure framework, Congressional leaders and the White House are considering changes to the Internal Revenue Code that would dramatically increase both the number of crypto-currency transactions that must be reported to the IRS and the persons that would be subject to this new reporting regime. The proposed changes are as follows:

- Currently, businesses that accept $10,000 in cash must report those transactions to the IRS. That requirement would be expanded to include the receipt of digital assets which is defined to include crypto-currencies.
- Currently, securities brokers are required to report their customers' securities transactions. The law would drastically expand who is a "broker" and would require "brokers" to report <u>any</u> transfers of a digital asset, including crypto-currencies.
- The term broker would be expanded to include any person who, for consideration, is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.

Substantial penalties can be imposed for failure to report these transactions to the IRS and/or to the wallet holders.

Congress' goal with this new legislation is to increase the reporting of crypto-currency transactions by virtual currency exchanges and businesses that receive crypto-currency in the course of operating their businesses.

The Senate has suggested that these proposals would raise $28 billion in tax revenue. The theory is that by requiring these persons to report these transactions to the IRS that taxpayers will no longer be able to hide their crypto-currency transactions: either the taxpayers will self-report the income or the IRS' information matching program will catch the recalcitrant (or just negligent) taxpayers.

As with any new legislation, there are more questions than answers. For example:

Enforcement

Assuming that the exchanges provide the required information, will the IRS be able to correctly match the information to U.S. taxpayers?

A taxpayer moving funds from his checking account to his savings account is not a taxable event. The exchanges are required to report all transfers of digital assets whether or not a transfer is taxable. Query whether the IRS would be able to sort out the taxable transactions from non-taxable transactions.

Compliance

The definition of broker includes any person who, for consideration, regularly facilitates transfers of digital assets. Will a non-custodial "brokers" even have sufficient information to comply with the law since many times these holders do not have the names of the owners of the digital assets, let alone their taxpayer identification numbers?

Will taxpayers be able to demonstrate that a transfer from one wallet to another wallet was a non-taxable transfer?

Will loans of crypto-currencies also be captured by this new legislation? If yes, how should a taxpayer report the fact that it loaned (or borrowed) crypto-currency as the transfer will appear to be taxable?

Potential Relocation of Exchanges

These requirements will apply to U.S. exchanges. Will U.S. exchanges re-locate overseas to avoid these reporting requirements? Would this approach even be effective to avoid U.S. jurisdiction? Also, will U.S. account holders move their crypto-currencies to overseas exchanges to attempt to avoid this reporting regime? Will this approach be effective?

It is clear that crypto-currencies are in the crosshairs of both Congress and the IRS and whether or not this legislation moves forward, it is likely that there will be further compliance requirements imposed both on holders and owners of crypto-currencies in the near future.

Uncertainty Ahead

Given the complexities in the tax law and how it might be interpreted, we expect to see a significant amount of uncertainty as to how these provisions will be applied and enforced.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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