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Tax Alert

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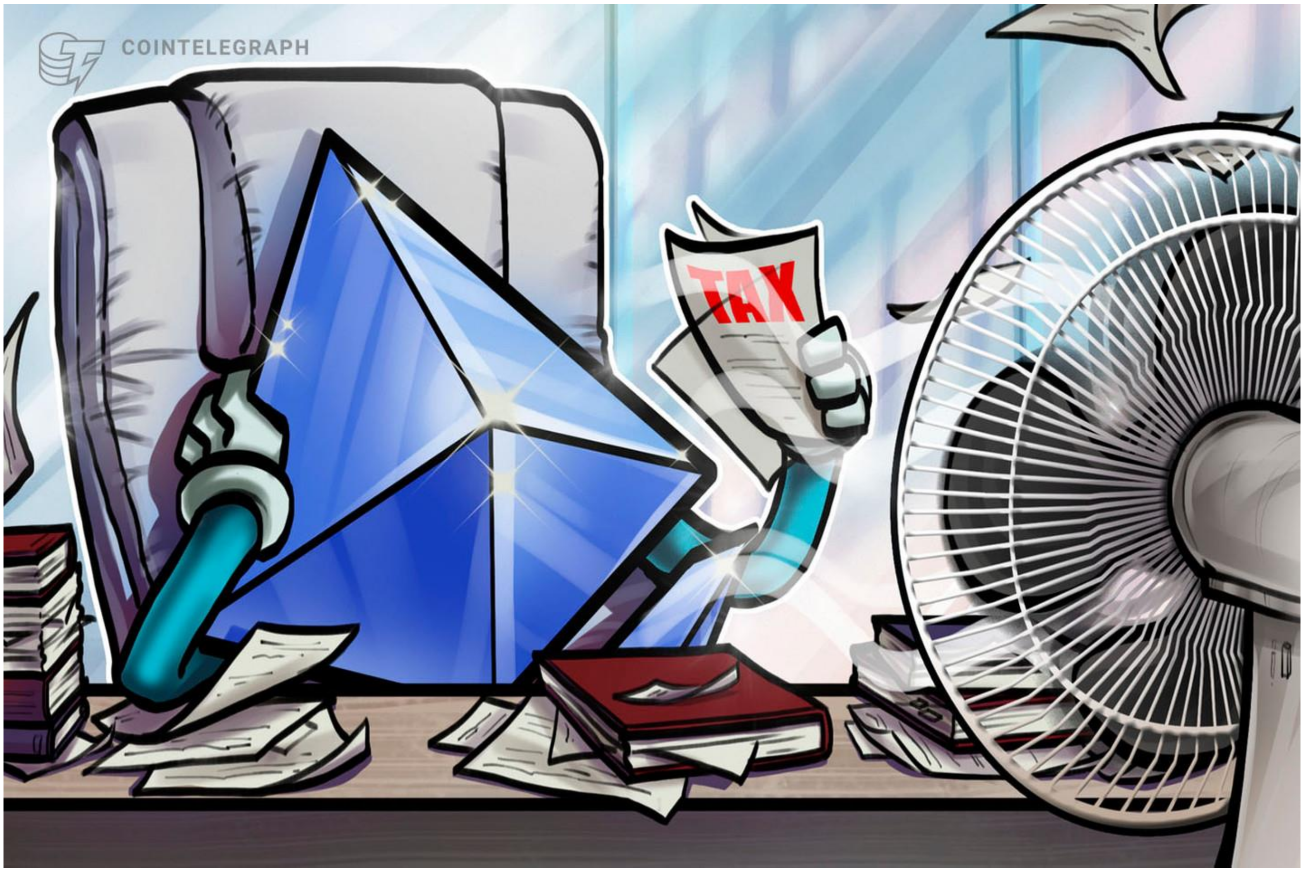
By **Robert W. Wood**

# IRS Tax Warnings on Ethereum's Fifth Anniversary

Since the time Ethereum was born, the crypto-tax landscape has dramatically changed, and that is where we are now.




**EXPERT TAKE**

As important as Ethereum has become, even eclipsing Bitcoin (BTC) in some circles, it is no wonder that its fifth birthday has prompted comments — some prophetic, others nostalgic. Few, however, will mark the occasion by thinking about taxes, but that could be shortsighted. The last five years have seen near-tectonic shifts in how investors, exchanges and government agencies see cryptocurrencies.

The Internal Revenue Service, or IRS, is at the top of the heap when it comes to tax enforcement. This is plainly true in the United States, and it is increasingly true worldwide, too. In 2008, the IRS and Department of Justice broke the back of Swiss banking. Over 50,000 Americans rushed to disclose their offshore accounts, paying billions in taxes and penalties while the U.S. secured numerous criminal convictions and huge fines from Swiss and other foreign banks.

With America's unique Foreign Account Tax Compliance Act, or FATCA, banks worldwide now routinely report account holders with an American connection to the IRS. The power of the IRS and the U.S. Department of Justice is clearly relevant to crypto, which is arguably the offshore banking of the modern era. The IRS would like to emulate its wildly successful offshore banking haul with crypto. A lot has changed in the five long years since Ethereum was born. Let's take a look.

**IRS forms for crypto taxes**

In 2015, not many people were reporting crypto transactions, according to the IRS. Now, there is practically an onslaught of IRS forms. Normally, these not-so-fun little tax declaration forms arrive around the end of January for reporting income paid to you or transactions made in the previous calendar tax year. Employees paid in crypto? The IRS says that wages paid to employees using virtual currency are taxable, must be reported on a Form W-2, and are subject to federal income tax withholding and payroll taxes.

Payments using virtual currency made to independent contractors are taxable to them, and payers engaged in business must issue Form 1099. A payment made using virtual currency is subject to Form 1099 reporting just like any other payment made in property. That means if a person in business pays crypto worth $600 or more to an independent contractor for services, a Form 1099 is required.

If you receive Form 1099, keep track of them. Each one gets reported to the IRS (and state tax authorities). If you don't report or otherwise address the reported income on your tax return, you can expect that the IRS will follow up.

**IRS information access**

This is a big one. In 2015, it was widely assumed that the IRS was struggling to make any headway with crypto. Almost no one was issuing tax forms, and many crypto investors evidently just weren't reporting — so said the IRS reported statistics. The year 2020 is completely different. Now, the IRS is using software to track crypto.

The IRS also got access to Coinbase account holder records in the Coinbase John Doe Summons litigation that started in 2016. It is widely assumed that we will see more efforts of that sort for any exchanges that are not issuing plenty of IRS information returns. Remember, the IRS broke the back of Swiss banking with a Joe Doe Summons.

**Records**

In 2015, there was little attention paid to this topic, and there were few systems and vendors for keeping track of trades and activity. It was generally recognized that you needed to have access to trading data to report your taxes, but the details were scarce, and some assumed that repercussions might not be bad. Today, everyone knows what a stickler the IRS can be, and everyone knows that the IRS cares about crypto. Witness the crypto question that now appears on every U.S. tax return. The IRS is really watching now.

Yes, that applies to crypto investors too. You'd better have some if you are thinking about taxes. If you've ever tried to tell the IRS "I lost my receipt," you don't want to do it a second time. The IRS has heard every excuse in the book. While it is not without sympathy, you'll find it far easier not having to go to the additional effort of proving something by another means.

**Everything triggers taxes**

In 2015, we already knew that the IRS says crypto is property. That announcement came in 2014, but there were no details. There have been some since, and the IRS looks to collect taxes at just about every transaction. In 2015, it was generally assumed that you could trade one crypto for another under section 1031 of the tax code. With no fiat, there was nothing to tax, the argument was.

But in 2018, the law was changed to say "No deal," making even crypto-to-crypto trades taxable as sales. So for any transaction, while there is a lot more than taxes involved in decisions, it can be wise to always include taxes on your list.

**What crypto did you sell?**

In 2015, such topics as inventory systems and specific identification were being discussed, but these topics are vastly more important today. If you have 100 Bitcoin and you sell 10, which 10 did you sell? There is no perfect answer to this question. Most of the tax law considers shares of stock, not cryptocurrency.

Specific identification of what you are selling, when you bought it, and for what purchase price is likely to be the cleanest. But that may not be possible. Some people use an averaging convention, where you essentially average your cost across a number of purchases. Consistency and record-keeping are important.

**Gifts, holding for others**

Gifts of crypto were in their infancy in 2015. Some people struggled with how to do it, how to report it and more. But what if the recipient then sells it? In 2020, this is far more common, and estate planners are mentioning it more and more. Charitable contribution counts too. Crypto is being featured in estate tax planning and estate tax audits too.

Holding crypto for others is not a gift, so why mention it? Various escrow and trust arrangements — some informal, some not — have blossomed. They can be sensitive, particularly now with the IRS's much greater access to information. Be careful who is selling and how such activities are reported.

**IRS audits**

Audits involving crypto were in their infancy in 2015, but have now ramped up bigtime. The IRS has crypto training now for its auditors and criminal investigation division agents. Should the latter scare you? I think so. The IRS and Department of Justice still bring criminal charges primarily involving crypto use for illegal purposes involving other crimes. Say, money laundering or child pornography.

But that is no guarantee. Besides, most criminal tax cases historically come out of regular old civil IRS audits. The IRS auditor sees something he or she thinks is fishy, and invites the criminal people at the IRS to take a look. It's called a referral, and you don't know if it is happening. In fact, you usually don't know until it is too late.

*The views, thoughts and opinions expressed here are the author's alone and do not necessarily reflect or represent the views and opinions of Cointelegraph.*

***Robert W. Wood is a tax lawyer representing clients worldwide from the office of Wood LLP in San Francisco, where he is a managing partner. He is the author of numerous tax books and writes frequently about taxes for Forbes, Tax Notes and other publications.***