THE COINTELEGRAPH
future of money

JUL 22, 2021

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Get a passport, pay crypto, live tax-free?

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Way back in 2014, the United States Internal Revenue Service (IRS) ruled that cryptocurrency is property in Notice 2014-21. That classification as property has some big tax consequences accentuated by wild price swings. Buying and selling crypto can trigger gain or loss and be taxable. Yes, *buying* something using crypto — a house, a car, a new suit — can trigger taxes. Even paying taxes in crypto can trigger taxes.

If you owe $5,000 in taxes, you could pay the $5,000 in dollars. However, if you pay with $5,000 worth of Bitcoin (BTC), as long as the crypto is worth $5,000 when you pay, you're home free, right? Not really. You need to consider the sale you just made. The transfer of the crypto to the tax man is a sale, and that could mean more taxes for the year of the payment. If you bought the crypto for $5,000 the day you pay your taxes, there's no gain.

Crypto as a gift

Paying employees or independent contractors in crypto results in taxes to them when they receive it. And when you pay them, you too can have a tax hit since, on your side of the equation, you just sold your crypto. If you are paying with crypto, remember that most transfers of crypto are taxable, unless the transfer qualifies as a gift or a charitable contribution. You can give crypto as a gift, and it doesn't trigger income taxes. That's right, no income tax to you as the donor, and no income tax to the recipient.

Of course, when the recipient transfers or sells it, there would be income taxes *then*. And at that point, the donee would need to calculate gain or loss. What is his or her tax basis, since it was a gift? The tax basis is the same as it was in your hands when you made the gift. However, keep in mind that to avoid income taxes, a gift has to actually be a gift. The tax law is littered with cases of people who claimed something was a gift, but who got stuck with income taxes.

With gifts not being subject to income taxes, it can seem tempting to try to characterize money or property you receive as gifts. But be careful: The IRS hears this "it was a gift" excuse a lot. And the IRS is unlikely to be persuaded unless you can document it. Plus, the IRS usually expects a gift to occur in a normal gift-giving setting. For example, if an employer or former employer gives a loyal employee $10,000, is that a gift? No, it is a bonus, treated as wages. Even trying to document it as a gift may not change that result.

True gifts may not trigger any *income* taxes, but there could be gift taxes involved. If you give crypto to a friend or family member — to anyone really — ask how much it is worth. If the gift is worth more than $15,000, it requires you to file a gift tax return. For 2021, $15,000 is the amount of the "annual exclusion." You can give gifts up to this amount each year to any number of people with no reporting required. Any gifts over that $15,000 amount require a gift tax return, even though you may not have to pay any gift tax. Rather than paying gift tax, you normally would use up a small portion of your lifetime exclusion from gift and estate tax.

What if your gift isn't to a person, but to charity? If you give to charity, that can be very tax-smart from an income tax viewpoint. If you give crypto to a qualified charity, you should normally get an income tax deduction for the full fair market value of the crypto. If you bought it for $500, and donate to a 501(c)(3) charity when it is worth $15,000, you should get a $15,000 charitable contribution deduction.

What's more, you won't have to pay the capital gain or income tax on the $14,500 spread. That's a good deal. It's why most savvy people — think Warren Buffett — want to donate appreciated property rather than money to charity. Remember, if you use crypto to *buy* something, the IRS considers that a *sale* of your crypto. You have to calculate gain or loss. You might have *bought* something with your crypto, but you made a *sale* in the process.

How about buying a new passport?

Plan B Passport offers clients who hold crypto a way to use their crypto to buy a second passport. Customers can take their pick of seven tax-haven nations that happen to exempt crypto holdings from capital gains taxes. You are buying into a citizenship by investment program, which is not illegal. You can keep your U.S. passport, or you could give it up if you wish. A key feature of the deal is the notion that you are making a donation of $100,000 or $150,000 to the sustainable growth fund of the country, plus some fees.

However, it is worth asking if this is a real donation or is rather the purchase of citizenship. If the latter, one might expect the IRS to say that using appreciated crypto for the purchase triggers U.S. taxes. Remember, the IRS is still very much on the hunt for taxpayers not paying taxes on crypto.

Having a second passport would be nice, but what about people who decide to give up American citizenship along with U.S. taxes?

Ironically, that can bring yet another tax: the U.S. exit tax. To exit, you must prove five years of IRS tax compliance, and getting into IRS compliance can be expensive and worrisome. If you have a net worth greater than $2 million, or have average annual net income tax for the five previous years of $171,000 or more, you can pay an exit tax. It is a capital gain tax, calculated as if you sold your property when you left. A long-term resident giving up a Green Card can be required to pay the exit tax too.

Most people exiting the U.S. arrange gifts, use formal valuations, pre-exit sales, and devise other plans to try to avoid or minimize their exit tax. But heck, if you do have to pay exit tax, perhaps you could pay with crypto? Well, as long as it was clear that the crypto would not trigger even more tax…

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