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Unclear Tax Reporting Criteria May Dog Crypto Compliance

By **Amy Lee Rosen**

Law360 (July 15, 2020, 6:40 PM EDT) -- Despite guidance on the tax treatment of cryptocurrency, an absence of uniformity in how various wallets report transactions, or sometimes provide no information at all, may make it harder for holders to accurately report liabilities to the Internal Revenue Service.

In 2014 the Internal Revenue Service issued Notice 2014-21, which required cryptocurrency holders to treat virtual currency as property with a basis that must be subtracted from its value at the time of disposition in order to calculate reportable gain or loss. In 2019 the IRS reiterated its position that cryptocurrency is treated as property but did not specify what tax forms a wallet or exchange must give to its users.

The absence of guidance has led to various cryptocurrency wallets offering different types of tax forms, or none at all. For example, Bitstamp LTD, a bitcoin exchange based in Luxembourg, told Law360 it is not able to provide its users with 1099 forms, and neither does San Francisco-based bitcoin exchange Kraken, according to its website.

On the other hand, Robinhood, a broker-dealer that is regulated by the Financial Industry Regulatory Authority and registered with U.S. Securities and Exchange Commission, and that offers cryptocurrency trading, said it will provide users with relevant forms such as the 1099-B, which includes gains and losses, its website said. Meanwhile, digital currency exchange company Coinbase said that it provides it users with Form 1099-MISC, which covers miscellaneous income, for customers who received $600 or more in cryptocurrency earnings and that Coinbase Pro and Prime customers with over $20,000 in gross proceeds in 2019 will receive a Form 1099-K, which generally includes payment card transactions or settlement of third-party payment network transactions.

One possible problem with being issued a Form 1099-K is that it simply provides someone's gross proceeds of sale and not the aggregate basis amounts in the coin sale or exchanges, which may lead to inaccurate tax reporting, according to James N. Mastracchio, a tax partner at Eversheds Sutherland LLP.

"I had one client with an excess of $500,000 of gross proceeds [on a Form 1099-K], but that represented hundreds of transactions," he said. "So after taking into consideration his basis from those purchases and sales, he actually wound up with a net loss."

The 1099-K is generally used and simply tracks gross proceeds, but it does not track the basis in the sales or exchanges of cryptocurrency, Mastracchio said. So, even if a cryptocurrency holder receives the Form 1099-K, the individual will still have to go back and look at each transaction, figure how much was sold and track any related commissions charged that can be deducted, he said.

Receiving a Form 1099-B, which is a federal tax form used by brokerages and barter exchanges to record customers' gains and losses during a tax year, would be more helpful because it has more information, Mastracchio said. Form 1099-B would include a description of the investment, like the name of the coin someone invested in, the purchase date and purchase price, and it would have the sale date and sale price, so you could easily compute the gain or loss on that particular holding, he said.

However, providing a Form 1099-B may be easier said than done because the cryptocurrency industry is still in its infancy, whereas the securities industry is much more advanced in its ability to track stocks and provide 1099-Bs for those users, Mastracchio said.

Some wallets may provide only Form 1099-K or Form 1099-MISC because Notice 2014-21 mentions only those forms and not any Form 1099-B reporting requirements, according to Roger M. Brown, head of tax and regulatory affairs at blockchain and cryptocurrency software company Lukka Inc.

"When the 2014 notice went out, there was no reference to 1099-Bs, and so many in the industry didn't think that 1099-Bs applied to crypto," he said. "That's why many exchanges — and I won't say all, because it's not all — many didn't [issue] 1099-Bs."

Someone in the course of a trade or business who makes a payment of $600 or more to an independent contractor for performing services must report the payment to the payee on Form 1099-MISC, according to Question 13 of the notice. Form 1099-MISC is linked to compliance with Section 6041 of the Internal Revenue Code, which requires reporting miscellaneous payments of more than $600 made in the course of a trade or business to a nonemployee for specified purposes like gains and profits.

Those that settle cryptocurrency payments on behalf of merchants are classified as third-party settlement organizations and must report payments on Form 1099-K if they exceed more than 200 transactions or $20,000 per year, according to Question 15.

Providing the Form 1099-B is nowhere in the 2014 notice, which may be why some wallets and exchanges have chosen to issue Form 1099-MISC or Form 1099-K, Brown said.

The IRS should clarify when Form 1099-K reporting does or does not apply and whether the government expects to require certain business models to use Form 1099-B reporting instead of Form 1099-K reporting, according to a letter from the Chamber of Digital Commerce to Treasury and the IRS.

Brown, who helped write portions of the letter, told Law360 information reporting rules are a product of statute, so if a statute does not clearly require reporting, then a wallet or exchange won't automatically file Form 1099-B when it may not clearly be required to do so by law.

Under Section 6045 of the IRC, brokers must file information returns on Forms 1099-B of gross proceeds for the sale or disposition of covered securities, which include commodities, but the statute and regulations are silent on whether that includes cryptocurrency, he said.

"There's an uncertainty whether crypto is a covered security, so it may not be covered by the requirements of the 1099-Bs via Section 6045," Brown said.

Similarly, an exchange may not know if a sale occurred because the token goes from one wallet to another wallet of the same taxpayer — which isn't actually a sale, Brown said. This is especially true if the cryptocurrency is transferred to a wallet that is overseas, he said.

So, if an exchange is required to report the basis, it may not know the actual basis or may even report the wrong data, which is why Form 1099-K may be a better indicator in showing that some form of cryptocurrency transaction simply happened, Brown told Law360.

Edward L. Froelich, a tax lawyer of counsel at Morrison & Foerster LLP, told Law360 the 1099-K may be easier for a wallet to provide because it simply says this is how much someone agreed to receive in value through a payment card or through a third-party network like a cryptocurrency network.

Reporting requirements for payment cards and third-party networks are covered under Section 6050W of the Internal Revenue Code. Third-party settlement organizations must report the gross amount of transactions for any payee that they issue settlement payments for using a network if the transactions exceed $20,000 and the number of transactions exceeds 200, according to frequently asked questions on the IRS' website.

"The 1099-K is easier [to issue] because it simply says this is how much you agreed to receive in value through a payment card or through a third-party network, [while] the 1099-B does require a fair amount of work on the party issuing it," Froelich said.

While Form 1099-K does not provide the full basis information that a Form 1099-B may include, Form 1099-K may still be helpful to the IRS for enforcement, Froelich said.

"It shows that some vendor or provider of goods or services received X amount of gross value in cryptocurrency in a particular calendar year," he said.

The IRS may simply accept Form 1099-K to check against someone's tax return, so if an individual is claiming gross income of only $500, that may not reconcile with a Form 1099-K that lists $1,000 in cryptocurrency aggregate transactions, he said.

But all taxpayers still must understand the gain or loss on a cryptocurrency transaction in an exchange, sale or disposition of property even if they receive a Form 1099-K by comparing it to their own records, Froelich said.

Form 1099-K "doesn't help anyone figure out exact transactions, but when you sell something you have to presumably reconcile how much you made and what you sold," Froelich said.

"Everyone who sells goods or services has to keep track of that," he said.

In 2019, IRS Chief Counsel Michael Desmond said the agency plans to release additional guidance for cryptocurrency information reporting requirements under Section 6045, which covers reporting requirements for brokers.

The IRS and U.S. Department of the Treasury did not immediately respond to questions from Law360.

--Additional reporting by Joshua Rosenberg. Editing by John Oudens and Vincent Sherry.
