TAX-DEFERRED/TAX-EXEMPT US PLANNING STRATEGIES IN A CRYPTO WORLD

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Cryptocurrency – Is it "Currency"?

- Gains or losses in non-US currency is considered "ordinary income" or "ordinary loss" for US tax purposes
- Cryptocurrency is – however – not "currency" but "property" for US tax purposes: IRS Notice 2014-21

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Cryptocurrency – Property for Tax Purposes!

- Because Bitcoin and other cryptocurrencies are viewed as property from a tax perspective there are two potential taxes that could apply
  - Income Tax or
  - Capital Gains Tax

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US Tax Treatment Generally

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Earning Crypto?

- Earning – “Business” income, taxable as such “ordinary income”
  - Income from employment
  - Income from “mining” is likely a business
    - “Proof of work” requires active maintenance of computers, etc.
    - Same w/ mining “pool” – pool’s activities are active; partnership’s activities “attributed” to partners
    - IRS Position (Notice 2014-21) = “business income”

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What about Staking?

- Less certain, but activities substantially different than mining
  - Posting coins for reward
  - Seems like “investing”
- *Jarrett* tax case – ongoing: IRS attempted to settle, taxpayer rejected
  - Taxpayer claims no income from staking rewards until sells those rewards
  - Analogize to long-standing notion that no income from baking bread or painting works of art until bread/art sold.

Business v. Non-Business: Why do we Care?

- Putting aside tax rates, planning strategies depend – in part – on whether activities are business activities or not
  - Many tax-deferral strategies (pension plans, retirement plans, etc.) require non-business activities
  - Otherwise, if activity rises to level of trade or business then tax owed on a current basis

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Comparing Alternatives:

Taxation of Non-Deferral, Non-Business Income

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Gain Triggered When?

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Holding Period: Determines Rate of Tax

- **Trading Activity = Short Term Gains**
  - Hold one Year or Less: Marginal Rates ranging from 0% to 37%
- **HODL = Long Term Capital Gain**
  - HODL for at least one Year and 1 Day : 0%, 15% or 20% tax rate, depending on other income

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Non-Trading Investment Income

- “Interest” income
  - taxed at marginal rates (0% to 37%)
  - Crypto lending is non-business income
- Crypto “dividends”
  - also not business income but taxed at marginal rates

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How Can US Taxpayers Defer/Eliminate Tax on Crypto Non-Business Activities?

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Viable Strategies to Defer Crypto Income

- Generally same as other investment assets: Key is that **crypto = property**
  - Pension plans
  - Individual Retirement Accounts
  - Charitable Remainder Trusts
- Idea is that you have **tax-free investment growth** and, depending, **tax-free use** of funds

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Use of Individual Retirement Accounts ("IRAs") to Minimize/Eliminate Crypto Trading Tax

Individual Retirement Accounts: Traditional IRA

- Funded with "pre-tax" money, meaning taxpayer is eligible for a deduction from income for contributions
  - Contributions subject to annual limits
    - $7000 if over 50 years, $6000 if under
  - Deduction "phases out" over certain income
- Tax-free investment growth
- Taxable distributions included in income at marginal rates – regardless of character earned within IRA – and "minimum" distributions required
  - Distributions for taxpayers younger than 59 ½ subject to penalty charge

Individual Retirement Accounts: Roth IRA

- Generally, not available for taxpayers with income over certain levels (e.g., MFJ @ $214,000)
  - Funded with after-tax dollars
  - Contributions subject to annual limits
    - $7000 if over 50 years, $6000 if under
- Tax-free investment growth
- Tax-free distributions for taxpayers *older* than 59 ½ where Roth IRA is at least 5 years old
  - No minimum distributions

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“Back-Door” Roth IRA

- Although Roth IRAs are generally not available for taxpayers with income over certain levels, workaround exists
- Can’t contribute existing crypto holdings to an IRA (Roth) or otherwise, but can “convert” existing IRA into a Roth IRA
  - Conversion is taxable
  - Investment growth and distributions = tax-free
- Like other Roth IRAs, tax-free distributions for taxpayers *older* than 59 ½ where Roth IRA is at least 5 years old

Most Practical for Higher-Income Taxpayers?

- Convert existing traditional IRA into a Roth IRA
  - Pay tax on conversion at marginal rates
    - No 10% penalty for conversion (regardless of age or income)
- Trade away!

Charitable Remainder Trusts

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Charitable Remainder Trust

- A “split-interest trust”, a charitable remainder trust (a “CRT”) offers those taxpayers with charitable intent the advantage of making “split gifts” – a gift in part to charity and a gift in part either to others or to be retained for themselves during their lifetimes.

- Through careful choice of jurisdiction, planning and drafting, taxpayers may enhance the after-tax benefits of a CRT – so much so that the after-tax benefits outweigh the charitable cost.

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Charitable Remainder Trusts: Benefits

- Deferral of income tax “within” CRT permitting tax-free diversification of portfolio
- Contributions of unencumbered assets = tax-free
  - May contribute crypto wallet to CRT tax-free
- Contributions give rise to tax (charitable) deduction
- Tax-deferred income stream retained by beneficiary and family members

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More Specific Requirements

- Trust = irrevocable with completed transfer of assets
- "Unitrust amount" payable to non-charitable beneficiaries at least annually (except in case of NIMCRT or NICRT) –"implied yield" set by statute
- Actuarial value of remainder interest to charity must be at least 10% of transfer at time of funding, based upon implied yield, trust term, pay-out percentage
- Unitrust annual pay-out not less than 5% nor more than 50% of CRT fair market value
- No ability to leverage (no margin, no borrowing)
- No "personal use" of assets within CRT.

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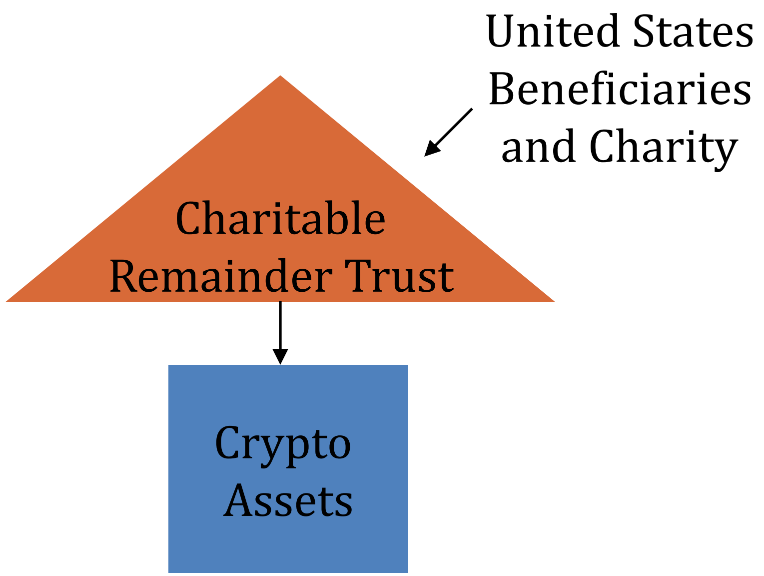
CRT Tax Treatment Generally

- CRT itself s tax-exempt unless unrelated business taxable income present – i.e., no “mining” allowed, staking questionable but likely permissible
- Unitrust payments are taxed to non-charitable beneficiaries under tiered system, as follows:
  - Ordinary income
  - Short term capital gains
  - Long term capital gains
  - Tax exempt income
  - Corpus
- In-kind distributions may trigger capital gains

Sale of Crypto Assets = Tax-Free

CRT is exempt from income tax

1. Contribution of crypto gives rise to charitable contribution deduction with taxpayer entitled to annual distributions equal to (e.g., 10%) of FMV of assets (measured annually)
2. CRT selling crypto/other assets exempt from tax
3. Reinvestment in crypto (or other assets) is tax-free
4. Taxable income realized only when taxable taxpayer receives a distribution of crypto gains
5. Gains taxable as HODL gains or short-term or interest or . . .
6. At end of term (e.g., 20 years), balance goes to charity



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Enhancing the Solution

Interposing an LLC can defer (and time) income realization to US Taxpayer

1. CRT has no requirement to “distribute” until there is “income”
2. Taxpayer realizes no tax until CRT “distribution”
3. No “income” to CRT until LLC distribution to CRT
4. Thus, taxable income deferred within LLC – i.e., CRT is tax exempt and beneficiary only taxable on CRT distribution