Revenue Estimation and Tax
Research Conference
Federation of Tax Administrators

Blockchain, NFTs and CyberCurrencies: Tax Issues to Consider

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October 2, 2023

What is a Blockchain?

- Blockchain is essentially a decentralized digital ledger that is powered and operated by numerous computers, or nodes that work to record transactions on the ledger.
- Network participants verify and update transactions through complicated consensus mechanisms, including proof of work.
- Once a transaction is verified along with other transactions, this block of transactions is added to the blockchain.
- Virtually "unhackable" due to the widely spread storage of the data and mathematical functions used in the consensus mechanism.
- Blockchain technology is most associated with cybercurrencies or cryptocurrency but also supports the exchange of NFTs.

What is cybercurrency or cryptocurrency?

- Digital asset that is created using cryptographic techniques that enable people to exchange them securely
- Supported by blockchain technology
- Cryptocurrency transactions are pseudonymous
  - Transactions on blockchain are verified using alphanumeric public and private keys allowing the transaction to occur without the actual identity of the account holder being revealed to other users on the blockchain.

Overview of Non-Fungible Tokens (NFTs)

- NFTs are “non-fungible tokens”
    - Fungible assets – goods that are freely exchangeable or replaceable for another of like nature or kind (e.g. currency, bitcoin, etc.)
    - Non-fungible assets – unique, irreplaceable, and non-interchangeable assets
- NFTs are tokens that can be used to represent ownership of unique items, like:
    - digital artwork,
    - a piece of artwork or manuscript
    - your own personal medical records
    - concert tickets
    - tangible items, like a car, jewelry or luxury items
    - real property or
    - legal documents

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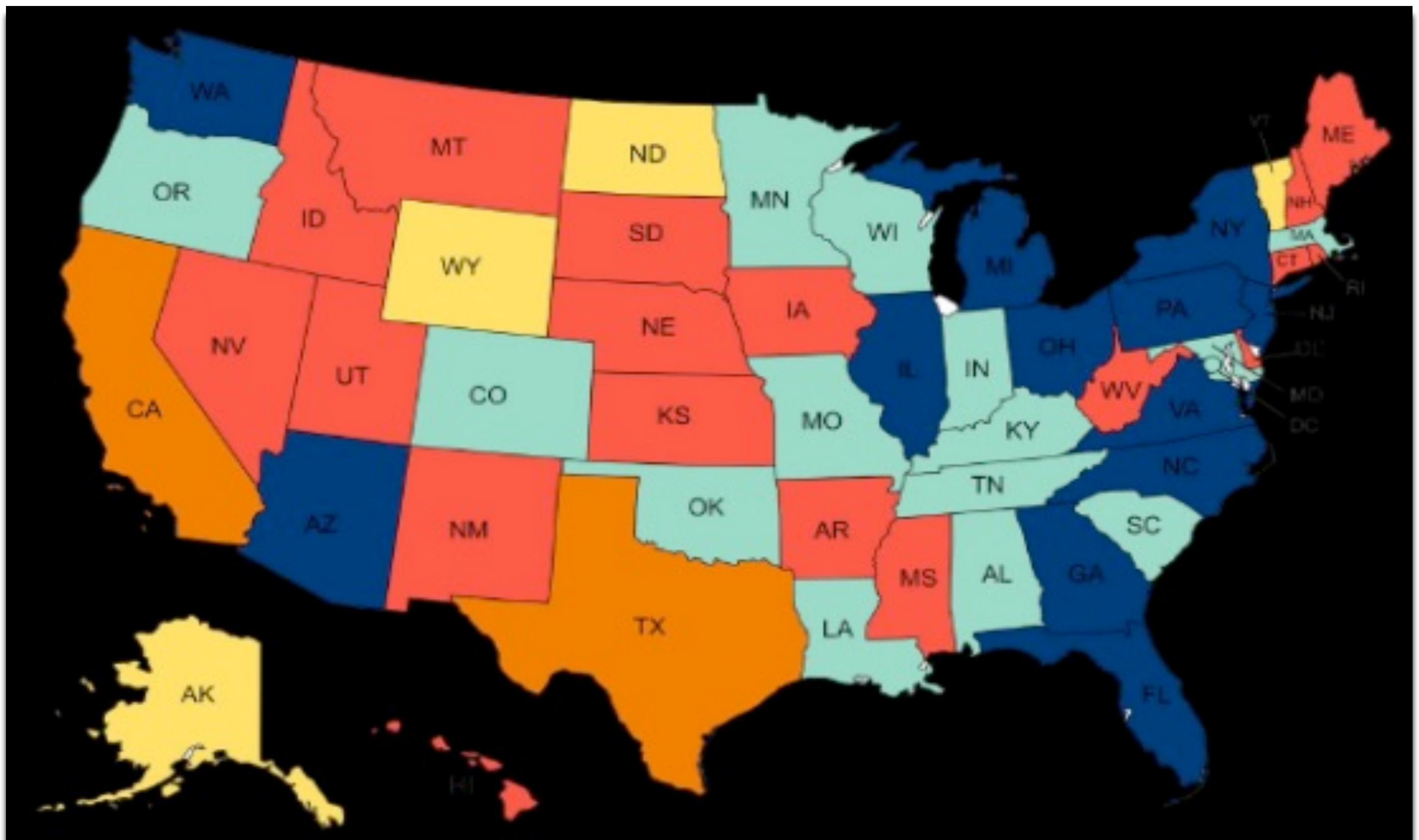
Potential Revenue Impacts

Crypto Market size - $1.05 T

US Taxpayers hold roughly $468 billion in cryptocurrency assets.



$30 B+

$10 B - $30 B

$5 B - $10 B

$1 B - $ 5 B

< $1 B

Source: Revenue Solutions Inc., Fran D'Antonio Study and States Leave Big Bucks on the Table by Ignorning Cryptocurrency by Michael J. Bologna, Bloomberg Law News 9-1-2023

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Basics of Federal Digital Asset Taxation

Impact of Tax Treatment on Data Needs

Treated as Property - Not Money

Legal tender in the US is defined by Federal statute
IRS Notice 2014-21

Capital Asset When Held for Investment

Gain or loss based on change in value

Bartering Treatment

Used as a method of payment, resulting in property for property exchange

Receiving assets as income

Unique economic activity permits receipt of assets as income or payment for services
Rev. Rul. 2019-24 (income from chain-split)
Rev. Rul. 2023-14 (income from staking)

Appraisal Requirement

Digital asset donations over $5k need an appraisal
CCA 202302012 (Donation requirements)

NFTs as Collectibles?

NFTs may be subject to sales tax as digital goods
Notice 2023-27 (NFT guidance, request for comment)

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What digital asset transactions *ARE* taxable?

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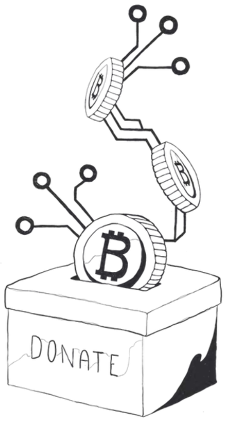
What digital asset transactions *AREN'T* taxable?

Not every crypto transaction is taxable.

The following activities aren't considered taxable events:

- Buying digital assets with fiat currency like USD
- Transferring units of a particular digital assets between wallets or accounts you control
- Gifting digital assets excluding large gifts that could trigger other tax obligations
- Donating digital assets which are tax deductible



IIJA Information Reporting Framework

Digital Asset Information Reporting Rules (coming soon)

Digital Asset Brokers

Yet to be defined clearly

Centralized exchanges vs. decentralized (DeFi)

Digital Assets Defined

Statutory definition of Digital Assets

IRS moving away from "virtual currency"

Form 1099-DA

Capture proceeds, cost basis, asset, units

Possible include address / wallet info in certain scenarios

Form 8300-DA

Receipt by trade or business of digital assets exceeding $10,000

Reporting requirement

Transfer Statements

Transfers from broker to a non-broker require a transfer statement to be filed with the IRS

Novel reporting requirement

Putting the Pieces Together

Data points on multiple returns that need to be correlated

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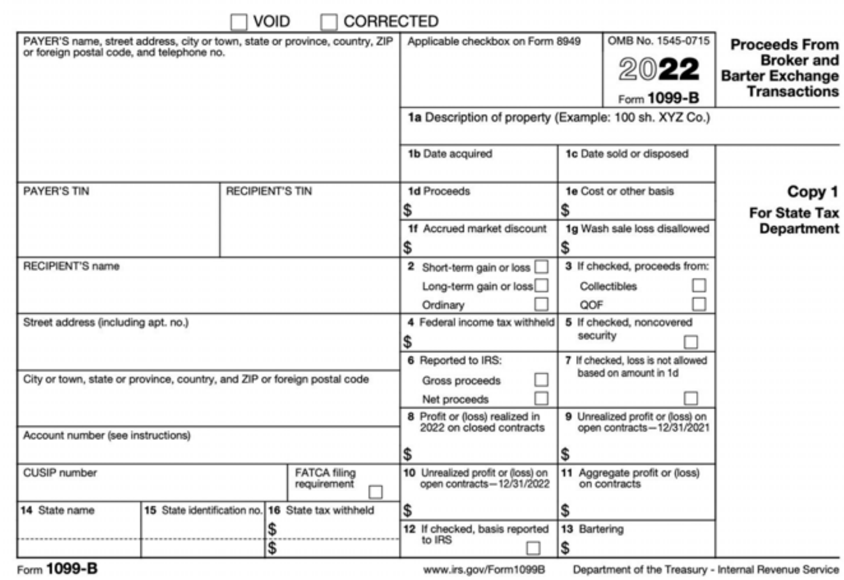
Implementing IIJA – Proposed Treasury Regulations

Information Reporting – Updates to 1099 Reporting

- Defines Digital Asset – cryptocurrencies, tokenized assets, stablecoins, and NFTs
- Defines Broker – Centralized Exchanges, Digital Asset Payment Processors, certain Wallet Providers and certain DeFi Protocols
- New Form - 1099-DA (similar to 1099-B)
- Phased Effective Dates –
  - 1/1/2025 – Proceeds tracking & reporting
  - 1/1/2026 – Cost Basis tracking & reporting



VOID CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

Applicable checkbox on Form 8949

OMB No. 1545-0715

2022

Form 1099-B

Proceeds From Broker and Barter Exchange Transactions

1a Description of property (Example: 100 sh. XYZ Co.)

1b Date acquired

1c Date sold or disposed

PAYER'S TIN

RECIPIENT'S TIN

1d Proceeds $

1e Cost or other basis $

Copy 1

For State Tax Department

1f Accrued market discount $

1g Wash sale loss disallowed $

RECIPIENT'S name

2 Short-term gain or loss / Long-term gain or loss / Ordinary

3 If checked, proceeds from: Collectibles / QOF

Street address (including apt. no.)

4 Federal income tax withheld $

5 If checked, noncovered security

6 Reported to IRS: Gross proceeds / Net proceeds

7 If checked, loss is not allowed based on amount in 1d

City or town, state or province, country, and ZIP or foreign postal code

Account number (see instructions)

8 Profit or (loss) realized in 2022 on closed contracts $

9 Unrealized profit or (loss) on open contracts—12/31/2021 $

CUSIP number

FATCA filing requirement

10 Unrealized profit or (loss) on open contracts—12/31/2022 $

11 Aggregate profit or (loss) on contracts $

14 State name

15 State identification no.

16 State tax withheld $ $

12 If checked, basis reported to IRS

13 Bartering $

Form 1099-B www.irs.gov/Form1099B Department of the Treasury - Internal Revenue Service

State Income Tax Guidance

- **New Jersey**
  - New Jersey's Division of Taxation issued a technical advice memorandum in March 2022 indicating it would conform to the primary Internal Revenue Service guidance applicable to Bitcoin and other cryptocurrencies, including IRS Notice 2014-21, Rev. Rul. 2019-24, and IRS Chief Counsel Memorandum 202114020.
  - Those guidance statements generally view virtual currencies as property and require taxpayers to determine the fair market value of convertible virtual currency in US dollars as of the date of payment or receipt for tax calculation purposes.
- **Michigan**
  - Michigan's Department of Treasury issued informal guidance in August 2022 stating a taxpayer's AGI as reported on its federal income tax return is the starting point of the Michigan income tax return and the calculation of state income tax. While Michigan permits certain deductions and other adjustments to federal AGI, currently, Michigan does not have any rules or policies with respect to digital currency transactions that differ from the federal policies regarding such transactions.

State Income Tax Guidance

- **New York**
  - The New York State Department of Taxation and Finance clarified in its recently proposed regulations on apportionment that cryptocurrency and similar digitally delivered assets fall within the definition of digital products. Transactions involving a "digital product" must be sourced to the state the same as other products delivered via wire, cable, fiber-optic, laser, microwave, radio wave, satellite or similar media.

- **Arizona**
  - The value of cryptocurrency and non-fungible tokens that are sent for free to digital wallets won't be subject to Arizona income tax based on H.B. 2204 signed into law in July 2022. The changes take aim at "airdrops," a promotional tool to distribute tokens to customers at no cost.
  - Airdropped assets are treated like stocks by considering them as gifts. Taxes would still apply to gains made by selling them.
  - The new law also allows taxpayers to subtract transaction fees, known as "gas fees," on gains or losses from cryptocurrency sales.
  - The law takes effect Jan. 1, 2023.

State Income Tax Guidance

- **Illinois**
  - Illinois' Department of Revenue recently issued a general information letter in 2022 addressing how bitcoin is characterized for purposes of applying the state's apportionment rules and regulations
  - Under the regulations, intangible personal property includes "only an item that can ordinarily be resold or otherwise reconveyed by the person acquiring the item from the taxpayer." This includes items such as tickets, software, membership interests, and "tokens" similar to bitcoin.
  - In contrast, "patents, copyrights, trademarks, and other similar items" are more limited to items registered under the U.S. code as a patent, copyright, or trademark, or recognized under U.S. law or another country's law as such.
  - The Department confirmed that bitcoin is considered intangible personal property, but it is not included under the more limited definition of patents, trademarks, copyrights, or other similar items.
  - See IT-21-0004.

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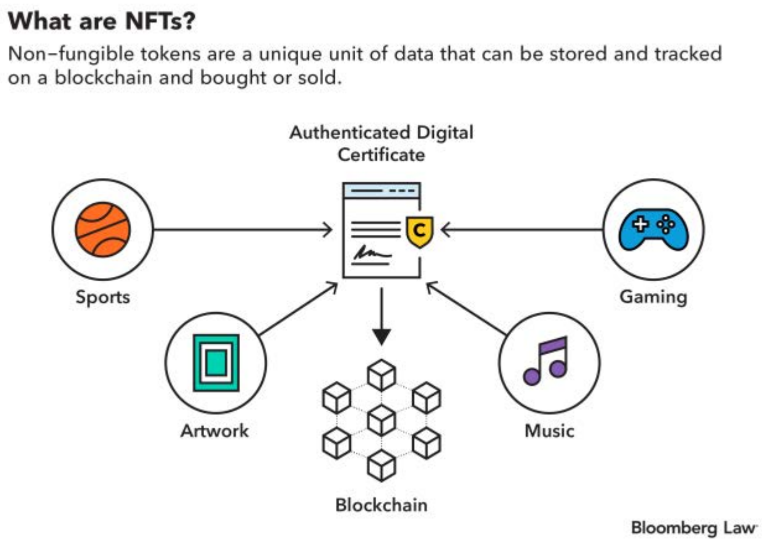
— **NFTs present numerous indirect tax issues:**

- Classification of NFTs – what property and rights are associated with the NFT?
- Bundling of items with NFTs – are there multiple products or rights included?
- NFT tax base – what fees are included?
- Sourcing of NFTs – how do you source when blockchain transactions are often pseudonymous?
- NFT marketplace responsibilities – are they marketplace facilitators?
- NFT royalties – are they subject to gross receipts taxes?



State Guidance on NFTs

— Puerto Rico has issued a regulation providing that NFTs may be considered a specified digital product: a code that gives a buyer the right to obtain a digital product will be treated the same way as the specified digital product

— Pennsylvania issued sales tax guidance in May 2022 that NFTs are a digital representation of TPP

— In July 2022, Washington State issued an interim statement on the tax issues associated with NFTs, explaining that NFTs are taxed based on the character of the underlying products included in the sale. The statement also provided guidance on issues such as the tax base, sourcing, bundling, and marketplace transactions

— In August 2022, Minnesota updated a Digital Goods fact sheet to provide that NFTs are taxable when the underlying product is taxable

— In October 2022, Wisconsin state that the sale of an NFT may be taxable if the underlying product, good, or service is taxable in Wisconsin

State Sales Tax Guidance on NFTs

- The Pennsylvania Department of Revenue (DOR) published guidance in June 2023 to provide more details on the taxability of NFTs. It provides that the taxability of the sale of an NFT depends on the taxability of the underlying product. The guidance also notes that while NFTs technically became taxable as digital products from August 1, 2016, the DOR is not planning any retroactive enforcement with regard to taxes owed on NFT sales that occurred prior to the issuance of the May 2022 guidance

- In July 2023, the Michigan Department of Treasury updated a **R**evenue **Administrative B**ulletin to address the taxability of digital goods. The guidance provides that to the extent that a digital good does not fall within the definition of "prewritten computer software," it is not subject to tax. An example of a digital good includes digital code on a blockchain, commonly referred to as a non-fungible token

State Guidance on NFTs

Could NFTs be taxable in SSUTA states as a "digital code"?

- The Streamlined Sales and Use Tax Agreement (SSUTA) contains a definition for a "digital code" as well as a tax treatment rule
  - A "digital code" means a code, which provides a purchaser with a right to obtain one or more such products having the same tax treatment
  - A "digital code" may be obtained by any means, including email or by tangible means regardless of its designation as "song code," "video code," or "book code"
  - The tax treatment of a digital code shall be the same as the tax treatment of a the "specified digital product" or product "transferred electronically" to which the "digital code" relates
- A Streamlined Sales Tax Governing Board representative recently discussed whether SSUTA member states have additional flexibility to tax NFTs
  - Another option: an NFT could be considered a product "transferred electronically"
  - SSUTA does not limit states from taxing products outside the definition of "specified digital product"

Questions?

Thank You

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