



Taxation of digital assets:
Bringing clarity to complexity

Identifying opportunities and avoiding surprises: Tax reporting and SALT considerations for digital assets

June 29, 2022 | 1:15-2:15 p.m. Eastern

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Infrastructure Investment and Jobs Act expansion of Digital Asset Reporting

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State sales tax and income tax treatment of crypto and NFTs

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Two scenarios: Walk through a crypto mining scenario and an NFT scenario



Digital asset reporting

- Infrastructure Investment and Jobs Act expands broker/cost basis reporting to cover digital assets
 - Definitions
 - Digital asset: Any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology
 - Broker includes “any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person”
 - Covered security includes digital assets acquired on or after Jan. 1, 2023
 - Section 6045A transfer reporting
 - Applies to digital assets acquired on or after Jan. 1, 2023
 - Expands digital asset transfer reporting to transfers from a broker to a nonbroker
 - Effective for returns required to be filed or furnished after Dec. 31, 2023

Section 6050I: Receipt of \$10,000 cash

- Unless an exception applies, any person who receives more than \$10,000 in cash in the course of their trade or business must report the payment
 - Related transactions aggregated
 - Same payor (or agent of payor) within 24-hour period
 - Recipient knows or has reason to know it's a series of transactions even if not within a 24-hour period
 - Report on Form 8300 within 15 days of receipt
 - Information shared with Financial Crimes Enforcement Network (FinCEN)
- Infrastructure Investment and Jobs Act adds reporting for digital assets meeting the \$10,000 threshold for returns required to be filed and statements required to be furnished after Dec. 31, 2023

Lummis-Gillibrand Responsible Financial Innovation Act

- Changes the definition of digital asset (Sec. 101):
 - A ***natively electronic asset*** that (1) ***confers economic, proprietary, or access rights or powers*** and (2) is recorded using cryptographically secured distributed ledger technology, or any similar analogue [current Section 6045 definition is “any digital representation of value”]
 - Definition of ***digital asset*** includes virtual currency and ancillary assets, payment stablecoins, and other securities and commodities that otherwise meet the definition

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- **Ancillary asset** means an intangible, fungible asset that is offered, sold, or otherwise provided to a person in connection with the purchase or sale of a security through an investment contract, but excludes an asset that provides the holder with certain rights in the business entity, such as debt, equity, or liquidation rights
- **Virtual currency** means a digital asset that:
 - Is used primarily as a medium of exchange, unit of account, store of value, or combination of such functions;
 - Is not legal tender;
 - Does not derive value from or is backed by an underlying financial asset (except other digital assets); and
- Includes a digital asset that is accompanied by a statement from the issuer that a denominated or pegged value will be maintained and available on redemption from the issuer or other identified person based solely on a smart contract

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- ***Payment stablecoin*** is:

- Redeemable, on demand, on a one-to-one basis for instruments denominated in U.S. dollars and defined as legal tender or for instruments defined as legal tender under foreign law (excluding digital assets defined as legal tender under foreign law);
- Issued by a business entity;
- Accompanied by an issuer statement that the asset is redeemable from the issuer or another identified person;
- Backed by 1 or more financial assets other than digital assets; and
- Intended to be used as a medium of exchange

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- Changes the definition of broker (Sec. 202):
 - “any person who (for consideration) stands ready in the **ordinary course of a trade or business** to effect **sales** of digital assets at the **direction of their customers**” [current Section 6045 has no trade or business language and refers to transfers “on behalf of another person”]
- Delays reporting to digital assets acquired on or after Jan. 1, 2025
- Limits section 6045A reporting for transfers to nonbrokers:
 - Only if the digital asset is transferred from an account “wholly controlled and maintained” by the broker
 - Reporting limited to information voluntarily provided by customer and held by the broker for a legitimate business purpose

What about Form 1099-MISCs and 1099-Ks?

- Generally, Form 1099-MISC is required to be issued if during the calendar year a payor in the course of their trade or business made payments of more than \$600 of income
- Generally, a Form 1099-K is required to be issued by a third-party settlement organization (TPSO) that settles transactions between the provider of goods and services and their customers and guarantees payment to the provider if TPSO pays more than \$600 to a provider during a calendar beginning after 2021

State and local tax considerations for digital assets

SALT considerations – Where are you on the distribution chain?

- Where are you on the crypto distribution chain?
- Are you involved in mining crypto? Are you involved in creating NFTs?
- Are you buying or selling crypto to purchase products or services?
- Does your company accept crypto as payment for goods and services?

Current sales tax and state income tax treatment

- Information reporting required by the IRS (e.g., 1099, 1099-K, 1040, and 8300) and potential sharing or exchange of information between the IRS and the state tax authorities?
- Barter transaction treatment of sales and purchases of digital assets
- Treatment of sales of NFTs as "digital assets"
- Income tax apportionment considerations in states that have special rules for "digital assets" (e.g., New York and Texas)
- New Jersey TAM 2015-1 (R) issued on March 21, 2022, on virtual currency

Planning for SALT

- Planning options to seek potential refunds or rulings on creation of NFTs or processing and mining crypto
- Very limited state guidance may create both opportunities and risk

Other key SALT considerations

- Planning to clearly define NFTs, crypto or blockchain products as nontaxable where feasible
 - Can the terms be drafted to avoid treatment as a digital good or to avoid treatment as software?
- States that tax data processing and computer services
- Planning to best manage the uncertainty of destination for sales and state income tax purposes
- Burden of proof where customer is not willing to disclose their location
- Set-up process to minimize risk related to income tax apportionment in states that have a sales factor throwback rule or throw out rule, and default hierarchy rules for assigning sales other than tangible personal property
- Default hierarchy rules for sales tax sourcing

Impact on gross receipts type taxes

Some states and cities have gross receipts type taxes:

- Ohio Commercial Activity Tax
- Washington State Business and Occupation Tax
- Oregon Corporate Activity Tax
- Nevada Commerce Tax
- Texas Franchise Tax
- City of Philadelphia Business Income and Receipts Tax

Ohio, Oregon, Texas, Washington, and Philadelphia impose these taxes once the sales volume threshold is met, regardless of whether a business has a location or employees working in these jurisdictions.

Impact on gross receipts type taxes

Challenges facing both the tax authority and seller for gross receipts type taxes:

- Developing a methodology to measure sales activity when customer information might be difficult to obtain or unavailable
- Fairly imputing the tax for both businesses with a location(s) in the jurisdiction and those without a location

SALT case study 1 – mining

Consider a situation where Company Z is planning to mine crypto.

- Company Z is constructing a modular data center mining site in Texas including foundations, enclosed building and computer server racks. The computer servers will require cooling systems, switches and generators. The primary expense will be the purchase of electricity.
- Company Z will pay for the electricity with the mined crypto.
- A supplier will sell equipment and services to a contractor, and then contractor will sell these items to Company Z.
- Maintenance and operation services will also be purchased by Company Z.

SALT case study 1 – mining

Potential Texas planning opportunities:

- Texas data center exemption
- Manufacturing and processing exemption
- Resale exemption
- Construction labor
- Local rates

What would the considerations be in New York?

SALT case study 2 – non-fungible tokens

- Company A plans to sell NFTs representing artwork and songs using an online exchange.
- There is an agreement between the creator(s) of the NFTs and Company A conveying the right to license or sell the token to Company A.
- As part of the agreement, Company A agrees to pay the creator(s) 10% of the revenue it generates from the sale or license of the NFT.
- Customers of Company A have the option to purchase the NFTs by credit card or Bitcoin.

SALT case study 2 – non-fungible tokens

- Acquiring an NFT is generally owning a token which is a digital representation of an item
- Depending on the terms of the NFT sales contract, the owner of an NFT may have the right to trade (i.e., sell, license, or exchange), display, or hold the digital representation
- What are the potential state income and/or sales tax implications of these types of transactions?
- Would states apply their current sales tax and income tax law to NFTs or enact specific new rules governing the taxability of NFTs?
- If subject to tax, how would you source these types of transactions for income and sales and use tax purposes?

SALT case study 2 – non-fungible tokens

- What are the state tax challenges or opportunities that a seller should consider?
- What guidance, if any, currently exists?
- How might this change in the future?



Thank you

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