Contact Us:

Kramer & Jensen LLC
7430 E. Caley Ave. Suite 300E
Centennial, CO 80111
T 303-741-2253
F 855-330-4215
sjensen@kramerjensen.com

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Fall Tax Planning May Be Wise

Taxes are like vehicles in that they sometimes need a periodic check-up to make sure they are performing as expected, and if ignored, can cost you money. That is true of taxes as well, especially for 2021, as the pandemic benefits begin to wane and President Biden's tax proposals loom.

The following is a list of potential tax strategies that you might benefit from. Every taxpayer's situation is unique, and not all the tax strategies suggested here will apply to you. However, opportunities for tax planning are available for all income levels and a variety of tax circumstances, some of which may apply to your situation. But waiting too late in the year may not give you the time needed to take advantage of some of these strategies.

Maximize Education Tax Credits - If you qualify for either the American Opportunity Tax Credit (AOTC) or Lifetime Learning Credit (LLC), check to see how much you have already paid for qualified tuition and related expenses during the year. If it is not the maximum allowed for computing the credits, you can prepay 2022 tuition if it is for an academic period beginning in the first three months of 2022 and use the expense for the 2021 credit.

Employer Health Flexible Spending Accounts - If you contributed too little to cover expenses this year, you may wish to increase the amount you set aside for next year. As a reminder, amounts paid after 2019 for over-the-counter medicine (whether or not prescribed) and menstrual care products are considered medical care and are considered a covered expense. The maximum contribution for 2021 is $2,750.

Maximize Health Savings Account Contributions - If you become eligible to make health savings account (HSA) contributions late this year, you can make a full year's worth of deductible HSA contributions, even if you were not eligible to make HSA contributions for the entire year. This opportunity applies even if you first become eligible in December. In brief, if you qualify for an HSA, contributions to the account are deductible, or nontaxable if made by your employer (within IRS-prescribed limits); earnings on the account are tax-deferred; and distributions are tax-free if made for qualifying medical expenses. Amounts paid after 2019 for over-the-counter medicine (whether or not prescribed) and menstrual care products are considered medical care and are considered a covered expense. However, only medical expenses you incur after you establish an HSA are eligible for tax-free distribution. It is possible for an HSA to become a supplemental retirement plan if the funds are left to accumulate.

Convert Traditional IRAs to Roth IRAs - If your income is unusually low this year or even negative, you may wish to consider converting your traditional IRA to the more favorable Roth IRA which provides tax free accumulation, and the distributions are tax-free at retirement. The lower income results in a lower tax rate, which provides you an opportunity to convert to a Roth IRA at a lower tax amount.

Don't Forget Your 2021 Minimum Required Distributions - If you are age 72 or older, you must take required minimum distributions (RMDs) from your IRA, 401(k) plan, and other employer-sponsored retirement plans (but if you are still working, distributions from your current employer's plan can be postponed in some circumstances). Failure to take a required withdrawal can result in a 50% penalty of the amount of the RMD not withdrawn. If you turned age 72 in 2021, you could delay the first required distribution to the first quarter of 2022, but if you do, you will have to take a double distribution in 2022, the one for 2021 and the 2022 RMD. One needs to carefully consider the tax impact of a double distribution in 2022 versus a distribution in both this year and next.

Bunching Deductions - If your tax deductions normally fall short of needing to itemize and the standard deduction you are allowed is greater, or even if you can itemize but only marginally, you may benefit from adopting the "bunching" strategy. To be more proactive, you can time the payments of tax-deductible items to maximize your itemized deductions in one year and take the standard deduction in the next.

Take Advantage of the Zero Capital Gains Rate - There is a zero long-term capital gains rate for those taxpayers whose taxable income is below the 15% capital gains tax threshold. This may allow you to sell some appreciated securities that you have owned for more than a year and pay no or very little tax on the gain.

Defer Deductions – When you itemize your deductions, you may claim only the deductions you paid during the tax year (the calendar year for most folks). If your projected taxable income is going to be negative and you are planning on itemizing your deductions, you might consider putting off some of those year-end deductible payments until after the first of the year and preserving the deductions for next year. Such payments might include house of worship tithing, year-end charitable giving, tax payments (but not those incurring late payment penalties), estimated state income tax payments, medical expenses, etc.

Increase IRA Distributions – Depending upon your projected taxable income, you might consider taking an IRA distribution to add income for the year. For instance, if the projected taxable income is negative, you can take a withdrawal of up to the negative amount without incurring any income tax. Even if projected taxable income is not negative and your normal taxable income would put you in the 24% or higher bracket, you might want to take out just enough to be taxed at the 10% or even the 12% tax rates. Of course, those are retirement dollars; consider moving them into a regular financial account set aside for your retirement. Also be aware that distributions before age 59½ are subject to a 10% early withdrawal penalty.

Defer Capital Gains by Investing in an Opportunity Zone Fund - A unique tax benefit is the ability to defer any capital gain into a qualified opportunity fund (QOF). QOFs are funds that invest in areas in need of development. If you have a capital gain from selling property to an unrelated party, you may elect to defer that gain by investing it into a QOF within 180 days of the sale or exchange. The gain won't be recognized (i.e., you won't be taxed on the gain) until your return for the earlier of the year of sale of the QOF or 2026. You can get up to 10% of the deferred gain forgiven entirely by holding the investment for the required time period, and you will pay no tax on any additional gain if the investment is held for 10 years.

Sell Loser Stocks – Although the stock market has been performing well recently you still may have stocks that have declined in value. If you sell them before the end of the year you can use any losses to offset other gains for the year or produce a deductible loss. The net capital loss deductible on a tax return is limited to $3,000 ($1,500 if filing married separate) for the year, but any excess loss carries over to future years. You can repurchase stock in the same company for which you sold shares at a loss after 30 days have passed and avoid the wash sale rules.

Take Steps to Avoid Underpayment Penalties - If you are going to owe taxes for 2021, you can take steps before year-end to avoid or minimize the underpayment penalty. The penalty is applied quarterly, so making a fourth quarter estimated payment only reduces the fourth-quarter penalty. However, withholding is treated as paid ratably throughout the year, so increasing withholding at the end of the year can reduce the penalties for the earlier quarters. This can be accomplished with cooperative employers or by taking a non-qualified distribution from a pension plan, which will be subject to a 20% withholding, and then returning the gross amount of the distribution to the plan within the 60-day statutory rollover limit. Please consult this office to determine if you will be subject to underpayment penalties (there are exceptions) and, if so, the best strategy to avoid or minimize them.

Prepay State and Local Taxes - You probably know that if you are not subject to the alternative minimum tax and you itemize your deductions, you are eligible to deduct both your property taxes and your state income tax. But did you know that you can increase the amount that you deduct on your 2021 tax return by prepaying some taxes? You can ask your employer to boost your state withholding by a reasonable amount or, if you are self-employed, pay your 4th-quarter state estimate due in January in December and increase your deduction. The same is true for your real estate taxes: if you pay your first 2022 installment in 2021, you can take it as part of your 2021 deduction.

But be careful, the state and local tax deduction for any year is limited to a maximum of $10,000, so any amount more than $10,000 would be wasted as a tax deduction.

Don’t Waste the 2021 Annual Gift Tax Exemption – Part of President Biden’s tax plan is to reduce the lifetime gift and estate tax exemption. Whether for that reason or you simply want to limit your estate’s exposure to inheritance taxes, you can give $15,000 each to an unlimited number of individuals in 2021, but you can't carry over unused exclusions from one year to the next. Taxpayers and their spouses can use their gift tax exemptions together to give up to $30,000 per beneficiary. For example, if you are married, have four children and four grandchildren, you can remove $240,000 from your estate tax-free this year. The transfers also may save family income taxes when income-earning property is given to family members who are in the lower income tax brackets and are not subject to the kiddie tax.

Not Needing to File May Be an Opportunity - If your income and tax situation is such that you do not need to file for 2021, don’t overlook the opportunity to bring in some additional income, to the extent it will be tax-free. For instance, if you have appreciated stock that you can sell without incurring any tax, consider selling it, or perhaps take a tax-free IRA distribution if you are 59½ or older or if younger and qualify for an exception to the “early withdrawal” penalty.

Utilize IRA-to-Charity Transfers – If you are age 70½ or over, you can request that your IRA trustee directly transfer funds from your IRA to a charity. Although not deductible as an itemized charitable deduction, the distribution is not taxable. If you are age 72 or over when the IRA to charity direct transfer is made, the distribution can count towards your required minimum distribution for the year. This also reduces your AGI, which in some circumstances can reduce the amount of taxable Social Security income. There is no minimum charitable distribution, but the maximum amount per individual is limited to $100,000 per year. There are some complications if you are age 72 or older, have earned income and make a contribution to the IRA. Check with our office for the details.

Maximize Tax-Deductible Medical Expenses - For example, if you have outstanding medical or dental bills, paying the balance before year-end may be beneficial, but only if you already meet the 7.5% of the AGI floor for deducting medical expenses, or if adding the payments would put you over the 7.5% threshold and you are itemizing your deductions. You can even use a credit card to pay the expenses, but you would only want to do so if the interest expenses you’d incur if you don’t pay off the card right away would be less than the tax savings.

Make Business Purchases - You can reduce taxable income if you make last-minute business purchases such as for office equipment, tools, machinery, and vehicles and write them off using the 100% bonus depreciation or Sec. 179 expensing, provided you place the item(s) into business service by the end of the year. However, you must consider the impact that expensing the items will have on your taxable income and the Sec. 199A 20% pass-through deduction. It may be appropriate to contact this office in advance of any last-minute business acquisition.

Divorced or Separated During the Year – A divorce or separation can have a significant impact on a couple’s tax filings. Filing joint or separate returns, who claims the children, the tax rules related to whether to take the standard deduction or itemize, how income and tax prepayments are allocated, and more are issues to be considered. Best to figure that all out in advance.

Disaster Loss Planning – 2021 has had some significant declared disasters including

Hurricane Ida and the wildfires in the West. Any losses incurred because of a federally declared disaster can be claimed on the current year's tax return or, at the election of the taxpayer, on the prior year's return (2020 for 2021 disasters), generally providing quicker access to a tax refund. However, care must be exercised to ensure a disaster loss is claimed on the return of the year that will provide the greatest benefit. In addition, after insurance reimbursement is accounted for, the result may not be as expected and should be determined before making the decision of which year to claim a loss.

Increased Charitable Giving Opportunities – 2021 is the final year that the normal 60% of AGI limit on cash contributions has been increased to 100%, giving those with the means and the desire to increase their normal charitable contributions and deduct them as an itemized deduction. The normal 5-year carryover applies to any excess over 100% of AGI.
Those who don't itemize (currently about 90% of income tax return filers), are allowed to claim a deduction of up to $300 ($600 on a joint return) for cash charitable contributions made in 2021. Normally, only itemizers can deduct their charitable contributions.

Take Advantage of Energy Credits – Two of the major green credits are the solar tax credit and the electric vehicle credit. The solar credit for 2021 is 26% of the cost of the installed solar system but the system must be complete and functional before year's end to claim the credit in 2021. The credit is not refundable, and any excess has a limited carryover. The credit for electric vehicles must be determined from the IRS website since credit begins to phase out once 200,000 of the vehicle type by manufacturer has been sold.
If you have obtained your medical insurance through a government marketplace, employing some of the strategies mentioned could impact the amount of your allowable premium tax credit.

Residents of states that have an income tax will also need to consider the impact of some of these strategies on their state return.

If you would like to discuss how these strategies and others not included in this article might provide you tax benefits based upon your tax circumstances, or would like to schedule a tax planning appointment, please give the office a call.

Required Minimum Distributions Have Resumed for 2021

When Congress established tax-favored retirement plans, they allowed taxpayers to take a tax deduction for the amount of their allowable contribution to the plans. But they also included a requirement for a portion of the funds to be distributed each year and be subject to income tax. Such a distribution is referred to as a required minimum distribution (RMD).

RMDs are commonly associated with traditional IRAs, but they also apply to 401(k)s, SEP IRAs and other qualified retirement plans. The tax code does not allow taxpayers to keep funds in their qualified retirement plans indefinitely. Eventually, assets must be distributed, and taxes must be paid on those distributions. If a retirement plan owner takes no distributions, or if the distributions are not large enough, he or she may have to pay a 50% penalty on the amount that is not distributed.

There is no maximum limit on distributions from a Traditional IRA, and as much can be withdrawn as the owner wishes. However, if more than the required distribution is taken in a particular year, the excess cannot be applied toward the minimum required amounts for future years.

There have been some recent tax law changes that have led to some confusion among taxpayers subject to the RMD requirement. Prior to 2020, the required starting age for RMDs was 70½. Thanks to the Secure Act passed by Congress in late December 2019, the age at which distributions have to begin was increased to age 72 starting in 2020.

However, as part of the 2020 COVID relief, Congress suspended the RMD requirement. Thus those turning 72 in 2020, and those who turned 70½ in prior years, were not subject to the RMD requirement for 2020.

RMDs Resume in 2021 - Since the suspension was for one year only, the RMD requirement resumes for 2021. Of course, the resumption applies to those that attained the age of 70½ in years before 2021, those who turned 72 in 2020 and those who turn 72 in 2021.

Still Working Exception – If you participate in a qualified employer plan, generally you need to start taking RMDs by April 1 of the year following the year you turn 72. This is your required beginning date (RBD) for retirement distributions. However, if your plan includes the "still working exception," your RMD is postponed to April 1 of the year following the year you retire. This delayed-until-retirement distribution provision does NOT apply to IRAs, so even though someone age 72 or older with an IRA is still working, and perhaps still contributing to the IRA, they are required to take a minimum distribution from the IRA each year.

First Year IRA RMD Exception – If a taxpayer so chooses, he or she can delay an RMD for the first year an RMD is required until the second year, thus making the distribution includible in the second year's tax return. This is sometimes desirable if the taxpayer has substantial wages or other income in the year the mandatory distribution age is reached and expects less income the next year. In this situation, by delaying the distribution to the second year the tax bracket could be substantially lower. If the taxpayer chooses that option, then:

- The first year RMD must be taken by April 1 of the following year, and
- The taxpayer must also take the second year RMD distribution by December 31 of year two, thus doubling up the distributions in year two.

Determining the RMD Amount - The required withdrawal amount for a given year is equal to the value of the retirement account on December 31 of the prior year divided by the life expectancy ("distribution period") from the Uniform Lifetime Table illustrated below, with the exception where the taxpayer's spouse is 10 years younger, in which case the Joint and Last Survivor Table is used. It is not illustrated because of its size.

UNIFORM LIFETIME TABLE – THROUGH 2021

Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period	Age	Distribution Period
70	27.4	80	18.7	90	11.4	100	6.3	110	3.1
71	26.5	81	17.9	91	10.8	101	5.9	111	2.9
72	25.6	82	17.1	92	10.2	102	5.5	112	2.6
73	24.7	83	16.3	93	9.6	103	5.2	113	2.4
74	23.8	84	15.5	94	9.1	104	4.9	114	2.1
75	22.9	85	14.8	95	8.6	105	4.5	115+	1.9
76	22.0	86	14.1	96	8.1	106	4.2		
77	21.2	87	13.4	97	7.6	107	3.9		
78	20.3	88	12.7	98	7.1	108	3.7		
79	19.5	89	12.0	99	6.7	109	3.4		

Note: the above table is only valid through 2021. The IRS has released a new table which must be used for the RMD computations beginning for 2022 and subsequent tax years.

- ***Example:*** *An IRA account owner is age 75 in 2021, and the value of his only IRA account was $120,000 on December 31, 2020. His 73-year-old wife is the sole beneficiary of the IRA. From the uniform lifetime table, we determine the owner's distribution period to be 22.9. Thus, his RMD for 2021 is $5,240 ($120,000/22.9). That amount must be withdrawn by no later than December 31 of 2021. If the same set of facts were to occur for a different taxpayer in 2022, using the new table (not illustrated), the distribution period will be 24.6 and the RMD $4,878 ($120,000/24.6). The new table was designed to take into account individuals' longer life expectancies based on actuarial statistics developed since the last time the tables were updated. Thus, the comparable RMD is less than under the current table, and at least in theory, the IRA won't be depleted as quickly.*

The RMD for the year can be taken from any one or several of the taxpayer's IRA accounts, but the minimum distribution amount must be figured separately for each account, and then totaled to determine the RMD for the year.

Caution: Some individuals roll over their distribution in the mistaken belief they can circumvent the RMD requirement. This is not true – remember, the purpose of the RMD is to force taxable distributions.

If the taxpayer dies prior to taking the entire RMD for the year of death, the IRA beneficiaries are responsible for figuring the owner's required minimum distribution in the year of death and distributing it to the named beneficiaries. If there are no beneficiaries, the distribution goes to the decedent's estate.

Excess Accumulation Penalty – The tax law includes a penalty referred to as an excess accumulation penalty. This draconian penalty is 50% of the RMD that should have been distributed for the year and wasn't. In the preceding example, if the taxpayer does not withdraw the $5,240 for 2021, he would be subject to a 50% penalty (additional tax) of $2,620 ($5,240 x 50%).

Under certain circumstances, the IRS may waive the penalty if the taxpayer demonstrates reasonable cause and makes the withdrawal soon after discovering the shortfall in the distribution. But don't count on it. Additionally, the hassle and extra paperwork involved in asking the IRS to waive the penalty makes avoiding it highly desirable; to do so, always take the correct distribution in a timely manner. Some states also penalize under-distributions.

Even though a qualified plan owner whose total income is less than the return filing threshold is not required to file a tax return, he or she is still subject to the RMD rules and can thus be liable for the under-distribution penalty even if no income tax would have been due on the under-distribution.

Qualified Charitable Distribution – A taxpayer is allowed to transfer funds from their IRA to a qualified charity and the distribution is non-taxable. To constitute a qualified charitable distribution (QCD), the distribution must be made:

1. Directly by the IRA trustee to a qualified charitable organization other than a private foundation or a donor-advised fund, and
2. On or after the date the IRA owner attains age 70½. A distribution from an IRA made to a charitable organization in the year that the IRA owner turns 70½ but prior to the date the individual reaches age 70½ is not a qualified charitable distribution.

For those 72 and older a QCD will also count towards the annual RMD requirement. However, after 2019 the restriction on making traditional IRA deductions after age 70½ was repealed and Congress added a complication to QCDs. That provision requires the non-taxable portion of a QCD to be reduced by any deductible IRA contribution made after reaching age 70½.

- ***Example*** *– Bob makes a traditional IRA contribution of $7,000 when he is age 71 and another $7,000 contribution at the age of 72 and deducts the IRA contributions on his returns. Then later when he is 74, he makes a QCD in the amount $20,000 to his church's building fund. Since Bob had made the deductible IRA contributions after age 70½, his QCD must be reduced by the $14,000. As a result, of the $20,000 QCD, $14,000 is a taxable distribution and only $6,000 is nontaxable. However, because the $14,000 was taxable Bob can claim a $14,000 charitable contribution if he itemizes his deductions. In addition, the entire $20,000 will count towards his RMD for the year.*

Designated Beneficiaries - Keeping your designated IRA beneficiary or beneficiaries current is very important. You may not want your account going to your ex-spouse, and you certainly do not want a deceased individual to be your beneficiary.

In many cases, advance planning can minimize or even avoid taxes on Traditional IRA distributions. Often, situations will arise in which a taxpayer's income is abnormally low due to losses, extraordinary deductions, etc., where taking more than the minimum in a year might be beneficial. This is true even for those who may not need to file a tax return but can increase their distributions and still avoid any tax. If you need help with planning, please call this office for assistance.

Understanding the Taxation of Cryptocurrency Transactions

If you have purchased, owned, sold, gifted, made purchases with, or used cryptocurrency in business transactions, there are certain tax issues you need to know about. Unfortunately, there are some unanswered questions and little specific guidance offered by the IRS other than in [Notice 2014-21] and [Revenue Ruling 2019-24]. This article includes the guidance from the Notice as well as general tax principles that apply.

One of the big issues of cryptocurrency is how it is treated for tax purposes. The IRS says that it is property, so that every time it is traded, sold, or used as money in a transaction, it is treated much the same way as a stock transaction would be, meaning the gain or loss over the amount of its original purchase cost must be determined and reported on the owner's income tax return. That treatment applies for **each** transaction every time cryptocurrency is sold or used as money in a transaction, resulting in a major bookkeeping task for those that use cryptocurrency frequently.

- ***Example A:*** *Taxpayer buys Bitcoin (BTC) so he can make online purchases without the need for a credit card. He buys a partial BTC for $2,425 and later uses it to buy goods worth $2,500 (let's say the partial BTC was trading at $2,500 at the time he purchased the goods). He has a $75 ($2,500 – $2,425) reportable capital gain. This is the same result that would have occurred if he had sold the BTC at the time of the purchase and used cash to purchase the goods. This example points to the complicated record-keeping requirement for tracking BTC's basis. Since this transaction was personal in nature, no loss would be allowed if the value of BTC had been less than $2,425 at the time the goods were purchased. Of course, if the taxpayer in this example only sold a fraction of his Bitcoin – say enough to cover a $500 purchase – the gain would only be $15: $500/$2500 = .2 x 2425 = 485; 500 – 485 = 15.*

On the bright side, for most individuals, cryptocurrency is generally treated as a capital asset, so any gain is a capital gain, and if the asset is held for more than a year, any gain will be taxed at the more favorable long-term capital gains rates. If the cryptocurrency is being held as an investment and the sale results in a loss, then the loss may be deductible. Capital losses first offset capital gains during the year, and if a loss remains, taxpayers are allowed a $3,000-per-year loss deduction against other income, with a carryover to the succeeding year(s) if the net loss exceeds $3,000.

If you don't understand how cryptocurrencies function here is a brief explanation.

- **Who Keeps Track of Cryptocurrency Ownership and Transactions?** – Blockchain is a system of recording information in a way that makes it difficult or impossible to change, hack, or cheat the system and provides seamless peer-to-peer transactions around the world. A blockchain is essentially a digital ledger of transactions that is duplicated and distributed across the entire network of computer systems on the blockchain. Those who maintain these digital ledgers are referred to as miners.

- **How Many Cryptocurrencies Are There?** - There are currently over 10,000 different cryptocurrencies traded publicly. The total value of all cryptocurrencies in mid-July 2021, was approximately $1.4 trillion. This was down from an April 2021 high of $2.2 trillion. This is evidence of the volatility of cryptocurrency.

- **What Is Cryptocurrency Mining?** - Mining is the process by which new blocks of cryptocurrency are inserted into circulation and the way that new transactions are confirmed by the network. Mining is a critical component of the maintenance and development of the blockchain ledger and requires sophisticated hardware that solves extremely complex math problems. The computer that finds the solution to the problem is awarded the next block (files where data pertaining to the cryptocurrency network are permanently recorded) and the process begins again. Miners are rewarded for their efforts in cryptocurrency. For tax purposes the IRS in their guidance have determined that miners are operating a trade or business and the value of the cryptocurrency earned (determined in U.S. dollars at the time of the transaction) is included in the gross income of that business. The business' profit is treated the same as it is for any other business – taxed as ordinary income and subject to self-employment tax.

    - ***Example -*** *An individual mines one Bitcoin in 2020. On the day it was mined, the market price of a Bitcoin was $10,000. The miner has $10,000 of business income in 2020 subject to both income tax and self-employment tax. Going forward, the basis in that Bitcoin is $10,000. If the miner later sells it for $12,000, there is a taxable capital gain of $2,000 ($12,000 − $10,000).*

- **What Is a Cryptocurrency "Hard Fork"?** – You may have heard the term "hard fork" associated with cryptocurrency and wonder what it means. A hard fork occurs when there is a split in a cryptocurrency's blockchain. Bitcoin had a hard fork in its blockchain on August 1, 2017, dividing into two separate coins: Bitcoin and Bitcoin Cash. Each holder of a Bitcoin unit was entitled to one Bitcoin Cash unit. Similarly, Litecoin, the fifth-largest cryptocurrency, had a hard fork— Litecoin Cash—in February 2018. In October 2019 the IRS released cryptocurrency guidance (Revenue Ruling 2019-24) that explains that a taxpayer:

    - Does not have gross income from a hard fork of the taxpayer's cryptocurrency if the taxpayer does not receive units of a new cryptocurrency; and

    - Has ordinary income as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of the new cryptocurrency. (An airdrop is a distribution of cryptocurrency to multiple taxpayers' distributed ledger addresses.)

According to the IRS, taxpayers who received Bitcoin Cash as a result of the 8/1/2017 Bitcoin hard fork received ordinary income because the taxpayers had an "accession to wealth". Further, the date of receipt and fair market value to be included in income was dependent on when the taxpayer obtained dominion and control over the Bitcoin Cash.

- **Why Is Cryptocurrency Appealing to Some?** Cryptocurrencies appeal to their supporters for a variety of reasons.

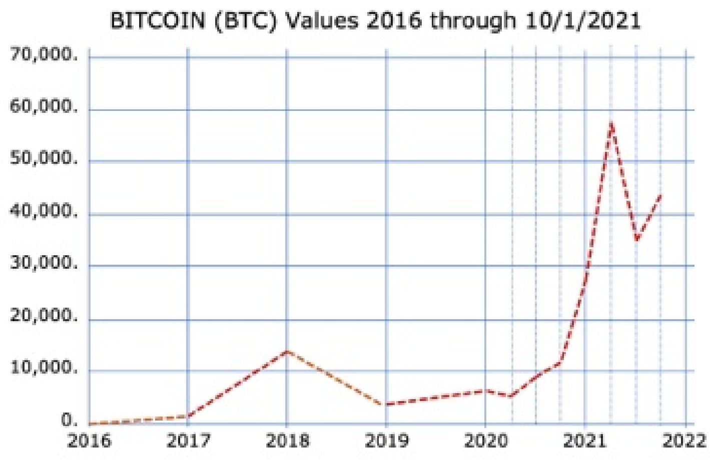
    - Supporters see cryptocurrencies such as Bitcoin as the currency of the future and are racing to buy them now, presumably before they become more valuable.

    - Some supporters like the fact that cryptocurrency removes central banks from managing the money supply, since over time these banks tend to reduce the value of money via inflation.

    - Other supporters like the technology behind cryptocurrencies, the blockchain, because it's a decentralized processing and recording system and can be more secure than traditional payment systems.

    - Some speculators like cryptocurrencies because they're going up in value and have no interest in the currencies' long-term acceptance as a way to move money.

- **How Is the Value of Cryptocurrency Determined?** Unlike corporate stocks whose values are based on current earnings and the potential for growth, cryptocurrency values are based on what a willing buyer is willing to pay a willing selling. Using Bitcoin as an example you can see the volatility associated with this most popular cryptocurrency.



- **Are Cryptocurrencies Good Investments?** That depends upon whom you talk to. Some cryptocurrency investors have made substantial amounts with their investments while others have lost substantial amounts. Cryptocurrencies may go up in value, but many investors see them as mere speculations, not real investments. Just like real currencies, cryptocurrencies generate no cash flow, so for you to profit, someone must pay more for the currency than you did. Contrast that to a well-managed business, which increases its value over time by growing the profitability and cash flow of the operation. Some notable voices in the investment community have advised would-be investors to steer clear of cryptocurrencies. Warren Buffett once compared Bitcoin to paper checks: “It's a very effective way of transmitting money and you can do it anonymously and all that. A check is a way of transmitting money too. Are checks worth a whole lot of money? Just because they can transmit money?"

Here is some guidance that applies to specific issues:

- **Virtual Currency and 1031 Exchanges** – Many virtual currency investors believe they can exchange one type of virtual currency for another without any tax consequences. Unfortunately, that is not true. Beginning in 2018 Congress altered the rules related to exchanges, limiting them to real estate transactions. Thus, investors in virtual currency who trade one type of virtual currency for another will have to treat exchanges as a sale and purchase and are required to report their capital gain or loss for each exchange.

- **First In – First Out (FIFO)** – When trading stocks investors who purchase various stock lots at different times and for different costs can choose which stocks they are selling for a specific transaction, giving them the ability to minimize their taxable gains. Brokerage firms generally have the capability to identify blocks of stock. This does not seem to be the case for cryptocurrencies and the IRS has not provided any guidance. Thus, it would seem cryptocurrencies would be traded FIFO.

- **Foreign Currency Transactions** – Under currently applicable law, cryptocurrency is not treated as currency that could generate foreign currency gain or loss, for U.S. federal tax purposes.

- **Foreign Bank and Financial Account (FBAR) Reporting** –Reporting certain foreign bank and financial accounts is required by the Treasury Department's Financial Crimes Enforcement Network (FinCEN), and the FBAR report is filed with that agency rather than the IRS. Through the filings for 2020, cryptocurrency transactions have not been required to be reported on the FBAR. However, in January, 2021, FinCEN said that it intends to propose to amend the regulations implementing the Bank Secrecy Act regarding FBARs to include virtual currency as a type of reportable account. No further details have been announced so far.

- **Payments To Employees** - When cryptocurrency is used as payment to an employee, the usual payroll withholding and reporting rules still apply and the employee must be issued a W-2. All amounts are reported in U.S. dollars.

- **Payments To Independent Contractors** – If independent contractors are compensated with cryptocurrency more than the equivalent of U.S. $600 (as determined on the date of the payment), the payment must be reported to the government by filing form 1099-NEC. Payments, whether more than $600 or not, are includable in the independent contractor’s business income and profits are subject to both income tax and self-employment income tax.

- **Backup Withholding** – There are situations when the payer is required to withhold on payments to individuals who are not paying their taxes. In these cases, the IRS will notify the payer that they must withhold from payments to certain individuals and remit the withholding to the IRS. When payments to these individuals is made in cryptocurrency, the equivalent U.S. dollar amount of cryptocurrency payment and withholding must be determined at the time the payment was made to the individual. The withholding must be determined and remitted to the IRS in U.S. dollars. The current backup withholding rate is 24 percent of the payment.

- **Charitable Donations of Cryptocurrency** – Instead of selling the cryptocurrency and donating the after-tax proceeds, a taxpayer can donate it directly to a charity. If the virtual currency has been held longer than one year, this approach provides significant tax benefits:

    - The tax deduction will be equal to the fair market value of the donated cryptocurrency (as determined by a qualified appraisal), and the donor will not pay tax on the gain.

    - This also results in a larger donation because, instead of paying capital gains taxes, the charity will receive the full value of the donation.

- **IRS Compliance Campaign -** The IRS has been engaged in a virtual cryptocurrency compliance campaign to address tax noncompliance related to virtual currency use through outreach and examinations of taxpayers and plans to remain actively engaged in addressing non-compliance related to virtual currency transactions through a variety of efforts, ranging from taxpayer education to audits and criminal investigations. Taxpayers who do not properly report the income tax consequences of virtual currency transactions are liable for the tax, penalties and interest. In some cases, taxpayers could be subject to criminal prosecution. To further the IRS' efforts to flush out taxpayers who may have cryptocurrency reporting requirements, a Yes/No question has been included on Form 1040 asking taxpayers whether they received, sold, exchanged, or otherwise disposed of any financial interest in any virtual currency during the tax year. When signing their return, a taxpayer attests under penalties of perjury to have a "true, correct and complete" return. Taxpayers who answered the cryptocurrency question "no," and the IRS finds that they actually had reportable virtual currency transactions, could be subject to significant penalties.

If you have questions related to your involvement with cryptocurrency, please give this office a call.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

Scott Jensen
Kramer & Jensen, LLC

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sjensen@kramerjensen.com

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