

# CRYPTO ASSETS: WHAT ACCOUNTANTS NEED TO KNOW



Bitcoin, Ethereum and other types of crypto assets make headlines regularly. They're no longer solely a hobby of anti-establishment groups or institutional investors. In fact, your clients may own them, and you simply aren't aware of the fact.

In November of 2020, we hosted a webinar featuring Kell Canty, CEO and co-founder of Verady, a cryptocurrency tax and accounting platform. Canty believes current events are bringing us to the tipping point of crypto-asset usage and adoption and discussed its impact on taxation, accounting and auditing.

In this white paper, we're sharing takeaways from that presentation and what you need to know about crypto assets to serve your clients better.

## Crypto assets: an overview

Cryptocurrencies are a type of digital asset. It's designed to work as a decentralized medium of exchange, independent of banks, financial institutions or other central authorities.

Bitcoin is the most well-known crypto asset, but it is far from the only one. It's difficult to determine exactly how many different cryptocurrencies exist because it depends on the definition and the day.

According to CoinLore, as of November 2020, there are 5,177 cryptocurrencies worldwide, with a total market capitalization of \$26,357 billion. <sup>1</sup> However, new cryptocurrencies are being introduced every day.

There are several indications that crypto assets are going mainstream, and they're important enough that every CPA firm should be paying attention.

## On the regulatory front:

- ◆ The IRS is signaling that crypto assets are going to be an enforcement priority going forward. Starting with 2020 tax returns, a question on page 1 of Form 1040 asks, "At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?" Every taxpayer will need to definitively answer. This question is similar to the foreign bank account question on Schedule B, and the Department of Justice's Tax Division has successfully argued that merely failing to check that box constitutes a willful intent to avoid taxes. <sup>2</sup>
- ◆ The Office of the Comptroller of the Currency (OCC), the regulatory authority that charters, regulates and supervises all national banks, announced that banks can custody crypto and facilitate trading. <sup>3</sup> That's a huge turning point for banks, as it can help them keep institutional clients interested in crypto, use it as a marketing tactic to attract new clients, and collect fees to store these assets.

- ◆ The Wyoming Bank Board voted to approve an application for a special purpose depository institution (SPDI) charter from Kraken, a San Francisco-based crypto exchange. This makes Kraken Financial the first cryptocurrency bank, gives them direct access to federal payments infrastructure and integrates banking and funding operations for customers more seamlessly. <sup>4</sup>
- ◆ The OCC also announced that banks can hold reserves for stablecoins, a cryptocurrency backed by assets such as U.S. dollars or other foreign currency. <sup>5</sup> This allows bank clients to pay others without having to go through interchange fees or credit card charges.
- ◆ The Security and Exchange Commission (SEC) issued a statement responding to the OCC's announcement saying stablecoins are not securities under federal law. <sup>6</sup> The statement also said the SEC is willing to publish a "no-action" letter, which would assure the recipient that the SEC will not bring enforcement action against the company.
- ◆ The Conference of State Bank Supervisors (CSBS) is releasing a streamlined state regulatory framework for crypto and other new, innovative FinTech companies that will facilitate the use of crypto for payments and Licensing. <sup>7</sup>

## As for institutions and corporations:

- ◆ Fidelity states that 33% of large institutions own crypto assets. <sup>8</sup>
- ◆ More publicly traded companies are purchasing Bitcoin as part of their capital allocation strategy. MicroStrategy, a Nasdaq-listed business intelligence company, purchased 21,545 bitcoins (worth \$250 million) in August of 2020. <sup>9</sup> As of November 25, 2020, those Bitcoin are worth \$414 million.
- ◆ Square reported \$1.63 billion in Bitcoin revenue from its Cash App for Q3 2020, making a gross profit of \$32 million from that figure. <sup>10</sup>
- ◆ PayPal announced eligible account holders in the U.S. can now buy, hold and sell cryptocurrency directly from their PayPal account. <sup>11</sup>

And it's not just institutions and large corporations getting into crypto. Individual investors are, too. Coinbase, a cryptocurrency exchange platform, has over 35 million users and is preparing for an IPO. <sup>12</sup>

Clearly, things are moving rapidly, and the popularity of this asset class is soaring.



## The challenge of working with crypto clients

Beyond investment opportunities, one of the most exciting innovations to come out of the cryptocurrency boom is blockchain – the decentralized ledger of all transactions across a peer-to-peer network. Blockchain was originally devised for Bitcoin, but the tech community has now found other potential uses for the technology.

### All of that might sound great, but there are a few complications:

- ◆ There are widely diverse methods of asset and transaction network access
- ◆ Asset data is difficult and technically challenging to represent
- ◆ There is no standard representation of value since there is no centralized exchange for crypto assets
- ◆ Traditional tax and accounting platforms cannot natively handle crypto-assets, and guidance is still evolving



One of the areas of particular concern is the taxation of crypto assets.

Taxing crypto assets is very complex & often the client's data is scattered across several wallets. The IRS recognizes this lack of education, guidance & compliance around crypto assets. The agency is starting to issue guidance, but it's difficult to keep up with an industry that is moving at such a rapid pace.

The IRS estimates that 8% of Americans own cryptocurrencies and are required to report their activity. However, only a tiny percentage of crypto-asset users report related gains and losses on their tax returns.

Remember, according to IRS 2014-21, cryptocurrencies are treated as property, so gains and losses are taxed as capital gains or losses. In other words, if you pay for a cup of coffee with Bitcoin, you have to report the transaction on your tax return. That's a level of recordkeeping few taxpayers are willing to keep up with – if they're aware of the requirement at all.



## According to an affidavit from IRS agent David Utzke,

*"The IRS searched the MTRDB for Form 8949 data for tax years 2013 through 2015. I received the results of those searches. Those results reflect that in 2013, 807 individuals reported a transaction on Form 8949 using a property description likely related to bitcoin; in 2014, 893 individuals reported a transaction on Form 8949 using a property description likely related to bitcoin; and in 2015, 802 individuals reported a transaction on Form 8949 using a property description likely related to bitcoin."*<sup>13</sup>

When you compare those numbers to the 35 million Coinbase accounts, it's easy to see why the IRS is making crypto one of their top three enforcement priorities in the next year.

Accounting for crypto assets is also an area of concern. According to FASB, crypto-assets should not be treated as cash, financial instruments or inventory, but as long-lived intangible assets with annual testing for impairment. Many companies are utilizing fair value and regarding any possible impairment as temporary. There is still a great deal of discussion around this, and FASB may eventually take up a more comprehensive crypto-asset accounting project soon.

## Do your clients own crypto assets?

Many firms ask about trading crypto on client organizers, but that's likely not enough.

During our webinar, we asked participants about their level of involvement in crypto assets, on a spectrum from being aware of them, but none of their clients have mentioned owning them, to having a growing number of crypto clients and actively growing the service line.

Surprisingly, about a third of respondents said they're aware of crypto assets but haven't been approached by their clients. However, we've found that many people who own crypto-assets don't disclose it to their CPA about it unless they perceive the CPA can add value.

It becomes a stalemate, with the client and accountant each waiting for the other to bring it up, until eventually another firm comes by that is actively promoting their knowledge and expertise in crypto. That's why you need to get the message out to clients that you understand crypto assets, so they don't feel they need to look elsewhere.

For now, the IRS is encouraging voluntary compliance, so it behooves everyone to get in front of it. You don't want your clients to become an example case for people who don't report transactions or report them in an egregiously incorrect way. In fact, the IRS has already put out an RFP for contractors to assist with prosecutions, so clearly, this is a serious concern.

For CPA firms, there is a huge increase in reporting and compliance on the near horizon, and it's up to you to communicate with clients to make them aware of the issues, help them disclose properly, and discuss whether they have any past returns that need to be amended.

Many clients who haven't reported in the past may feel caught in a trap of needing to amend prior year returns if they start reporting now, so their trusted advisors need to initiate an open, honest conversation. There are good reasons to believe that the IRS is looking to get people in line, but the time will come soon when they start making examples of people who don't fall in line. Opening that conversation with your clients and getting them to start reporting now – and off the radar for possible IRS enforcement actions later – is crucial.

## How to prepare your firm

To prepare your firm and your clients for crypto, Canty offered the following recommendations:

1. Appoint a specific group or individual to be the lead for understanding, tracking and evaluating your firm's relationships and opportunities in the crypto asset space
2. Review 2019 returns to see how many clients answered "yes" to the virtual currency question
3. Establish basic Blockchain 101 training and education for the entire firm to have a baseline of knowledge. A natural leader for in-house blockchain and crypto knowledge may emerge. Some resources for keeping up with changes include:
  - ◆ Verady's newsletter – sign up at [ledgerio.io](https://www.ledgerio.com/)
  - ◆ Join industry groups such as the Wall Street Blockchain Alliance ([wsba.co](https://www.wsba.co/)) and Accounting Blockchain Coalition ([accountingblockchain.net](https://www.accountingblockchain.net/))
  - ◆ IRS FAQs on Virtual Currency Transactions <sup>14</sup>
  - ◆ AICPA's Accounting for and Auditing of Digital Assets practice aid <sup>15</sup>
4. Start or increase cryptocurrency marketing activities, including basic website coverage. Allocating blog space to crypto topics and thought leadership can help raise your firm's profile.
5. Design and implement pricing, processes and procedures for crypto asset clients. This can include updating checklists, adapting your workflows and creating additional review levels.
6. Ensure your Client Acceptance has appropriate knowledge and risk assessment for onboarding crypto asset-involved clients.
7. Explore the tools available and determine which provides the broadest and most reliable coverage for your client needs. The systems and organizations that create those tools should be AICPA SOC audited. If you wait for your clients to self-select consumer-grade solutions, you will have issues with client management, workflow and reporting.

The crypto-asset ecosystem can lead to significant opportunities for accounting firms in tax, outsourced accounting, auditing and advisory. Clients are looking for trusted advice and guidance, so it's up to firms to become that resource.

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<sup>1</sup> CoinLore, "Cryptocurrency List," accessed November 17, 2020 at [https://www.coinlore.com/all\\_coins](https://www.coinlore.com/all_coins)

<sup>2</sup> CoinTelegraph, "IRS Crypto Tax Return Question – Be Careful How You Answer," accessed December 3, 2020 at <https://cointelegraph.com/news/irs-crypto-tax-return-question-be-careful-how-you-answer>

<sup>3</sup> Gould, Jonathan V., "Interpretive Letter #1170," Office of the Comptroller of the Currency, issued July 22, 2020, accessed November 17, 2020 at <https://www.occ.gov/topics/charters-and-licensing/interpretations-andactions/2020/int1170.pdf>

<sup>4</sup> Boot, Patrick J., "The First Cryptocurrency Bank," The National Law Review, published September 22, 2020, accessed November 17, 2020 at <https://www.natlawreview.com/article/first-cryptocurrency-bank>

<sup>5</sup> Office of the Comptroller of the Currency, "Federally Chartered Banks and Thrifts May Engage in Certain Stablecoin Activities," published September 21, 2020, accessed November 17, 2020 at <https://www.occ.gov/newsissuances/news-releases/2020/nr-occ-2020-125.html>

<sup>6</sup> U.S. Securities and Exchange Commission, "SEC FinHub Staff Statement on OCC Interpretation," published September 21, 2020, accessed November 17, 2020 at <https://www.sec.gov/news/public-statement/sec-finhubstatement-occ-interpretation>

<sup>7</sup> Conference of State Bank Supervisors, "State Regulators Roll Out One Company, One Exam for Nationwide Payments Firms," published September 15, 2020, accessed November 17, 2020 at <https://www.csbs.org/regulators-announce-one-company-one-exam-for-payments-companies>

<sup>8</sup> Kharif, Olga, "Fidelity Says a Third of Big Institutions Own Crypto Assets," Bloomberg, updated June 9, 2020, accessed November 17, 2020 at <https://www.bloomberg.com/news/articles/2020-06-09/fidelity-says-a-third-of-large-institutions-own-crypto-assets>

<sup>9</sup> MicroStrategy, "MicroStrategy Adopts Bitcoin as Primary Treasury Reserve Asset," published August 11, 2020, accessed November 17, 2020 at <https://ir.microstrategy.com/news-releases/news-release-details/microstrategyadopts-bitcoin-primary-treasury-reserve-asset>

<sup>10</sup> Helms, Kevin, "Cash App's Bitcoin Revenue Soars 1,000% to \$1.63 Billion in Q3, Square Announces," Bitcoin.com, published November 7, 2020, accessed November 17, 2020 at <https://news.bitcoin.com/cash-app-bitcoin-revenuebillion-square/>

<sup>11</sup> PayPal, "PayPal Launches New Service Enabling Users to Buy, Hold and Sell Cryptocurrency," updated November 12, 2020, accessed November 17, 2020 at <https://newsroom.paypal-corp.com/2020-10-21-PayPal-Launches-NewService-Enabling-Users-to-Buy-Hold-and-Sell-Cryptocurrency>

<sup>12</sup> Sen, Anirben, Joshua Franklin, and Anna Irrera, "Exclusive: Crypto Exchange Coinbase Readies Landmark Stock Market Listing, Sources Say," published July 9, 2020, accessed November 17, 2020 at <https://www.reuters.com/article/us-coinbase-ipo-exclusive/exclusive-crypto-exchange-coinbase-readieslandmark-stock-market-listing-sources-say-idUSKBN24A21W>

<sup>13</sup> Utzke, David, "Declaration of David Utzke in Support of Petition to Enforce Internal Revenue Service Summons," filed March 16, 2017, accessed November 17, 2020 at <https://www.scribd.com/document/342374347/IRSAffidavit-for-Coinbase>

<sup>14</sup> IRS, "Frequently Asked Questions on Virtual Currency Transactions," updated October 8, 2020, accessed November 17, 2020 at <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-onvirtual-currency-transactions>

<sup>15</sup> AICPA, "Accounting for and Auditing of Digital Assets," 2020, accessed November 17, 2020 at <https://www.aicpa.org/content/dam/aicpa/interestareas/informationtechnology/downloadabledocuments/accounting-for-and-auditing-of-digital-assets.pdf>