



COUNSEL TO GREAT COMPANIES

Crypto-Philanthropy: *Virtual Currency and the Future of Charitable Giving*

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Successfully resolves complex tax controversies for businesses, individuals and estates before the IRS, California Franchise Tax Board and other state agencies.

Represents clients at every stage of a tax dispute, including examination, appeals, and in litigation.

Matters include estate and gift tax, income tax, international tax and offshore reporting and property tax assessments.

Former Senior Attorney at the Office of Chief Counsel, IRS

- Litigated 16 trials before the United States Tax Court
- Advised IRS Estate Tax Attorneys, Appeals Officers, Revenue Agents, and the Offshore Voluntary Disclosure Program

Overview

1. What is virtual currency?
2. What is exciting about virtual currency and philanthropic giving?
3. What are the issues for clients donating virtual currency?

What is Virtual Currency?

Terms to Know

- Virtual Currency – IRS Notice 2014-21
- Cryptocurrency
 - E.g. Bitcoin, Bitcoin Cash, Ripple, Ethereum
- Blockchain – a shared immutable ledger for recording the history of transactions

How does Bitcoin Work: What is a Bitcoin?

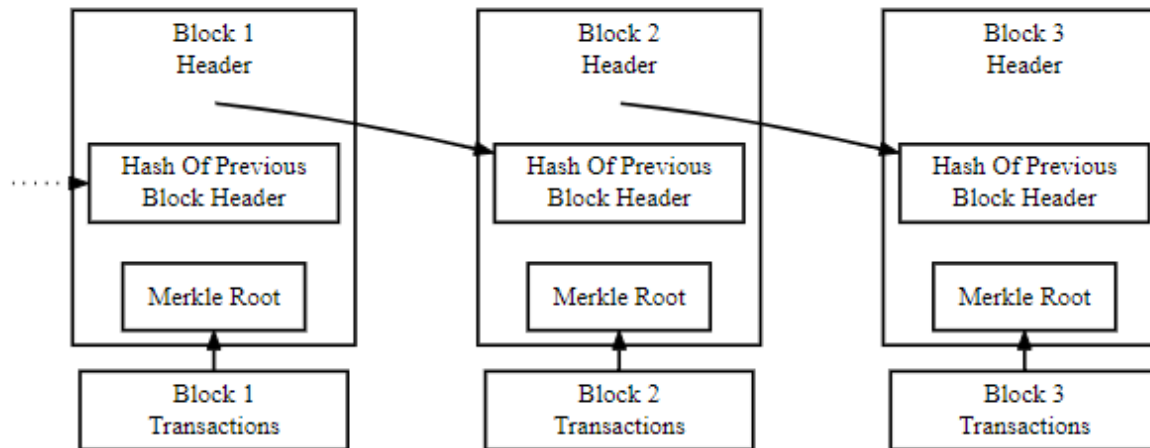
- A Bitcoin is a reward from the bitcoin blockchain you get for mining a new block
- The Bitcoins are stored on the blockchain
- You have an address to those Bitcoins – that address is simply a SHA-256 hash of your public key
- You can send those Bitcoins using your private key

Key Technologies Bitcoin Uses

- Public-key Cryptography
 - Private Key
 - Public Key
- Peer-to-peer networking
- Blockchain
- Hashing – Bitcoin uses SHA-256

How does Blockchain Work? Simplified

- As each transaction occurs – it is put into a block
- Each block is connected to the one before and after it
- Transactions are blocked together using hashes
- Each block is added to the next in an irreversible chain



Simplified Bitcoin Block Chain

How does this Hashing Magic Work?

- Key properties of cryptographic hash functions:
 - Deterministic – with the same input, you get the same output
 - Small changes in the input changes the entire hash
 - Preimage Resistance - infeasible to determine the input from the output
 - Collision resistant – infeasible for two inputs to have the same output
- Examples:
 - input = Jon sends Bob 1,000 Bitcoins
output = 92b27cbf9ea7af6681f9f2c7f85181dd0571a7a92da3e06ef387a904d96ac114
 - Input = Jon sends Bob 1,001 Bitcoins
Output = 13f0423629f0f58c899b3c6aa0acfee2139558f6878256afde58075f11ec0dc9
 - Input = Jon sends bob 1,000 Bitcoins
Output = db89c0484fe1cef001aab7dfdc58602a73178c00055661d9971f9a0675f7dedc

What is a Bitcoin Wallet?

- A Bitcoin wallet contains
 - Address (hashed version of your public key)
 - Private key
- A Bitcoin wallet can be a mobile app, desktop software, website, or even a piece of paper

What does a Bitcoin Wallet Look like?

Example of a Paper Bitcoin Wallet



Sending payments: Simplified


Example of a transaction


A is sending 1 BTC to B



- B sends his public address to A
- A adds B's public address and the amount of Bitcoins to transfer to a message: a 'transaction' message
- A signs the transaction with her *private* key, and announces her public key for signature verification
- A broadcasts the transaction on the Bitcoin network
- Once a transaction is confirmed that it has been included in a block, and confirmed X numbers of blocks have been added, he can be confident the transaction is permanently recorded, preventing A from spending the BTC again


What does an actual transaction look like?


(from blockexplorer.com)


5cb2775d21ce6030ffc02f106db891b4a770a8f4f58ac5c82127aacb9b0ca890  mined Sep 9, 2013 7:06:04 PM


1GokqxYhF7pw2ozJdmwbX3pvnTW1jaY4aY 0.1 BTC 


Confirmations:
scriptSig
3044022043bcd2539556606886ba9b23b0ddaeafab0906938366c2c... 
04174bc4b225eeda76ac74ca25e803b4c9ba2b8d26c11875d88085d2... 

1PJqihqxurPWcKuvCmMrDfgtQvVp98s93 0.099 BTC 

Type pubkeyhash
scriptPubKey
OP_DUP OP_HASH160 f4b281d7c285f0f18da2419c32b076cd9d68f18f OP_EQUALVE... 

1BdmrFtJhEesx8E5XyeQ7KoDcMtkMX7mo5 0.001 BTC 

Type pubkeyhash
scriptPubKey
OP_DUP OP_HASH160 74a5abb5218c09939185809142f2093eccdb9bb7b OP_EQUAL... 

Included in Block 00000000000001ab0434ee736fa807f80e5bf5cade0601d0a7905127c0f6249 

FEE: 0 BTC

266029 CONFIRMATIONS

0.1 BTC

What from a transaction gets saved to the blockchain? **Simplified**

- The sender's address (hash of the public key) + public key
- The receiver address (hash of the public key) + public key
- Amount of the Bitcoin transferred
- Timestamps:
 - Time transaction broadcasted into the Bitcoin network
 - Time transaction details were stored on the blockchain
- What is missing?

Problems and Challenges

- “double-spending”
- Hacking/Attacks
- Confirmations
- Losing your private key

What is exciting about virtual currency and philanthropic giving?

- Completely anonymous
- Low transaction costs (theoretically)
 - Feasible to donate pennies
- No currency conversions – worldwide currency
- A lot of new found wealth to donate

Issues for Clients Donating Virtual Currency

Likely donating low basis property

- Virtual Currency is treated as property
IRS Notice 2014-21, Q&A-1
- Amount of Deduction
 - If long-term capital gain – deduction is fair market value (subject to AGI limitations)
 - If not long-term capital gain – deduction is limited to the donor's tax basis

Issues for Clients: Areas Without Clarity

Substantiation: How do you prove you gave?

- Anonymous like cash
- Must give the virtual currency, otherwise you recognize the built-in gain
- Contemporaneous written acknowledgement by the donee
- Form 8283
- What if you give your private key to someone? Is that a completed transfer? You could keep a copy?

Issues for Clients: Areas Without Clarity

Valuation?

- Must convert into US Dollars “**in a reasonable manner that is consistently applied**” IRS Notice 2014-21, Q&A 5.
- Qualified appraisal by a qualified appraiser (if > \$5,000)
 - Qualified appraiser?
 - Minimum education and experience requirements
 - Regularly performs appraisals for which the individual receives compensation
- Publicly traded stock – no appraisal needed

Issues for Clients: Areas Without Clarity

Timing: What is the best analogy?

- General Rule: Time of its unconditional delivery
- Mail or Delivery Service: Deemed delivered when mailed
- Text Message: Delivered when sent if the contribution is charged to your telephone or wireless account
- Letter of Credit: Delivered when established (even if not drawn on)

Important Notice

This material does not establish an attorney's standard of due care for a particular situation and/or in any particular community. Rather, it is our intent to encourage our community to act in a manner which may be well above the standard of due care in order to attempt to avoid claims having merit, as well as those without merit. This material does not contain legal advice and is for general educational purposes only.