

# Crypto Assets & Tax: Current Tax Issues

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# Need to know

Most global tax authorities have stated that their respective income tax acts cater to crypto assets.

Tax authorities view:

- They see crypto as an asset
- Income tax act caters to the taxation of assets - no further guidance is required.

I disagree with this; the nuances of the crypto asset space require special consideration.





# Mining and staking taxation

Definition of Crypto mining:

The competitive process that verifies and adds new transactions to the blockchain for a cryptocurrency that uses the proof-of-work (PoW) method. The miner that wins the competition is rewarded with some amount of the currency and/or transaction fees. PCMag.





# Mining and staking taxation

Definition of Crypto staking:

Loaning ("locking up") cryptocurrency to earn interest (see yield farming). Crypto is also staked to win block rewards as a crypto miner. For example, proof-of-stake (PoS) is a consensus algorithm that rewards miners who initially stake their crypto and then win the competition to add the next block of transactions to the blockchain. PCMag.





# Mining and staking taxation

Non-technical definition of Crypto staking:

You mine when you **expend** resources to perform specific tasks and are rewarded for that.

When you stake, you **lock up** resources to perform particular tasks and are rewarded for that.





# Mining and staking taxation

General stance of most global tax authorities:

The general stance is that both mining and staking rewards are taxed as income. You perform some service and pay tax on that reward. However, this is not as simple as it may appear.

See following example to why it is not as simple as it may appear.





# Mining and staking taxation

Example:

Say you are an author. You write a new book and print 1 000 books. Should you be taxed on the selling price of the 1 000 books immediately after it has been printed? Certainly not. You will be taxed when you sell the relevant books. This is precisely the point of several stakers. When staking, you lock up resources to produce future value. However, the future value is only realised when you sell the created assets.





# Mining and staking taxation

## Court Case:

Joshua and Jessica Jarrett, better known as the Tezos validator who took the Internal Revenue Service (IRS) to court, are creating big waves in the crypto industry, setting a possible precedent for how authorities will tax staking rewards.

The court case of Joshua Jarrett, Jessica Jarrett (plaintiffs) v. the US (defendant) is one worth following, especially in the crypto space.







# Mining and staking taxation

Court Case:

What happened?

The couple received a staking reward in 2019 and relying on the conservative approach, the couple declared the reward and paid the tax owed to the IRS on the income. However, they then decided to amend their tax return on July 31, 2020, arguing that the staking reward was not income, and thus, the tax amount on the income was invalid. Instead, they wanted to be paid back for the taxes they had previously paid the IRS.

They argued that newly created property is only taxed at the time of sale, not at the receipt of such property.





# Mining and staking taxation

Court Case:

Joshua Jarrett made the following statement explaining his reasoning behind their refusal:

*Fast forward to late December 2021, when I received a letter saying the government wanted to grant me a refund—in other words, a year and a half into this process, the government didn't want to defend the position that the tokens I created through staking were taxable income. At first glance, this seemed like great news. But until the case receives an official ruling from a court, there will be nothing to prevent the IRS from rechallenging me on this issue. I need a better answer. So I refused the government's offer to pay me a refund.*





# Mining and staking taxation

Court Case:

Why follow the court case?

If the judgment favours the plaintiff, it could set a clear precedent for the taxation of staking rewards in the future.

The court case is still ongoing, but resistance against unclear policy and the feeling of a ripple effect in the industry are signs of growth. Changes that it will bring are a step in the right direction. In addition, the outcome of Jarrett's case will clarify to the US public how staking rewards will be taxed in the future, which will be a big win for the US digital assets industry.





# The taxation of Airdrops

## Definition of an Airdrop:

A reward in tokens is given to people interested in a new cryptocurrency. Delivered to users who have crypto wallets, airdropped tokens are a way of spreading the word about a new coin. Users may have to post information about the crypto, mention it in some blog or article or simply show curiosity. Often, airdropped tokens are part of an overall scam to make money and run for the hills. PCMag.





# Is taxation of airdrops straightforward?

At first glance, one might argue that the taxation of airdrops is straightforward.

The taxpayer received a reward, which should be taxed as income.

This might be where the taxpayer had to perform a specific task and receive the reward. However, there are many cases where the taxpayer did not have control over receiving the airdrop.

**Remember, a crypto wallet address is public knowledge, and anyone can deposit coins into your wallet.**





# Is taxation of airdrops straightforward?

- 01 The taxpayer receives an airdrop of 10 token A on 1 December 2021; token A is valued at \$10 per token. The total value of the airdrop is \$100.
- 02 The taxpayer is unaware of this airdrop (which can easily happen).
- 03 The taxpayer's crypto tax advisor informs the taxpayer in the following year that there is a taxable amount of \$100 as the income is calculated at the spot rate of when the tokens were received. At this time, the value of token A is 0 (which can easily happen).
- 04 The taxpayer now has to pay tax on the \$100 worth \$0 in terms of fiat currency.





# Is taxation of airdrops straightforward?

This is another crypto nuance requiring attention from the tax authorities. Canada and Germany see airdrops as tax-free events. USA, Australia, and the UK tax airdrops as income. In South Africa, one can infer that airdrops should be taxed as income.





US Crypto Bill

# The Global need for proper guidance by tax authorities

In June of 2022, a proposed US crypto bill, sponsored by US Senators Cynthia Lummis, Republican of Wyoming, and Kirsten Gillibrand, Democrat of New York, has mentioned the following in Section 206 - Implementing effective IRS Guidance:

Not later than one year after the date of the enactment of this Act, the Secretary of the Treasury (or the Secretary's delegate) shall adopt guidance relating to the following:



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# US crypto bill

- 01 Classification of forks, airdrops, and similar subsidiary value as taxable, contingent upon the affirmative claim and disposition of the subsidiary value by a taxpayer. Such guidance shall also permit a taxpayer to provide notification through an annual return or other appropriate means to the Internal Revenue Service relating to the claim and disposition, or disclaimer of, subsidiary value.
- 03 Treatment of digital asset mining and staking, including mining and staking rewards, in which income is not realised until disposition of the assets produced or received in connection with such activity, in accordance with section 451(l) of the Internal Revenue Code of 1986 (as added by this Act).





# US crypto bill

01 mentions taxability “upon the affirmative claim and disposition”. This will resolve the issue mentioned earlier in this article with the taxation of airdrops.

03 mentions “in which income is not realised until disposition of the assets produced” this will resolve the issue with the taxation of staking and mining mentioned earlier in this article.

It is evident with the proposed timeline of “not later than one year” that the Senators infer that this necessary guidance is past due. The global tax authorities are outspoken about enforceability but not about providing proper guidance.





# Enforceability by global tax authorities

In South Africa and the US, tax authorities now require taxpayers to indicate on their tax returns if they held any crypto assets during a year of assessment.

In the same two countries, it is a fact that the tax authorities have approached centralised exchanges for details regarding taxpayers. With most centralised exchanges (CEXes) requiring “Know your customer (KYC)”, the identities of traders can be made available to the requesting tax authorities.

With most decentralised exchanges (DEXes), KYC is not a requirement. Some taxpayers are under the impression their identity cannot be revealed and that they are safe in terms of enforcement.

Think again.





# Enforceability by global tax authorities

The following are possible:

- 01 The tax authority subpoena the taxpayer for all their wallet addresses. This will lay bare all DEX trades as well. If the taxpayer does not come clean at this stage, they will expose themselves to significant criminal prosecution.
- 02 The taxpayer's identity is established at the CEX and flows to DEXes, and private wallets are traced from there.





# Enforceability by global tax authorities

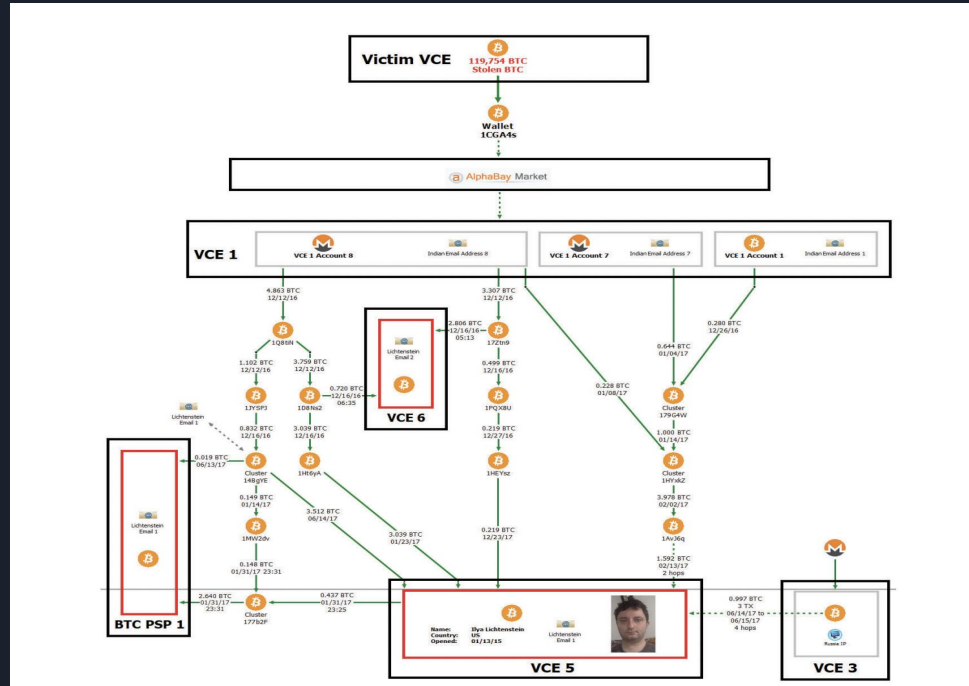
There is a nagging suspicion that SARS and the IRS are partnering with private firms to the like of Chainalysis, which connects real-world activities to blockchain transactions, and will enable them to track taxpayers' transactions.

The blockchain is wonderfully transparent.



# Enforceability by global tax authorities

Recently the FBI released their paper of facts regarding their track of the BitFinex hack. Here is a graphic of their trace through the blockchain to the hackers:





# Enforceability by global tax authorities

When you read the paper of facts, it will become clear that authorities are advancing in private partnerships and tracking capabilities.

Tax authorities are using fear to flush taxpayers not declaring their crypto dealings. The above is not to contribute to the anxiety but to make clear the risk is real and that tax authorities might hesitate to provide guidance due to technical adeptness but are getting ready to enforce.

Perhaps it will be a good balance if the tax authorities provide the same effort to guidance and enforcement.





# Experts in global crypto tax reconciliation

CountDeFi is a global crypto tax reconciliation expert and part of the South African Group, CH Consulting.

They have a deep understanding of the blockchain, liquidity & staking protocols, ICOs / IDOs, NFT ecosystem and other DeFi nuances and specialise in crypto tax reconciliation report preparation. The reports they prepare are non-crypto tax practitioner friendly and can be used to complete the taxpayer's tax returns efficiently.

**Please contact [CountDeFi](#) or [CH Consulting](#) if you have clients requiring crypto tax reconciliation.**

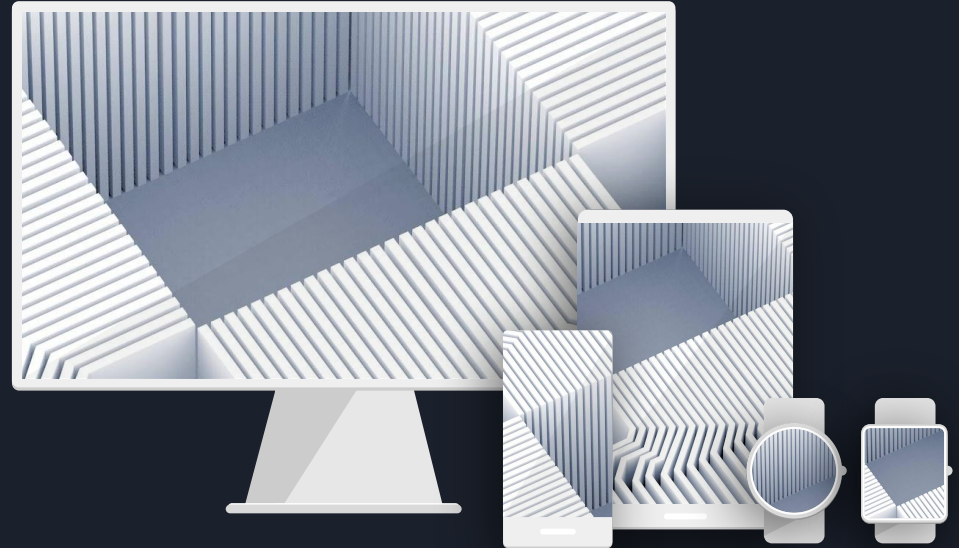




# Thank you!

How to find us:

- [chconsulting.co.za](https://chconsulting.co.za)
- [countdefi.com](https://countdefi.com)



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