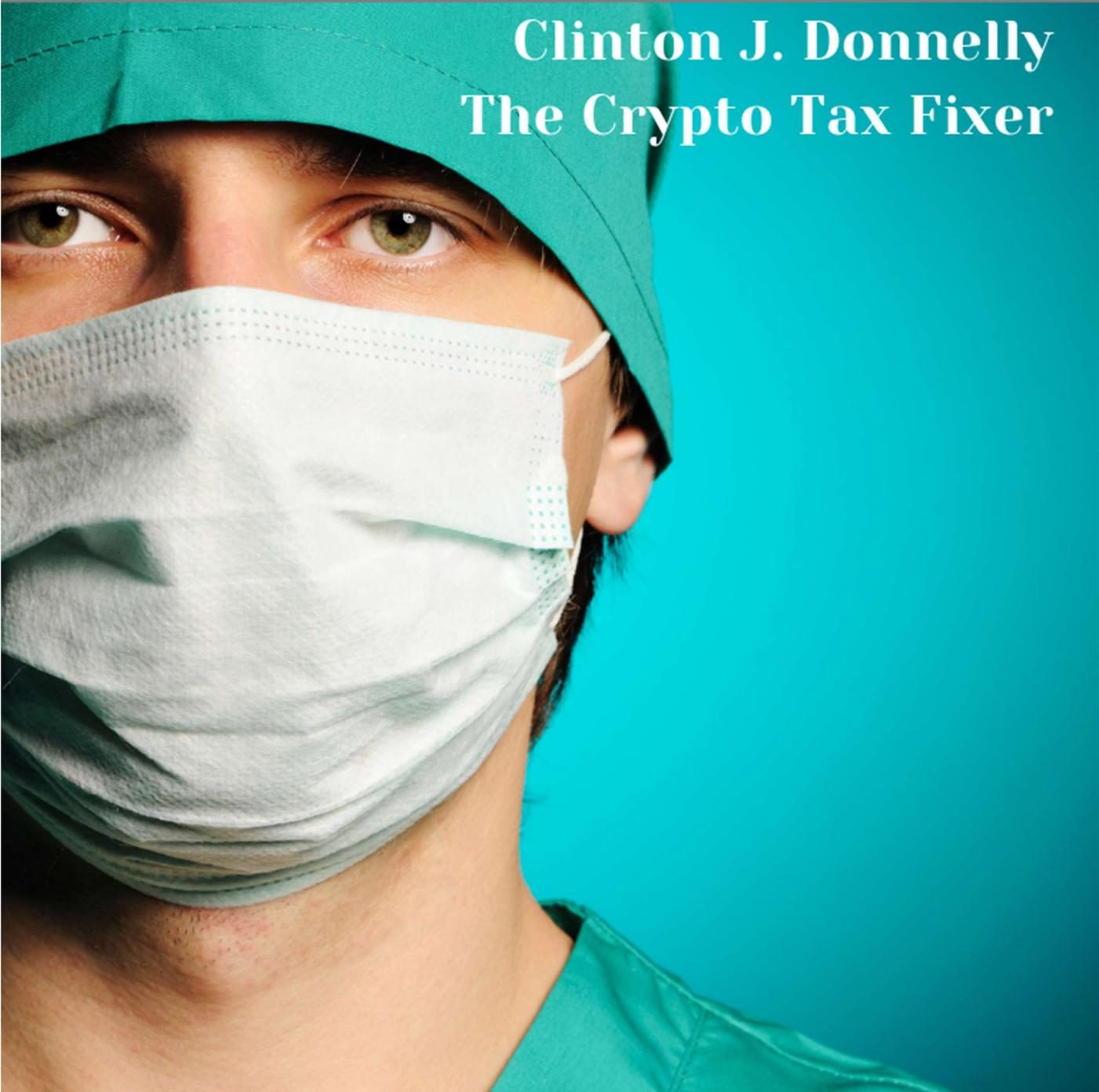


Do my Crypto Tax Returns Need Surgery?

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Do I need my Crypto Taxes Fixed?

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Should I fix my tax return to report my crypto's better? That is the question many traders are asking now that the IRS compliance campaign has begun sending letters to traders.

For many traders, it was the first time they ever did any investing. Reporting these investments on their taxes was a new awakening for them.

It is time to do HealthCheck. It makes sense. Every year you go to a doctor to have your body signs checked for hidden problems. We can do the same thing with your tax return.

Welcome to the tax doctor's waiting room!

First, complete a questionnaire of 13 questions. Then we'll enter the tax doctor's office and receive a diagnosis and a cure. Ready to begin?

Please answer these questions quickly. Don't worry about precision.
Answer the questions for each year.

	2018	2017	2016
1) Did you have crypto mining or wage income paid in cryptos?			
2) Did you suffer significant loss from financial or Ponzi scams?			
3) How many crypto exchange accounts did you have? Do not include accounts from these U.S. exchanges: Coinbase, Coinbase Pro/GDAX, Bitquick, Bittrex, Gemini, itBit, Kraken, Poloniex/Circle, or Uphold.			
4) Would the combined total of all the maximum balances of these non-US exchanges be greater than \$10,000 in value during the year? (Yes or No)			

The next set of questions has to do with what is on your tax returns.
So, dig out those old returns and answer these questions for each year.

	2018	2017	2016
5) On the form marked "Schedule B" are the two questions on line 7A both answered "YES"?			
6) If you had mining income or crypto wages, are they reported on "Schedule C"? If you don't have this type of income, leave it blank.			
7) Is there a Form 8824 with crypto transactions reported on it?			
8) Is there a Form 8949 with crypto transactions reported on it?			
9) Did you report ALL your crypto-to-crypto AND crypto-to-fiat trades on the two above forms?			

10) Is there a Form 8938 reporting crypto transactions and exchanges on it?			
11) If an IRS officer asks me today “if my tax return for this year was still true, complete, and correct, would you answer YES?”			

Diagnose the condition

A couple more diagnostic questions.

	2018	2017	2016
12) If question 3 is greater than zero, is question 5 marked “Yes”?			
13) If question 4 is greater than zero, is question 10 marked “Yes”?			

Do you have an IRS problem already?

Did you receive a letter from the IRS with the letter number 6173, 6174, or 6174-A? If so, you have a serious problem. The IRS is using data mining techniques to identify the most likely crypto traders who have failed to report their crypto’s correctly. If you got one of these letters, they have targeted you.¹ You have a short window of time to amend your prior tax returns and seek tax amnesty to avoid penalties. These are described later in the treatment section of this paper.

Do I have a Schedule B problem?

If you marked yes on question 12, then you have a Schedule B problem for that year. This is a serious problem. On Schedule B line 7A, the question is asked, “did you have a financial interest in or signature authority over a financial account located in a foreign country?” A crypto exchange is a financial account. Almost all crypto

¹ <https://www.irs.gov/newsroom/irs-has-begun-sending-letters-to-virtual-currency-owners-advising-them-to-pay-back-taxes-file-amended-returns-part-of-agencys-larger-efforts>

exchanges are outside the United States.² If you traded on foreign exchanges and didn't answer yes to this question, you have committed perjury.

How did I commit perjury? Look on the first or second page of the 1040 tax return where there is a box for you to sign the return. In small print you read that the statement "Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete." So, if you have a schedule B problem, you have a perjury problem. The penalty for perjury is up to three years in prison.

Was question 11 answered "No"? then you know you have a perjury problem.

Anyone with a Schedule B problem also has an FBAR problem

That question on line 7A, continues asking if you had financial accounts are you required to file Form FinCEN-114? The form then instructs the taxpayer to read this form and determine if the form is required. Everyone with a financial interest in or signature authority over foreign financial accounts must report these on Form FinCEN-114 also called the FBAR form. The FBAR form is due the same time as the tax return. Question 13 asked If the sum of the maximum balances of all your foreign accounts during the year is more than \$10,000 in value. If the answer is no, then filing the FBAR form is optional. (But I recommend filing it anyhow.)

² Exchanges located in the US are Bitquick, Bittrex, Coinbase, Coinbase Pro/GDAX, Gemini, itBit, Kraken, Poloniex/Circle, Robinhood, or Uphold.

FBAR problems are costly!

Failure to file an FBAR form on time is subject to a \$10,000 penalty. Filing an FBAR form late is also subject to a \$10,000 penalty. If you don't file an FBAR form and the IRS discovers you should have, they assess a \$10,000 penalty for every foreign financial account that you have regardless of its account balance. In other words, if you traded on 12 foreign exchanges, then you could be subject to a penalty of \$120,000 for that year. You need tax amnesty to avoid these penalties.

There's a second anti-money laundering form?

Question 13 asks if you filed Form 8938. This form and the FBAR form are the two anti-money laundering forms that individual taxpayers must file if they apply. Form 8938 overlaps with the FBAR form requiring listing of the maximum balances of foreign financial accounts. Form 8938 also requires the listing of the total value of all crypto transactions both buy and sell regardless of exchange when the counterparty to your trade is other than a US person.³

If the total of all your maximum balances in your foreign exchanges plus the total value of all your crypto buy and sell contracts is less than \$50,000, then this form is optional.⁴ (However, I recommend always filing this form, to be safe.)

Failure to file this form when required is a \$10,000 penalty, and it exposes you to a 40% foreign accuracy penalty. By the way, failure to file form 8938 on time is subject to a \$10,000 penalty. The only way to avoid this penalty is to amend the tax return to use a tax amnesty procedure.

³ Tax Code section 6038D. Since trades on crypto exchanges are anonymous, you must assume that the counterparty is a foreign person.

⁴ The \$50,000 is increased based on marital state, residence, and time of year.

Do I have a Schedule C problem?

If you answered “no” to question 6, then you have a Schedule C problem. Mining income is considered a home business. Report this on Schedule C. But, if your mining income is from cloud mining, report the payouts as dividends on Schedule B part II. If you received wages paid in cryptos instead of cash, report that income on Schedule C. Schedule C net income is also subject to self-employment.

Do I have a Schedule D problem?

If you answered “No” to question 9, then you have a schedule D problem because some gains from the sale or exchange of cryptos are missing from Forms 8949 or 8824.

I am still surprised at how many crypto traders do not yet accept that when you trade crypto-to-crypto or crypto-to-fiat, they are both taxable events. The tax is on the gain. The gain⁵ is the difference between the sale price and the purchase price.

With the big run-up in 2017, many traders believed that they only had to report crypto-to-fiat trades. They thought that crypto-to-crypto trades didn't have to be reported. This was a huge mistake. True, crypto-to-crypto trades before the year 2018 could be treated using the “Like-kind exchange” rules.⁶ Under these rules, the gain is deferred to the future resulting in no taxes on that transaction. However, to claim this treatment, the trade must be reported on form 8824. If you don't report the trade, you don't get like-kind exchange. Ouch.

⁵ Losses are considered negative gains.

⁶ Tax Code section 1031 prior to 2018.

In other words, the gain from every crypto sale or exchange must be reported on one of these two forms; otherwise, it is unreported income. If the IRS discovers unreported crypto income, it can apply a 40% foreign accuracy penalty if you didn't also file a form 8938. Otherwise, the accuracy penalty is 20%. If the unreported income is significant, then the IRS can apply a 75% fraud penalty or even make criminal charges of tax evasion.

Can I file still claim like-kind exchange?

Many traders who did not report all their trades in 2017, did so because they were afraid of having to pay enormous taxes on their incredible gains. This dilemma became worse when the value of their holdings plunged in 2018, making the size of the tax bill more staggering.

The good news is that is you can still claim like-kind exchange, save lots of money and protect yourself from massive penalties and taxes. For tax years 2018 and forward, like-kind exchange treatment for cryptos is no longer permitted, but it still can be claimed for prior years. I recommend it to most of my clients.⁷

Do I have a Schedule E problem?

You have a schedule E problem if you have cryptocurrency income derived from partnerships, royalties, or rental situations. Report the US dollar value of this income on schedule E.

Doctor, give me the cure!

What can be done to fix these problems? Amend prior tax returns by submitting a corrected return along with an explanation of changes. In my book, *10 Steps for a Great Crypto Tax Return*, I explain how to

⁷ Not every client benefits from like-kind exchange depending on their trading pattern.

prepare a defensive return which best protects you from the IRS and their data mining computers.

However, if you must submit a Form 8938 or FBAR, I recommend using one of several tax amnesty procedures to avoid the \$10,000 late-filing penalties. These procedures involve filing a legal affidavit attesting to acting with reasonable cause and in good faith and not engaging in willful action or negligence. In my book, *Tax Amnesty Made Easy*, I explain how to determine the best amnesty procedure for your circumstance and how to do it.

I have saved my clients over a million dollars in taxes by using like-kind exchange. My team has significant experience and success calculating and documenting these exchanges. We offer this service to our clients.⁸

At Donnelly Tax Law (donnellytaxlaw.com), we offer a full-service offering and a do-it-yourself “CryptoTaxFixer” package offering to fix past tax returns. Avoiding \$10,000 fines and using like-kind exchange⁹ can save a fortune when using these packages.

With our full-service offering, we help clients get significant tax credits for losses from Ponzi and other crypto financial scams. For one client, we got a \$139,000 deduction because of a Ponzi loss which reduced her taxes to \$0.

The third thing to remember is that the IRS has already begun its compliance campaign. The time to correct past filing mistakes is now.

⁸ We offer this service only to clients our Full-Service or CryptoTaxFixer package clients.

⁹ The cost of like-kind exchange calculation depends on the number of trades and exchanges involved.

If you already received the letter from the IRS, urgent action is needed. The IRS has said that they will withdraw the tax amnesty programs without notice in the future. Therefore, act now if you need amnesty before the programs disappear or you get caught by an IRS examination letter.