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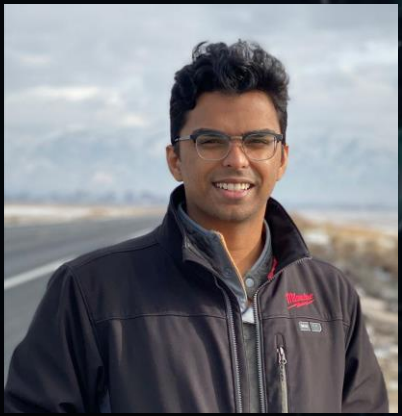
Virtual Event Series

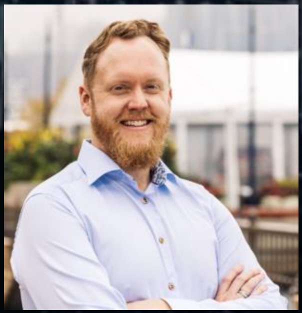
Crypto Tax Tete-à-tete

Guest Speaker:



Shehan Chandrasekera
Head of Tax Strategy
CoinTracker

Hosts:



Kenny Estes
CEO & Founder
Diffuse

Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseTap: Crypto Tax Tete-à-tete

Last time on DiffuseTap, Shehan Chandrasekera, Head of Tax Strategy at CoinTracker, talked to us about the many gray areas in crypto taxation, common myths and misconceptions around taxes for digital assets, and how to optimize your trades to minimize taxes.

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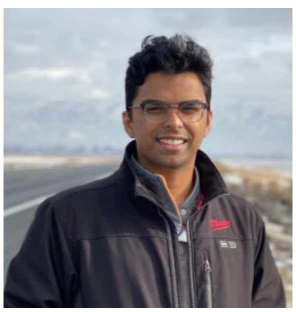
DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas) … straight from your armchair like a boss.

Meet the Speaker



Shehan Chandrasekera is the Head of Tax Strategy at CoinTracker, a portfolio and tax manager for cryptocurrency. Also a CPE instructor, Shehan has worked as a tax specialist at major companies including Forbes, focusing on accounting and crypto verticals. Winning a number of awards (including 2019 CPA Practice Advisor 40 under 40 accounting professionals), Shehan is recognized as a real-world operator and subject matter expert on cryptocurrency taxation. LinkedIn: @shehanc

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KENNY ESTES: Today's speaker is Shehan Chandrasekera. Shehan, can you please introduce yourself?

SHEHAN CHANDRASEKERA: Yes, my name is Shehan Chandrasekera, CPA and head of tax at CoinTracker, which is a cryptocurrency tax software tool. I'm here to answer your crypto tax questions and see how I can be helpful.

KENNY: Now's your chance to plug yourself, so can you give a little bit more detail on what CoinTracker does, and the problem you're trying to solve there?

SHEHAN: Sure. CoinTracker is a SaaS Company which was founded by Chandan Lodha and Jon Lerner in 2017. The problem with the crypto space is that none of these exchanges are giving good capital gains and capital loss reporting like brokerages. The typical crypto user has three to five exchanges, and they also interact with DeFi. At the end of the day, it's really hard for them to figure out their tax liability because their information and transactions are scattered across multiple places.

CoinTracker is a platform to which you can connect all your exchanges and wallets. CoinTracker automatically reconciles your cryptocurrency activity and gives you the reports that you need to file your taxes. CoinTracker has over 600,000 users. We support taxes in the U.S., U.K., Canada, and Australia. We are integrated with over 8,000 coins and over 300 exchanges. That's how CoinTracker works.

AYLA KREMB: Let's start with the first question, which is just a baseline. What are some of the mistakes that people make when it comes to crypto and taxes?

SHEHAN: A lot of people, believe it or not, think that crypto is not taxed, but it is taxed. That's the number one thing. On that point, a lot of people also think that just because crypto is built on this premise of decentralization, that it's completely invisible from the government. But that's not the case.

As you know, coins like Bitcoin are somewhat anonymous, but it's not completely anonymous. Your information is always on the blockchain. A lot of people who are new to the space think that crypto is not taxed. A large number of people think that. And even if they know that it's taxed, they don't want to report it because it's completely invisible from the government. But that's not the case.

The third thing is a lot of people think that the rules surrounding crypto taxes are not super clear. That's only partially true. If you're interacting with crypto, you're buying and selling, you're earning interest, or you're mining, the taxes are super clear for those main use cases, to be honest. But I would say that in 10% of those activities, we kind of have to guess what the tax treatment would be. But apart from those things, the taxation around crypto is pretty clear. Those are some of the misconceptions and mistakes that people make.

KENNY: Let's expand on that. I think we're already getting some questions in the chat there. What are the interesting developments in the last two years? I know a lot of people are talking about DeFi and NFTs. I'd say that for about probably three quarters of people, when they hear U.S., they think about restrictions from the IRS. What are the ambiguities, the question marks in this space right now, and what are the developments?

SHEHAN: I think last year we saw developments in DeFi, or more particularly, yield farming, which is a subsection of DeFi. Wherein, you would put your coin in some type of protocol, that protocol would give you a governance token, and you would take that governance token and go earn yield on another platform. The IRS hasn't given any direct guidance on how to tax those things.

But if we apply the general rules, it's reasonable to think that whenever you earn interest, even though you're not realizing that interest in USD, it creates a taxable event. The challenge is how to crack these things. Because you get these rewards credited every second, and some of these platforms don't even issue a year-end report. So, how are we going to crack these things? How are we going to quantify them? That's a challenge.

Last year we had DeFi and yield farming. In 2021, we saw the boom of NFTs. The IRS hasn't directly said how NFTs should be taxed. But again, if you apply the general tax rules, any type of art-based NFTs should be taxed as a collectible. There's a difference between something getting taxed as a collectible, versus a stock or security, or a digital asset.

The difference of a collectible is that if you are a high net worth individual, the collectibles are subject to a higher tax rate of 28%, as compared to the 20% highest tax rate that regular cryptocurrencies are subject to. And then, you also see these Web 3.0, or DeFi 2.0 things that are happening, like play-to-earn games. You have to wonder whether you're getting taxed on whatever token you're earning inside the game.

You also see these rebasing tokens like MetaversePro, and you have to wonder, are you really earning any income? Because as you're seeing your wallet balance going up, they're increasing the supply of that coin. So is it really earning income or not? Those are some of the ambiguities with the new things that we're seeing today.

AYLA: That makes sense. There are a lot of good questions coming in here, and I'm going to ask one. A lot of the exchanges only track the data in a way that's easily consumed, especially if you're staking in various places. I know Kenny knows exactly what it feels like to try to pull the ledger off one. It's just a nightmare.

What tools are out there to simplify this process, if any? And can it be applied to everything? Or is it limited, wherein you still have to manually pull out transactions to do more advanced stuff? How does it work?

SHEHAN: Going back to what I was saying in the beginning, the typical crypto user in the U.S. has two DeFi wallets or exchanges. There are transactions happening in between those exchanges, between centralized exchanges and self-custody wallets, as well as between centralized exchanges and decentralized exchanges. The problem is that only centralized exchanges issue some type of year-end reporting.

For example, Coinbase, Gemini, Binance, and a few others do this. If you're interacting with these DeFi protocols such as Uniswap, Aave, or Tao, etc., you're not going to get any type of reporting. The problem with that is, how are you going to figure out your taxes at the end of the year?

You cannot merely rely on what Coinbase is telling you as well. For example, let’s say you had one bitcoin in your self-custody nano ledger. You moved it to Coinbase and Coinbase sold it for, let's say, $50,000. Coinbase would report to you that you sold an asset for $50,000, but they would report that the cost of that asset is zero, because you didn't purchase that Bitcoin from Coinbase. So, the Coinbase report would be overstated in that example, because if you self-custody an asset, Coinbase doesn't have access to your cost basis. That's where a tool like CoinTracker could come in handy.

With CoinTracker, essentially what you're doing is connecting all your exchanges and wallets and giving CoinTracker access to read them. CoinTracker can combine all of your activity, detect the transfers, reconcile the cost basis, and apply the right lot ID method, based on whether you're selling something under FIFO, HIFO, or LIFO. And then, it generates your full tax picture at the end of the year so that you can file your taxes with it.

I would call these programs cryptocurrency aggregation tools. Single exchanges or wallets don’t have the visibility to see what's going on in your entire crypto profile. There has to be an aggregator that sits in the middle to combine all that activity, and give you the right reports.

KENNY: That's great. I recognize you're an accountant, so the next question is more of a nuts-and-bolts question particularly around DeFi yield farming. There are two different kinds of pools. There are pools that auto compound, and there are tools that spit out the resorbs and rewards that you have to harvest. What is your take on CoinTracker’s default policy, as far as when you have to actually realize that income? Is it income, or is it short term capital gains?

SHEHAN: Again, the IRS has not issued any direct guidance on that. All we can do is look at the general guidance that exists for non-crypto and apply it to crypto. That's one. Secondly, every platform has a different way of doing things. Generally speaking, whenever you earn something, like a token or a reward, you get taxed at the time you earn it, and you pay ordinary income taxes because it's ordinary income. And then, whenever you sell that token at a higher price, you would pay capital gain taxes based on the difference between the sales price, and the price at market value at the time you received it. Those are the general principles.

But again, each platform does it differently. For example, in Uniswap, you have to put a one-to-one ratio of two assets into a pool to get a unique token. And then, you're earning interest inside the pool. Therefore, there are several tax events that go into one Uniswap transaction.

The TLDR of it is that, whenever you earn something, it creates a taxable event. It's an ordinary income taxable event, even though you don't realize any cash. It's just the general rule. But again, every platform is doing things differently. We had to look into how each platform does things and tailor those general principles.

AYLA: That's a really good point about tailoring to the principles. There is a good question that pops up about trading style. In terms of being a professional trader and having hundreds of transactions a day, at that volume, is there no choice but to build your own tool to be able to deal with that? Or can you still use off-the-shelf tools? Kenny is running quite high volumes on our trades, and we've had no choice but to build and work with people to build our own stuff. So how does that work normally?

SHEHAN: Yeah. It's hard for high frequency traders. In CoinTracker, we have a handful of hedge fund clients for whom we had to allocate resources to build custom products. That's because whenever you do these 30,000 to 40,000 transactions a month, the systems have to be scalable to support that level. But basically, you have two options. Obviously, you can talk to some other platform and see if they can support your use case.

If not, and you're always on the latest blockchain or you're on the latest DeFi protocol, then it makes sense to build systems internally if you have the resources. If you're on the latest blockchain that nobody's using, I don't think anybody would build something for you because there's no other demand for that blockchain except you.

But that doesn't mean you should not be on the blockchain, because that might be where the highest ROI is, especially if you're the first to get there. But to answer this question, you can go for an off-the-shelf software like CoinTracker and see if they support the use case. If not, then you would have a problem. You'd have to make something internally.

KENNY: That's great. And again, the caveat is that this is not tax advice. The next question is about DeFi in particular. If you've got Ethereum, you're going to wrap Ethereum. So, when you convert that or bridge that, and you wrap Ethereum, is that a taxable event? Does that lock in any gains you have sitting on Ethereum, or not?

SHEHAN: This is a major issue. It's one of those gray areas. Again, I'll state the general principle that the IRS has issued. The IRS is pretty clear that if you're going from one coin to another, that is, if you exchange one coin to another coin, that's a taxable event. In the case of wrapping, you can take two approaches, given the IRS hasn't said anything directly on this case.

A conservative argument that you can take is that wrapped Ethereum is a separate coin from the regular Ethereum. Therefore, when you go from Ethereum to wrapped Ethereum, that creates a taxable event. To support that argument, wrapped Ethereum is a different line item on CoinMarketCap or CoinGecko. Also, you can directly trade wrapped Ethereum to other coins without converting it back to Ethereum. That's an argument for that conservative approach.

However, if you take the aggressive approach, which in my opinion makes more sense, it should not be taxable. Because again, when you convert your Ethereum to wrapped Ethereum, your intention is not to dispose of that asset. You're doing that to add additional functionality to that regular Ethereum, because regular Ethereum may not be accepted in a DeFi protocol.

Those are the two arguments you can take. The conservative approach is that you treat it as taxable. The aggressive approach, or the sensible approach, would be to say that it's not taxable, because your intention is not to sell it. Essentially, your asset is just changing from Ethereum to wrapped Ethereum. Unfortunately, there is no direct answer. We have no guidance. We can only take positions in these cases.

AYLA: To follow that up, maybe there's a way to optimize your trading to fit your taxes better. How do you optimize your taxes to save a little bit on them? When you look at your own trading books, what do you look out for where you could potentially optimize how much you owe at the end of the year?

SHEHAN: I think there are some strategies that are available to funds and individuals. The number one thing I've seen people using is the right lot ID method. Essentially, the lot ID method signals to the IRS which specific unit of crypto you're selling for tax purposes. Ideally, what you want to do is use the HIFO accounting method, which is highest in first out.

When you use that method, anytime you sell your positions, you're always disposing of the coin with the highest cost basis. That results in the least number of gains at the fund level, and also at the individual level. That’s because the fund distributes that profit and loss to the K-1s.

I'm not sure how practical this is at the fund level, but at the individual level, another easy thing that you can do if you really want liquidity is to make sure you sell your long-term coins first. That’s because long term capital gains are very favorable for taxpayers, as compared to short term capital gains. The highest long term capital gains rate is 20%. The highest short term capital gains rate is 37%. There is a big delta there. If you really need liquidity, if you really need to sell something, such as to rebalance, sell your long-term position first. Those are the two major things you can do.

As you know, the crypto market goes through ups and downs. So I would say the third thing you can do is tax loss harvesting, which should be done every month, or whatever frequency that is manageable. For example, use a site like CoinTracker. We track your portfolio, and we can show you which assets you can offset those taxes from, and what your tax savings is.

The other good thing about crypto is that crypto is not subject to the wash-sale rule that stocks and securities are subject to. If you want to do so, you can sell your losing positions and quickly get back into the same position without waiting for that 30-day period and claim the loss.

Those are the three things I would do. To summarize, one, use HIFO accounting. Number two, if you really need cash, make sure you sell your long-term positions. And number three, do tax loss harvesting frequently. Not just at the end of the year, but every month if you can. You can do tax loss harvesting all throughout the year.

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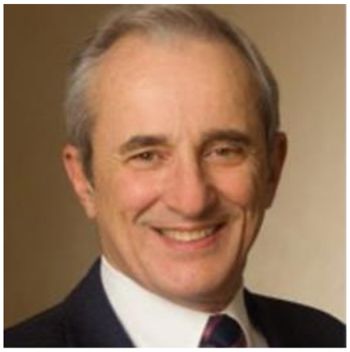
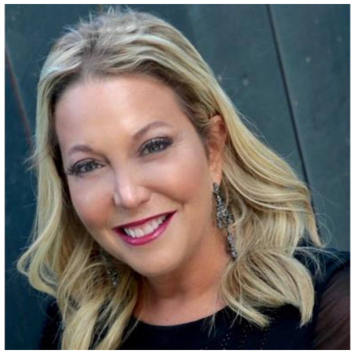


Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on



Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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