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Virtual Event Series

Crypto Taxes Decoded with Binance.US

Guest Speaker:

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DiffuseTap: Crypto Taxes Decoded with Binance.US

Last time on DiffuseTap, Raj Mukherjee J.D., Vice President and Global Head of Tax at Binance.US, talked to us about the gray areas and pitfalls within the current U.S. crypto taxation system, what the U.S. could learn from other countries, and how the IRS is approaching taxation on staking versus how they should be.

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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

Raj Mukherjee J.D. is a seasoned tax executive who oversees end-to-end tax obligations for Binance.US as Vice President and Global Head of Tax. Raj is also currently Co-Chair of the Tax Working Group at Blockchain Association. He has held a string of leadership positions in numerous global 100 companies, including as Global Head of Tax Information Reporting at Coinbase.

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KENNY ESTES: Joining us today is Raj Mukherjee. Raj, if you wouldn't mind, do you want to introduce yourself and give a brief intro on your background and what you do on Binance?

RAJ MUKHERJEE: Okay. I'm Raj Mukherjee, Global Head of Tax at Binance.US. I am a lawyer by trade, and I've been in the traditional finance tax world for most of my career. I switched over to crypto taxation about four years ago with Coinbase, where I managed their global reporting program for tax. And then recently, I joined Binance.US, which is the US affiliate of Binance.com (a different legal entity), as their Global Head of Tax.

AYLA KREMB: Beautiful. I'll just hop in with the first question. When you look at the current U.S. crypto tax system, what is it like, including the good, the bad and the ugly? Is it still a mess? Is it actually better than what people think? What is your view on that?

RAJ: Well, that is a million-dollar question. But I'll try to answer it without getting the million dollars, because I know you're not sending that my way. Well, I think the good is that we have some direction now. I think for a long time, the regulators were sitting around without releasing much, and people had a lot of confusion. When the IRS released some FAQs for tax purposes, defining crypto as a property, there were still a lot of questions unanswered.

And so, what ended up happening was, you had a highly innovative industry moving forward where people traded various coins, but there was a lot of confusion on how to report the income from a consumer perspective to the IRS. And then, a few years ago, that got more complicated because the IRS put this little box on the US tax return that basically said, "If you have traded crypto, you need to check this box and then provide all these details."

However, the regulated exchanges had no obligation. You could compare that to your regular broker dealer where you trade stocks and bonds. All of that would be included in a 1099-B at the end of the day, and you would have to do all of the work. But we've come some ways. We still don't have regulations, but the infrastructure act now gives directives to the U.S. Treasury Department, and we have some indication from Treasury that regs are coming soon.

We know now that starting January of 2023, crypto as an asset class will be re-designated to security. That has some parallels on how that works. But I think there's still a lot of unknown, generally. One, like I said, the regulations are not out yet. Two, we really don't have enough time as regulated exchanges to change our infrastructure within less than 12 months to get everything ready for reporting. We definitely need more time.

There are ongoing conversations with the regulators on this subject. While we have some directives, we still have a lot of unknowns in terms of who's included, what asset types are included, and who cannot be part of it. There was a lot of hue and cry about miners being included, for example, or some of the other actors who really don't fit into what the directive of the regulations are. And we really didn't get a lot of guidance from the regulators.

I think there are a lot of people who are expecting that the regulators will come up with perhaps transitionary periods, where they'll say, “Look, collect the information, but you don't need to report it.” There will hopefully be some suspension of any punitive action for reporting purposes.

Because, in the past, in my previous life when such regulations had hit the ground, we had between 18 and 24 months at an institution to internally educate customers, change our technology and architecture to collect the right information, and then give it to the government. We don't have that time; we don't have very specifics on the government. I guess that would be the ugly.

And then finally, if the government wants us to report, there needs to be some kind of a schema or a form on which we should report this. Something that the customers could then take to their CPAs or whatnot, and say, “here's what I've done.” We don't have any directives as of yet on what that form is going to be, either. A 1099-B is a possibility. But again, I'm just saying that because it's an asset class change to security. The form could be something else altogether.

KENNY: That’s super thorough, I really appreciate that. So, you’re obviously with Binance.US, which like you said is a different legal entity than Binance Global. You've talked about the U.S., and it sounds like things are improving, but we’re still four years behind and still catching up. What does the international landscape look like? What are the countries that in your opinion are doing particularly well? I've heard a lot about Zug in Switzerland. How does the U.S. compare to non-U.S. entities or agents?

RAJ: I think the OECD is trying pretty hard to get some proper directives in order. But I think the problem with the OECD, or the challenge rather, is that you have a large number of member states and each of them have their own opinion on what information they need to collect. For example, some countries such as Norway and France that are traditionally keen to collect every piece of information, want to collect all of it. They want transactional level information.

Whereas a country like the U.K., which by the way, has pretty detailed and very wholesome directives on crypto, want more aggregate information. I think the working party 10, which has been working on these directives, are looking to the Common Reporting Standard and seeing what to do as an extension of that. I think it will be similar, in my opinion, to the Common Reporting Standard in that they will have an overall directive. And then, each country will probably have its own national legislation where they will interpret that directive in a manner that works for them.

In the US, the main objective of CRS or FATCA ended up being the exchange of information. Now, do we get there? I don't know. Are we going to exchange crypto transaction information between governments? I think that remains to be seen. But I think the first step is we need the regulations. Singapore has been pretty good with that as well. As I said, HMRC has a really good set of directives that help customers qualify what it is that they're looking into.

They have done their version of John Doe Summons to various regulated exchanges, as I understand, to get information. And they're trying to assess what the right way of collecting this information is. This is new to everybody. I think one of the things that needs to be understood is that, from a regulator’s perspective, this is a big challenge. It's an industry that goes extremely fast from ideation to market. And the rules that we have from the financial world don't quite neatly fit.

It's a matter of figuring out what asset class fits into what, whether we should have various categories of it, and how they should be taxed. If you look at something like NFTs, depending on the actors that are involved, the taxation can be quite different, whether it's an individual trying to sell their own product versus going through a gallery or whatnot. I do empathize with the regulators in these challenges. They have to think of this and think of it quite quickly and come up with rules that then can be pragmatically implemented.

AYLA: You're exactly right. There are so many tight little nuances that we might want to dig into. A big one is staking. How is that treated from a taxation purpose at the moment? Is that interest or is that income? How does that get treated currently?

RAJ: So, because crypto is categorized as property, interest is not really deemed as interest. It's actually determined as fees. In the United States, any rewards you get from staking is generally reported as fees on a 1099 miscellaneous. And just for everybody's knowledge, the 1099 miscellaneous has a threshold of $600 per customer, not per product.

If you had staking rewards, or something like rewards that certain exchanges give you for going and taking a class or what have you, all that put together from a single regulated exchange, then they will issue you what is known as a 1099 miscellaneous. And that's where the staking rewards are reported currently. Now, will that change once the asset class is different? Probably. But we don't know what it will change to.

KENNY: That makes a lot of sense. A follow up question is around NFTs. That's a new area that's interesting. There's a part of yield farming within NFTs that raises this crystal ball question. How are those going to be taxed? Is it just all cap gains? Is it going to be handled separately from just these DeFi assets? What are your thoughts around that stuff?

RAJ: I think the challenge with NFTs is characterization and valuation. It's just difficult to identify. As a result, the tax treatments are quite different. As I was saying earlier, if you are an artist who is selling the NFT directly, at least in the U.S., then that could be treated as employment income subject to self-employment tax.

If you're going through galleries where the NFTs are being auctioned off or whatever, then there's issues like royalty income and things like that. And then, there are marketplaces where you have both individuals and galleries that are competing for consumers. So, those could be a whole other area.

It's hard to know. I doubt that there is going to be a single tax treatment for NFTs. I think it's one that will be very challenging for the regulators. If I look back on how they've done this in the traditional world, I think that would be one area wherein who the consumer is, or who the payee is of the income, will determine what the tax treatment would be.

AYLA: When you look at the way that you approached this whole tax system when you were at Coinbase, building it from scratch, what are the changes that you have seen in the last 18 months or so that people should really be aware of when it comes to the way that the IRS looks at crypto? Are they more detail oriented? Is it easy for them to verify people's tax returns these days? What has changed that traders and investors should be aware of?

RAJ: I would say that in the last few years, the reporting from the IRS perspective really hasn't changed. I will try to break it down by category. If you are someone that buys and sells crypto, right now there's no requirement to track something called cost basis, which is the cost of purchase. If you're doing it on a regular exchange, like Binance.US, where you come in and you buy Ethereum on our exchange and then you sell it, you know what you actually bought it for and what you sold it for. Therefore, you know what your capital gains are. That's a pretty easy thing to do.

The challenge that happens, and this is more the norm, is that very few people have accounts in just one regulated exchange. They usually have multiple wallets and multiple exchanges. The whole concept is buy from where you think is the cheapest, and sell where you think is the best price. You transfer your assets within wallets.

One of the things that happens in the traditional securities market in which there has been no requirement for in the crypto market is the transference of the basis. For example, if you bought something from Kraken and you moved it to your wallet in Binance.US to sell it, unless you are tracking it yourself, that information actually doesn't go from one to the other.

Then, let’s say you did 1,000 transactions in a year and you didn't keep track of it. At the end of the year, your CPA comes to you and goes “well, I need to calculate your gains.” That's a big challenge if you haven't kept records. That’s because the regulated exchanges at the moment do not have a requirement to send that basis across different exchanges. One of the things that I have spoken about through many industry trade associations to the regulators is that these rules need to be standardized, both to help us comply, and also to help customers comply.

The other thing I would say is that when I started at Coinbase and was given a blank slate to build this program, there's a lot of internal challenges that one needs to be aware of as well. Time being the most important one. Anybody who's been in any firm that builds any technology knows that it takes a while to build. You also need to make a decision on whether you're going to use internal resources to build, or you're going to look for outside vendors to buy from. If you do want to buy, then you have to customize it to what it is that you have within your internal orchestrate architecture. That takes time.

And then, outside of just the tax resources or finance resources, the other thing I have to think about is, are the engineers and development folks in our company best suited to spend a lot of time building something that's for tax compliance? Probably not. They want to build things that are more product-oriented. There's a lot of balancing going on. And in the middle of all of this, you have a lot of uncertainty.

I can report some income types the 1099 miscellaneous. I know that much. But some exchanges I know just send out 1099-Bs with proceeds in it. Other exchanges used to issue something called 1099-Ks, which most people don't anymore. So, there's a lot of discrepancy. I think that all these decisions have to be made, both internally, and also in looking at minimizing confusion for the customer who, again, has the responsibility to report their income, when there's not really a really good way to do it.

The IRS does have a form called 8949, on which they expect U.S. taxpayers to outline their crypto transactions. But that is most likely going to go away once they come up with which 1099 form, they want the customers to report on.

KENNY: That makes sense. You touched on this there at the end, but I don't know if Binance.US supports staking so that you get your 1099-B at the end of the year. But a lot of the things are on-chain these days. So, for traders, you're getting a lot of things on-chain, including sleepless nights from some of these protocols, but you're not getting a 1099. So, what are the trader options at that point? How is that managed? Is it that 8049, or whatever that form was? What are your recommendations for people that are a little bit further down the rabbit hole?

RAJ: I mean, this is as good a guess of mine as anybody else. I think the 8949 is a way to track your transactions. Is it going to work for the scenario that you explained? I don't know. I think the IRS is struggling on things like smart contracts and DeFi, and what to include and what not to include. Frankly, I don't see how DeFi protocols can fit into this mold of what we traditionally call tax reporting.

For some of the reasons you point out, it's like there are no active people for the things that are happening on the protocol. And if you think of how our taxation systems are worked out, there's always an actor who is a payor and an actor who is a payee. You know exactly who they are. And there are all these stop gaps in the middle.

I think that's one of the things that we are waiting for the IRS to see, if that's going to be part of the in-scope reporting or not. I think they may come up with some creative way of saying, "Look, some of this has to be reported." But to be honest with you, your guess is as good as mine. If I had to guess, I doubt it. But I can't actually say.

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VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

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