

TAX AUTOMATION FOR DIGITAL ASSETS

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Speakers



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Blockchain and Digital Assets –
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Topic	Speaker
Introduction - RSM	Mike Graber / Skip Carlson
Digital Asset transactions and taxation	Mario Sabates / Skip Carlson
Digital Asset tax software overview	Mario Sabates / Mike Graber
First choice advisor	Mario Sabates / Mike Graber
Finale	Mike Graber / Skip

RSM BLOCKCHAIN & DIGITAL ASSET TAX



- ✓ Demonstrate the risk mitigation benefits from utilizing a technology solution backed by professional review
- ✓ Review clarity to positions to allow for future tax planning opportunities
- ✓ Identify outcomes including the calculation of realized and unrealized gains and losses
- ✓ Explain the measurement of income and expenses
- ✓ Demonstrate the support provided to generate financial statements through tax technology



Bringing our experience to organizations that engage with Digital Assets

Clients & Projects

A list of clients and success stories can be shared upon request.

We have successful client engagements in a variety of project types including:

- Assurance Services
- Tax Advisory
- Chartering & Licensing
- BSA/AML/OFAC
- Product Strategy
- Risk Assessments
- Penetration Testing
- Technical Accounting
- Policies & Procedures
- Valuations
- Token Incentive Plans
- Operational Due Diligence
- Financial Due Diligence
- Global Structuring
- Transfer Pricing
- ERP Implementations
- Regulator MRAs
- Vendor Selection

Clientele

RSM provides blockchain and digital asset services to more than 350 clients nationally, including:

Exchanges, protocol foundations, RIAs, NFT marketplaces, MSBs, Digital Asset Securities, broker dealers, banks, custodians, trust-companies, on-chain data providers, payment processors, fintech companies, proprietary trading firms, hedge funds, insurance companies, miners, gaming platforms, digital media, and other blockchain enabled companies.

Benefits to our clients

- Keeping clients informed of evolving regulatory guidance as it pertains to their unique business and digital assets
- Helping anticipate and model both risks and opportunities concerning digital assets
- Staying proficient with new technical elements from both a risk and implementation perspective
- Deploying audit, tax, and accounting tools and services specific to the digital asset space
- Connecting industry peers for collaboration and development

RSM Blockchain by the numbers



Over 400

Digital Asset clients nationally



Leading

AICPA Digital Assets Working Groups



Largest

provider of audit, tax and consulting services to the middle market



100+

professionals serving the Blockchain industry

Specialized tax services for Blockchain and Digital Assets

RSM stands as an industry leader in applying specialized tax knowledge to the evolving landscape of blockchain and digital assets. We're committed to enhancing our clients blockchain ventures by offering comprehensive expertise across the following key areas

Tax compliance, planning, and reporting

- ✓ **Tax compliance and cost basis calculations**
 - Expertise in various digital asset sub-ledger tools for accurate and seamless calculations and tax return preparations
- ✓ **Tax planning and strategy**
 - Formulation of tax-efficient strategies and structures to minimize liabilities, considering the implications of business models in the blockchain industry
- ✓ **Taxation of validation rewards**
 - Specialized guidance on tax liability arising from mining and staking rewards
- ✓ **Disposition characterization**
 - Comprehensive analysis of blockchain transactions for tax implications (i.e., capital vs. ordinary)

Legal entity structuring

- ✓ **International tax structuring**
 - Advisory services for cross-border tax optimization
- ✓ **M&A structuring**
 - Tax efficient structures for mergers and acquisitions
- ✓ **Transfer pricing**
 - Support tax-efficient pricing of intercompany transactions involving goods, services, or intellectual property

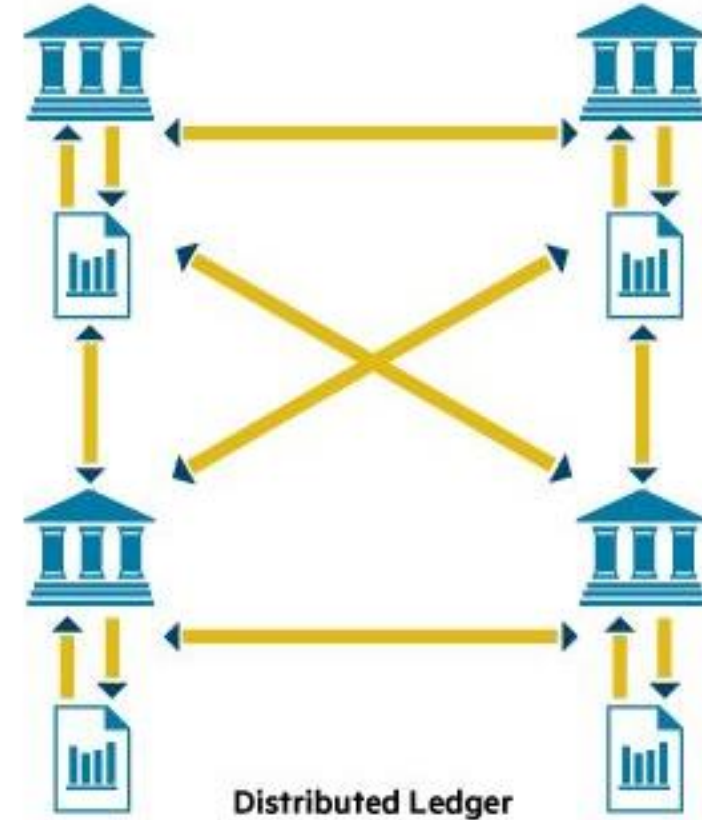
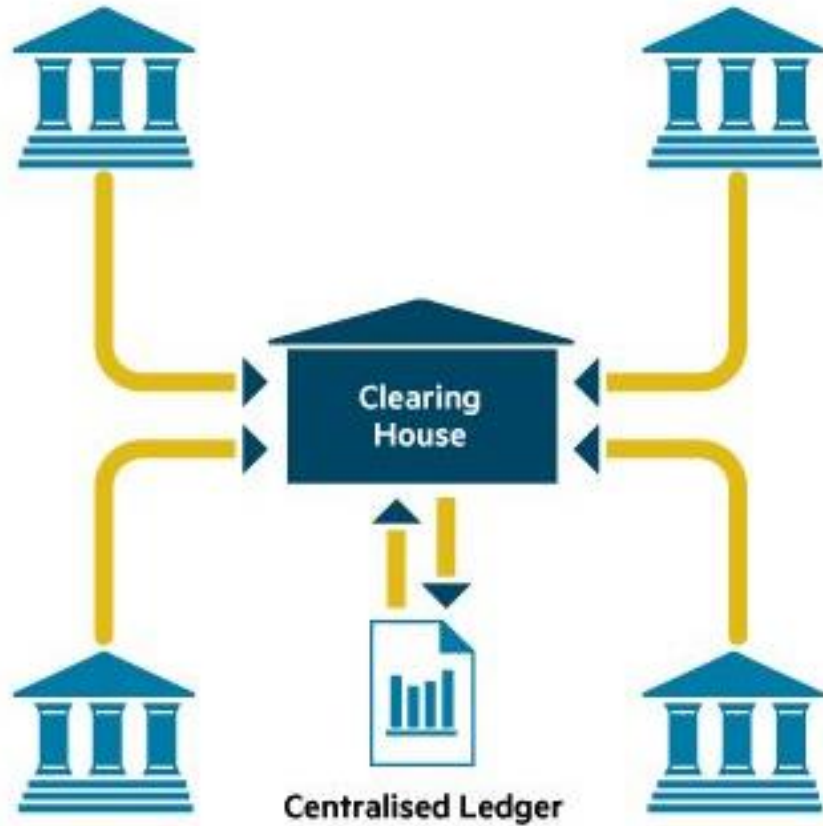
Strategic tax services

- ✓ **VAT consulting & compliance**
 - Advise businesses on navigating VAT laws, ensuring compliance with reporting and payments
- ✓ **SALT advisory**
 - Provide guidance on state and local tax obligations while optimizing tax savings
- ✓ **Global information reporting**
 - Consultation on global reporting obligations, including FACTA and CRS

DIGITAL ASSET TRANSACTIONS



Centralized versus distributed ledger



FT graphic. Source: Santander InnoVentures, Oliver Wyman & Anthemis Partners

Consensus mechanisms

- A “**consensus mechanism**” is the standardized way of how a blockchain’s **nodes** reliably agree on who owns what at any time.
 - A node is device (i.e., computer) that runs the blockchain protocol software.
- Proof-of-stake (“POS”) and proof-of-work (“POW”) are the two major **consensus mechanisms** cryptocurrencies use to verify new transactions, add them to the blockchain, and create new tokens.
- POW is mining (as done with Bitcoin). This entails using computing power to solve complex mathematical problems.
- POS entails posting (staking) a certain amount of cryptocurrency in return for the chance to validate transactions on the blockchain and earn rewards.

Mining (oversimplified)

- Step #1: A miner invests in powerful computer equipment like a graphics processing unit (GPU) or application-specific integrated circuit (ASIC).
 - These can run from \$500 into the tens of thousands of dollars.
- Step #2: Every 10 minutes, the Bitcoin network generates enough transactions to make a new “block”. For the new transactions to be confirmed, they need to be included in a block along with a mathematical proof of work.
- Step #3: The computers runs cryptographic formulas trillions of times per second, in hopes that they’ll be the first to produce a “hash” that satisfies the mathematical proof’s conditions.
- Step #4: If successful, the miner earns the opportunity to submit a block (with the newly generated hash), and if the other computers on the network find that it conforms with their records, the miner gets a reward (i.e., more BTC).
 - Hashes are a one-way encryption tool used by miners as an identifier for any particular block.
 - Altering even the tiniest component of a block would noticeably change its hash and that of every following block, too. The other miners would instantly reject this incorrect version of the blockchain, protecting the network from tampering.

Staking (oversimplified)

- Step #1: Buy ETH to lock up (stake) in the Ethereum's staking smart contract.
- Step #2: Set up a validator node.
 - A node is a basically a computer linked to the network which can perform specific tasks.
 - Requires technical knowledge, and a dedicated computer with enough memory space to perform validations day or night without any downtime.
- Step #3: The protocol will randomly assign blocks to validators. If chosen, the validator will propose a new block and validate the transactions inside. The rest of the validators vote on the proposed block and attest to the transactions.
- Step #4: Once the new block is added to the blockchain, the protocol rewards the validator with a staking reward (i.e., more ETH).

DeFi summary

- Decentralized Finance (“DeFi”)

- Defi is a catchall term for a group of financial tools and application built on a blockchain (e.g., Ethereum) and allow users to engage in financial transactions without the use of financial institutions or middlemen
 - Examples: trading, borrowing, lending, etc.
- Each DeFi protocol is permissionless (i.e., there is no third-party), the protocol runs on “smart contracts” (self-executing computer programs that perform the functions of a traditional contract)
- Each transaction on a DeFi protocol is executed peer-to-peer

“On-chain” versus “Off-chain”

- “On-chain” transactions refer to digital asset transactions that occur on the blockchain and remain dependent on the state of the blockchain for their validity.
 - Ex: Send BTC on Bitcoin blockchain.
 - Ex: DeFi applications
- “Off-chain” transactions don't occur on the blockchain network, but instead, are transacted on another electronic system such as PayPal.
 - Ex: Buying or selling crypto on Coinbase or Binance.

DeFi protocols

- Decentralized Exchanges (DEXs)
 - Utilize automated market-making—which means that rather than depending on an exchange’s order book, trades are filled using liquidity provided by ordinary traders who pool their holdings together with other traders, in what is called a liquidity pool.
 - Example: Curve, Uniswap, and PancakeSwap
- Lending protocols
 - Allow users to lend money, earn interest and take out collateralized loans.
 - Example: Compound, Aave, and MakerDAO

NFTs

- NFT means non-fungible tokens (NFTs), which are generally created using the same type of programming used for cryptocurrencies.
- NFT is a digital asset that represents internet collectibles like art, music, and games with an authentic certificate.
 - Anything can become an NFT—a piece of art, sports memorabilia, or even a tweet.



IRS guidance

- IRS Notice 2014-21
 - Guides individuals and businesses on the tax treatment of transactions using “convertible virtual currencies”.
 - For federal tax purposes, **virtual currency is treated as property**. General tax principles applicable to property transactions apply to transactions using digital assets.
- Forty-six Frequently Asked Questions (“FAQs”) on virtual currency transactions
 - Expands upon the examples provided in Notice 2014-21 and apply those same longstanding tax principles to additional situations.
- Revenue Ruling 2019-24
 - Addresses the tax implications of hard forks, airdrops, soft forks, and **constructive receipt**.
- Revenue Ruling 2023-14
 - IRS has ruled that rewards received by a cash-method taxpayer “staking” cryptocurrency in connection with validating blockchain transactions must be included in the taxpayer's taxable income in the year the taxpayer gains control over the staking rewards.
- Notice 2023-27
 - The Treasury Department and the IRS announced on March 21, 2023, that they are soliciting feedback for upcoming guidance regarding the tax treatment of NFTs as a collectible under the tax law.
 - Look-through provision
 - Ex: if an NFT certifies ownership of a gem, it constitutes a collectible under Code §408(m)(2)(C).

Treatment of cryptocurrency for U.S. federal tax purposes

- As property, generally:
 - Anytime digital assets are involved in a transaction, you'll have reporting requirements (e.g., Form 8949) even when using stablecoins pegged to the USD
 - Not treated as a currency
 - You are required to pay a capital gains tax when disposing (selling, trading, or using as means to purchase) of your cryptocurrencies
 - You must include in gross income the FMV of cryptocurrency received:
 - As payment for goods or services
 - For “mining” activities
 - From an airdrop
- FMV and basis of cryptocurrency received:
 - The FMV of the cryptocurrency received is measured in USD, as of the date received
 - If listed on an exchange and the rate is established by market supply and demand, the FMV is the conversion of cryptocurrency into USD (or into other real currency, then into USD)
 - **The basis of the cryptocurrency received is the FMV in USD, as of the date received**

Timing/Inclusion of income

- According to Rev. Ruling 2019-24, cryptocurrency received from an airdrop generally is received on the date and at the time it is recorded on the distributed ledger.
- However, a taxpayer may constructively receive cryptocurrency prior to the airdrop being recorded on the distributed ledger.
- The IRS clarifies that a taxpayer does not have receipt of cryptocurrency when the airdrop is recorded on the distributed ledger if the taxpayer is not able to exercise **dominion and control** over the cryptocurrency.
 - Example: the cryptocurrency is airdropped in a wallet managed through a cryptocurrency exchange and the cryptocurrency exchange does not support the newly-created cryptocurrency

Cost basis assignment

- Notice 2014-21 and 2019 FAQs
 - Your cost basis is the amount you spent to acquire the virtual currency, including fees, commissions and other acquisition costs in USD
- Tracking basis in each separate unit of cryptocurrency
 - Default (i.e., preferred) method – FIFO
 - Specific identification (IRS 2019 FAQ)
 - HIFO, LIFO, etc.
- Does the IRS expect you to apply whatever cost basis assignment method you choose consistently in future tax years?

Fees

- Most transactions involving cryptocurrency require taxpayers to pay a fee.
 - Trading fees or conversion fees;
 - Withdrawal or transfer fees; and
 - “Gas” fees paid to node operators for maintaining the blockchain.
- You may be able to subtract or add gas fees from or to your capital gains or cost basis, depending on what they’re being used for.
 - Fees can be added to your cost basis when you make a purchase.
 - Paid \$1,000 for ETH plus \$50 trading fee (\$1,050 basis)
 - When selling, fees can be subtracted from sales proceeds.
 - Sold ETH for \$1,500 plus \$50 trading fee (\$1,450 proceeds)
 - Exchange ETH for BTC? Either or.
 - \$400 in gain and \$1,500 basis in BTC; or
 - \$450 in gain and \$1,550 basis in BTC.
- DeFi activity often involves a whole series of transactions, so keeping track of fees can get tricky!

Fees

- Claiming rewards/airdrops?
 - Cost basis is FMV + fees paid to claim
- Fees transferring tokens or other miscellaneous fees not involving the direct acquisition or disposition of an asset?
 - Example: Fee to transfer my assets to another wallet
 - Misc. expense?
 - Ordinary business expense?
 - Investment expenses?
- **Important:** Most fees are paid with digital assets. Thus, generating both a potential expense **and** gain or loss on the disposition of said asset.
 - Ex: Bob pays a 0.03 ETH (FMV \$10) gas fee to transfer his assets to another wallet. His basis in the 0.03 ETH is \$5.

DIGITAL ASSETS TAX SOFTWARE



Features of Digital Asset Tax Software

- **More Accurate Digital Asset Reporting**: accurate reporting on all transactions brings clarity. Users can quickly analyze the implications of their trading activity from a taxation standpoint.
- **Automated Tax Filing**: automate the entire process of filing taxes, no more manual entry of data into forms or worry about incorrect calculations.
- **Time Savings**: leverage powerful algorithms and automation tools.
- **Save on Tax Compliance Cost**: keep compliance costs low by reducing errors due to human error and simplifying processes through automation.

Importance of accurately reporting Digital Asset transactions

1. The automated system makes it easy to track gains and losses over time, allowing users to accurately file taxes each year without worrying about missing any important information.
2. It also allows users to adjust their strategies according to changing regulations in order to make sure they are compliant with the latest laws.
3. Additionally, some services provide additional guidance throughout the process if users need help understanding more complex concepts like capital gains deductions or foreign currency conversion rates.
4. This means fewer costly mistakes that could lead to surprised tax assessments, including interest and penalties. Also provides greater peace of mind knowing that tax positions has been considered and calculated properly in real time.

Digital Asset Tax Software



Different types of Digital Asset Tax Software

1. **Digital Asset Tax Calculator**: assists users with automatically calculating their capital gains taxes on Digital Asset investments. The results are then used as part of the user's overall Digital Asset tax report and filing process.
2. **Digital Asset Tax Reporting**: provides users with an automated way to generate reports that track all relevant transactions and account balances associated with their investments over time.
3. **Digital Asset Tax Filing Software**: helps taxpayers complete their IRS forms quickly and accurately by automating the entire process from start to finish.
4. **Digital Asset Accounting Software**: Bookkeeping & ERP solutions

Importance of choosing the correct Tax Software for you

- Digital Asset investors have a vast array of software options for managing their Digital Asset tax obligations. These tools range from calculators and reporting systems to filing applications and preparation platforms.
- Many Digital Asset tax software options are designed with a geo-centric or one-size-fits-all approach, which may not be suitable for those dealing with specific local tax laws or types of transactions.
- The more features you need the more costly! Depending on what you need, you may not want all the bells and whistles.
- Does the tool accept the exact Digital Asset you trade, the exchanges you trade on, and the wallets you use?
- Different tax tools accept different amounts of Digital Asset.

FIRST CHOICE ADVISOR



Limitations of Digital Asset Tax Software

- **“Garbage in, garbage out”**
 - If you haven’t linked all your wallets and exchanges, your numbers will likely not be correct.
 - If you’ve been interacting with Digital Asset for multiple years but this is your first-time reporting, you need to start at the beginning. It’s critical to have your cost basis for each taxable event.
- **Limited automation capabilities**
 - For many types of transactions (such as wrapping tokens), there are multiple tax positions you could take depending on whether you want to be more careful or more aggressive.
 - Some tools have a limit on how much transaction volume it can handle.
 - No tool is both great at taxes and creating financial statements.
- **Difficulty integrating with exchanges & wallets**
 - It’s difficult for every tax software to support every new chain that pops up—especially if you’re using niche protocols. Digital Asset is evolving rapidly, and new blockchain protocols are constantly being developed and improved.
- **Manual input required for some data points**
 - *Correctly classifying all these transactions automatically is an industry-wide problem.* Fixing these errors often requires manual review or even legal analysis.

The intersection between Digital Asset Tax Software & RSM



Expertise



Human Oversight



Peace of Mind



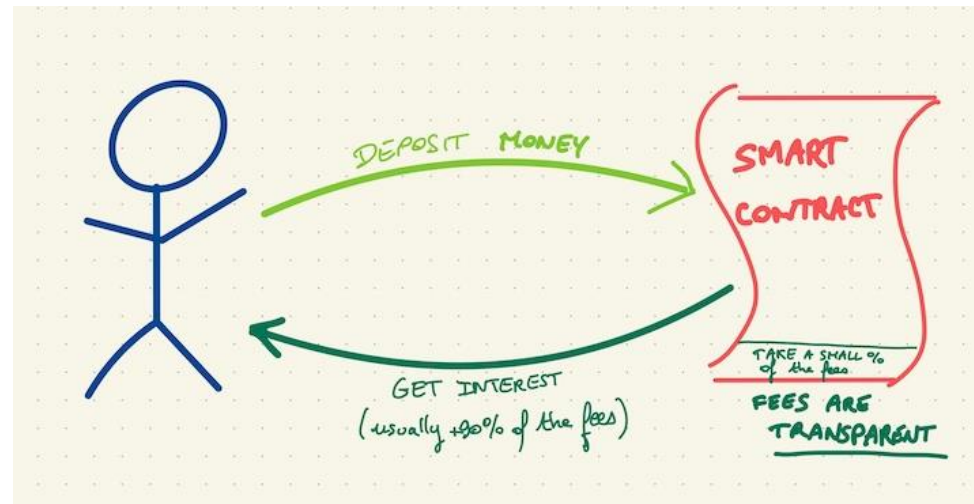
Localization

The case for RSM

- RSM brings a wealth of expertise to the table. We have extensive knowledge of tax laws and years of experience using these tax software tools to offer personalized advice that aligns with your specific situation.
- While Digital Asset tax software is becoming increasingly sophisticated, there's a unique value in human judgment. RSM can review your transactions for any inconsistencies and offer strategic advice that software may be unable to provide.
- There's a level of comfort and confidence that comes with knowing a seasoned team is managing your Digital Asset taxes. RSM can keep you updated on the latest tax laws and ensure that you're in full compliance, giving you the freedom to focus on your investments or other interests.
- One of the standout benefits of using RSM, especially for those outside the United States, is the advantage of localization. Many Digital Asset tax calculators are U.S.-centric or adopt a one-size-fits-all approach.

GMX example






















- GMX is a decentralized spot and perpetual exchange that supports low swap fees and low-price impact trades.
- Trading is supported by unique multi-asset pools that earns liquidity providers fees from market making, swap fees and leverage trading.



GMX example

- When taxpayers stake GMX on the protocol, taxpayers receive an equivalent amount of sbfGMF.
 - sbfGMF is a nontransferable placeholder token representing the amount of GMX staked—burn sbfGMF to reclaim your staked GMX.
- GMX stakers receive escrowed GMX (“esGMX”) and ETH from protocol revenues. esGMX is a nontransferable token generated by the smart contract which represents future newly minted GMX.
- Staking rewards can be claimed at any time.
- esGMX can be staked or vested. Staking and vesting esGMX can be done at any time.
- After initiating vesting, the esGMX tokens will be converted into GMX every second and will fully vest over 365 days. esGMX tokens that have been converted into GMX are claimable at any time.

GMX example

 Deposit 4:08 PM	 0x0000000000...	→	ARBITRUM  + 0.25453953 SGMX ≈ \$0.00
 No market price found for SGMX on this date. Learn more			
 Deposit 4:08 PM	 0x0000000000...	→	ARBITRUM  + 0.25453953 SBG... ≈ \$0.00
 No market price found for SBGMX on this date. Learn more			
 Deposit 4:08 PM	 0x0000000000...	→	ARBITRUM  + 0.25453953 SBFG... ≈ \$11.39
 Cost 4:08 PM	ARBITRUM - 0.00006729 ETH \$0.11 cost basis	→	 0xa906f338cb2... ≈ \$0.11
 Send 4:08 PM	ARBITRUM - 0.25453953 GMX \$11.54 cost basis	→	 0x908c4d94d3... ≈ \$11.39 - \$0.15 loss
 Send 4:08 PM	ARBITRUM - 0.25453953 SGMX \$0.00 cost basis	→	 0x4d268a7d4c... ≈ \$0.00
 No market price found for SGMX on this date. Learn more			
 Send 4:08 PM	ARBITRUM - 0.25453953 SBGMX \$0.00 cost basis	→	 0xd2d1162512f... ≈ \$0.00
 No market price found for SBGMX on this date. Learn more			

GMX example

From: [0x8ed1bccd1e08d7ee119f8ee63c2d59a7d064022d](#)


Interacted With (To): [Contract 0xa906f338cb21815cbc4bc87ace9e68c87ef8d8f1](#) (GMX: Reward Router)

- ERC-20 Tokens Transferred: 9
- From [0x8ed1bccd1e08d...](#) To [0x908c4d94d3492...](#) For 0.254539525327419071 (\$12.84) ▲ GMX (GMX)
 - From [0x23208b91a98c7...](#) To [0x908c4d94d3492...](#) For 0.134973556300033262 Escrowed GMX (esGMX)
 - From [Null: 0x000...000](#) To [0x8ed1bccd1e08d...](#) For 0.254539525327419071 Staked GMX (sGMX)
 - From [0x8ed1bccd1e08d...](#) To [0x4d268a7d4c16c...](#) For 0.254539525327419071 Staked GMX (sGMX)
 - From [0x03f349b3cc4f20...](#) To [0x4d268a7d4c16c...](#) For 1.81875709502366704 Bonus GMX (bnGMX)
 - From [Null: 0x000...000](#) To [0x8ed1bccd1e08d...](#) For 0.254539525327419071 Staked + Bon... (sbGMX)
 - From [0x8ed1bccd1e08d...](#) To [GMX: Staked GMX](#) For 0.254539525327419071 Staked + Bon... (sbGMX)
 - From [0x1de098faf30bd7...](#) To [GMX: Staked GMX](#) For 0.004398148148148146 (\$9.98) 🍷 Wrapped Ethe... (WETH)
 - From [Null: 0x000...000](#) To [0x8ed1bccd1e08d...](#) For 0.254539525327419071 ▲ Staked + Bon... (sbfGMX)

Value: 0 ETH (\$0.00)

Transaction Fee: 0.0000672934 ETH (\$0.15)


GMX example



Exchange

4:08 PM


ARBITRUM

- 0.25453953 GMX 

\$11.66 cost basis

→

ARBITRUM


+ 0.25453953 SBFG... 

≈ \$11.39 • \$0.15 loss

• 0.97% fee

Details
Ledger
Cost analysis





#593F50... [🔗](#) [✎](#) [🗑️](#)



Exchange

Oct 29, 2022 4:08 PM

Order ID / Tx Hash	Source	Destination
0xf54...1154b 🔗	0x000...00000	0x8ed...4022d
Contract		
0xd2d...a728f	Function	
	➤ stakeGmx	

-  0.25453953 GMX	 Arbitrum API 👁️
+  0.25453953 SBFGMX	 Arbitrum API 👁️
Fiat value	\$11.39 👁️
Fee	\$0.11 0.00006729 ETH
Cost basis	\$11.66
Gain	-\$0.15

Treasury Regulation Section 1.1001-1(a)

- Generally, under Treas. Reg. Sec. 1.1001-1(a), for gain to be recognized two conditions must be met:
 - 1) there is a sale or other disposition of digital assets
 - 2) in exchange for property that differs materially in kind or extent
- For there to be a sale or disposition, there must be a transfer of benefits and burdens of owning the property.
- Even if an exchange of digital assets can be viewed as relinquishing tax ownership, the exchange would not result in a “realization” of gain if the digital assets do not differ “materially either in kind or in extent.”



QUESTIONS AND ANSWERS

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