Bloomberg Tax

Tax Management Memorandum™

Crypto Record-keeping Technologies for Tax Professionals: Developments, Challenges, and Ethical Considerations

Hrishikesh Desai
Arkansas State University[*]
Jonesboro, AR

THE GRAVITY OF THE CRYPTO RECORD-KEEPING PROBLEM

One of my students at the university emailed me before Tax Day 2022 saying their Certified Public Accountant (CPA) had "no idea" on how to go about tax reporting for cryptocurrencies. It is no secret in the accounting profession that many tax professionals are yet to level up their skillset with respect to blockchain technology and cryptocurrencies, which is the most well-known use case of this technology. It is now common knowledge that the IRS has become serious about tax reporting for cryptocurrencies, which they classify as property rather than currency.[1] Tax professionals, along with their clients, were scrambling over getting accurate crypto transaction records close to Tax Day 2022. Several tax professionals also charged their clients a higher return preparation fee if they conducted any cryptocurrency-related transactions even though they might have just been doing so as a hobby.

Many tax professionals also noted that the record keeping for cryptocurrency transactions is an onerous and daunting task, and it is also extremely difficult to explain to clients what records to provide and maintain. There is also very little precedence for tax professionals to follow in this respect. I teach tax research as part of my "Applied Professional Research" capstone course at the university, and I can attest to the fact that there is no formal comprehensive textbook yet that appropriately trains CPAs and other tax professionals in this topic area. There is also limited IRS guidance on the treatment of certain crypto transactions, resulting in "grey" areas.

THE IDIOSYNCRASIES ASSOCIATED WITH CRYPTO TAXATION

Though the IRS classifies cryptocurrencies as "property," there are several idiosyncrasies with respect to transactions that are peculiar to cryptocurrencies and other use cases of blockchain. For example, some crypto transactions result in *ordinary income* (e.g., income from mining), while others result in *gains or losses* (e.g., gain from the sale of a cryptocurrency held as an investment). Some methods of transacting crypto are also novel (e.g., staking via an exchange to monetize one's crypto holdings). In my interview[2] with MoneyGeek.com earlier in the year, I talked about how complex tax reporting for cryptocurrencies can get and the various factors that tax professionals and their clients need to keep in mind.

Also, cryptocurrencies are just one of the many "use cases" of blockchain or distributed ledger technology. There are several other rapidly evolving use cases of blockchain such as decentralized finance or De-Fi (involves lending or borrowing or contributing cryptocurrencies to liquidity pools) and non-fungible

[*] Dr. Desai is an Assistant Professor in the Department of Accounting at Arkansas State University. Dr. Desai's research examines a wide range of topics in the following areas: accounting regulation, corporate governance, executive compensation, emerging technologies, financial reporting, judgment and decision-making, inter-firm relationships, sustainability reporting, disclosures via social media, personal finance and taxation.

This article may be cited as Hrishikesh Desai, *Crypto Record-keeping Technologies for Tax Professionals: Developments, Challenges, and Ethical Considerations*, 63 Tax Mgmt. Memo. No. 12 (June 6, 2022).

[1] *See* Notice 2014-21.

[2] Hrishikesh Desai, *Expert Insight on Online Software vs. Accountant*, MoneyGeek.com (Apr. 11, 2022). Available at https://www.moneygeek.com/financial-planning/resources/taxes-online-accountant/#expert=dr-hrishikesh-hrish-desai.

tokens or NFTs (digital items stored on a blockchain). It is extremely challenging for the average tax professional to keep themselves abreast of these developments and inform their clients at every turn when blockchain innovations result in new ways of transacting crypto or De-Fi or NFTs with different tax implications. Many CPAs are also not aware of Notice 2014-21, which explains the general tax principles that apply to cryptocurrencies. As mentioned earlier, there also several grey areas that create confusion for tax professionals (for example, there is a lot of debate about the exact method to use to calculate fair market values for certain crypto transactions, which would require the maintenance of specific records).

To sum it up, the status quo with respect to *crypto record keeping* (hereafter, this term encompasses tax reporting for all use cases of blockchain) for tax professionals and their clients is exigent and not going to improve unless certain measures are taken by them either themselves or through their clients to avoid another significant uphill battle on or before Tax Day 2023. Though Tax Day 2022 has gone by, CPAs and their clients have adequate time to prepare for Tax Day 2023. Gandalf rightly puts it to Frodo Baggins in the Lord of the Rings: ''*All we have to decide is what to do with the time that is given to us*.''

SOLUTIONS/INNOVATIONS TO MITIGATE THE CRYPTO RECORD-KEEPING PROBLEM

There have been quite a few software innovations that can considerably ease the burden of crypto record keeping and tax reporting for the next year. It is high time that tax professionals and/or their clients start using software starting now to avoid scrambling for records before Tax Day 2023.

The key software that tax professionals and their clients can consider using are as follows: *Cointracker, TokenTax, TaxBit, CoinLedger (Formerly, Cryptotrader.tax), Koinly, Accointing, ZenLedger, Bear.tax, CryptoTaxCalculator*, and *Bitcoin.tax*.[3] These software applications not only help with record keeping for cryptocurrencies, but some of them can also integrate record keeping for De-Fi protocols and NFT marketplaces. They claim to support most crypto exchanges and cryptocurrencies. One can also add their local/cold/hardware wallets by adding the extended public keys (xPub/yPub/zPub) for those wallets. Moreover, these software applications provide accurate crypto records at any given point in time as they sync all wallets and crypto exchanges daily, while also updating the pricing frequently every hour to provide users information on their crypto holdings and positions.

These software programs also claim to help users optimize *cost-basis* accounting methods. For example, *Cointracker* automatically defaults to the Highest-In-First-Out (HIFO) method, which assumes that the highest cost basis cryptocurrency is sold first to minimize taxes on capital gains. However, users can select the more conservative First-In-First-Out (FIFO) method or the other specific identification accounting method — Last-In-First-Out (LIFO).

They also provide excellent insights for *tax-loss harvesting*, which is a strategy that involves selling cryptocurrencies at a loss to offset crypto gains rather than hold underwater positions. Like most other tax-help software, they also produce tax-compliant reports (e.g., Form 8949 for reporting capital gains and losses) that one can file with certain tax preparation software, such as TurboTax. Some of them also produce FBAR (Foreign Bank and Financial Accounts FinCEN Form 114) for reporting international digital asset holdings if the aggregated value exceeds a certain threshold ($10,000).

Few of them (e.g., *TokenTax*) also provide reports on *Ethereum Gas Fees*, which can lower capital gains upon being added to an asset's cost basis for certain transactions, and reports on income from mining and staking, which are not taxed as capital gains. All of them also have excellent support from tax attorneys, CPAs, and enrolled agents for advice on certain crypto ''grey'' areas such as wash-sale rules (rules preventing investors from selling a crypto stock at a loss and then repurchasing a ''substantially identical'' asset in the 30 days before or after the sale), margin trading (making crypto trades by borrowing funds from an exchange), and airdrops (reporting of free tokens received from a blockchain start-up).

Tax professionals can also use these software platforms to manage the crypto, NFT, and De-Fi tax reporting for multiple clients at the same time. Some of them (e.g., *TaxBit*) also have a full-fledged corporate accounting suite for digital asset enterprises. For example, BlockFi, a holistic cryptocurrency ecosystem platform, was the first financial services company to partner with *TaxBit* for their users' tax reporting needs.[4] Several financial services companies have since proceeded to partner with crypto tax accounting

[3] *Cointracker* is available at https://www.cointracker.io/; *TokenTax* is available at https://tokentax.co/; *TaxBit* is available at https://taxbit.com/; *CoinLedger* is available at https://coinledger.io/; *Koinly* is available at https://koinly.io/; *Accointing* is available at https://www.accointing.com/en-US; *ZenLedger* is available at https://www.zenledger.io/; *Bear.tax* is available at https://bear.tax/; *CryptoTaxCalculator* is available at https://cryptotaxcalculator.io/en/; *Bitcoin.tax* is available at https://bitcoin.tax/.

[4] PR Newswire, *BlockFi Teams With TaxBit on New Tax Cen-*

ISSN 0148-8295

software providers to create a seamless record-tracking system for their clients and making crypto record keeping a less painful experience.

These software platforms are overall quite sophisticated and continue to improve in that some individuals can now DIY their crypto taxes themselves if they have a generic understanding of blockchain, the Internal Revenue Code (IRC), regulations, and some prior tax return preparation and filing experience. These platforms are also quite close to each other based on five parameters, namely, features, level of sophistication, user interface, support, and affordability. However, it is important to note that some functions (e.g., De-Fi) are only available to premium users, which can be an expensive affair for cost-sensitive individuals.

CHALLENGES IN GETTING CLIENTS TO USE CRYPTO RECORD-KEEPING TECHNOLOGIES

Despite the obvious advantages of using some of the software platforms previously mentioned for crypto record keeping, it is not an easy job to convince individuals to use these technologies.

The Silk Road Effect

I term the *Silk Road Effect* as the perception of an economically significant proportion of the general public that "cryptocurrencies are for criminals." This perception came into being during the 2013 downfall of the notorious dark market Silk Road, where people used bitcoins for engaging in illicit activities, such as drugs.

One of the fundamental premises behind the origins and adoption of cryptocurrencies is for its holders to be anonymous and untraceable. It is a widely held belief that cryptocurrencies appeal to individuals that are looking to circumvent the government, financial institutions, regulators, and law enforcement.[5] Individuals, who are not familiar with blockchain technology, fail to understand that the concepts, *anonymous* and *untraceable* that are constantly associated with cryptocurrencies in the news media are only in a relative sense and not in an absolute sense. In reality, the blockchain is publicly viewable, and transactions and the identities of individuals making them can be tracked through blockchain analysis by law enforcement with the cooperation of crypto exchanges and other allied parties.[6] For example, in February 2022, the Justice Department seized $3.6 billion worth of bitcoin stolen during the hack of a cryptocurrency exchange, Bitfinex, in 2016.

It is widely known that a significant group of users of cryptocurrencies still use them because of their ideas of seclusion and concealment. Thus, tax professionals will be in a quandary if they try to convince such individuals of using the aforementioned platforms, where detailed records of all their crypto transactions are maintained. It would be a dealbreaker for individuals that transact cryptocurrencies for their primary attribute of privacy, and they would never agree to use these software platforms since it would seem a self-defeating endeavor to them.

The Wild West Mentality

In his speech at a national conference in August 2021, the Chair of the U.S. Securities and Exchange Commission (SEC), Gary Gensler, referred to crypto as "the Wild West."[7] Several prominent personalities, including Warren Buffet and Charlie Munger, still hold this viewpoint. This is despite several use cases of blockchain making their way into mainstream finance (e.g., De-Fi), several large financial institutions investing in blockchain, and considerable venture capital investment finding its way into crypto. The regulations (tax and other) in the crypto space are still evolving in many areas and not quite there yet. Some regulators have even gone to say that the crypto space has a reputation of being poorly governed or just ungovernable.

This Wild West mentality is quite common to crypto investors. Most of them are high risk-taking individuals that continue to transact crypto despite numerous frauds, scams, and abuse. Many of these individuals hold unbalanced, incomplete, and at times, inaccurate information about crypto. It is also widely known that many individual players in the crypto space simply follow social media influencers and Reddit boards for information. It is also their perception that they won't run into trouble with the IRS or regulators or law enforcement because "no one properly understands crypto." Some of these concerns are not unfounded, and that is why, in March 2022, even the White House intervened with the release of Presi-

---

ter for US Clients (Aug. 9, 2021). Available at https://www.prnewswire.com/news-releases/blockfi-teams-with-taxbit-on-new-tax-center-for-us-clients-301358377.html.

[5] David Adler, *Silk Road: The Dark Side of Cryptocurrency*, Fordham Journal of Corporate & Financial Law (Feb. 21, 2018). Available at https://news.law.fordham.edu/jcfl/2018/02/21/silk-road-the-dark-side-of-cryptocurrency/.

[6] Ezra Galston, *Untraceable Bitcoin Is a Myth*, Wall Street Journal (June 16, 2021). Available at https://www.wsj.com/articles/untraceable-bitcoin-is-a-myth-11623860828.

[7] Chris Morris, *SEC nearly doubles size of crypto unit meant to protect investors*, Fortune (May 3, 2022). Available at https://fortune.com/2022/05/03/sec-nearly-doubles-size-of-crypto-protection-unit/.

ISSN 0148-8295

dent Biden's new executive order on crypto titled, *Ensuring Responsible Development of Digital Assets*, which requires federal agencies to evaluate the risks posed by crypto.[8]

As a result of this Wild West mentality that is prominent among many individual players in the crypto space, there is little regard for adhering to regulations (tax and other) or the need to maintain complete or accurate crypto records. Many tax professionals have received comments from clients suggesting that the crypto space is in its initial heydays, and regulators are still in the process of figuring out the tax implications themselves. It is also common knowledge that the IRS is short staffed and struggling with their workload.[9] This can lead many individuals to believe that the IRS will not come after them if their crypto transactions aren't of significant value. However, the IRS is already on a massive hiring spree to address this issue.

To sum it up, unless there is a complete tax and regulatory overhaul of the crypto market, there will continue to be an absence of will amongst individuals to devote time or effort or money towards crypto record keeping. This poses a serious challenge for tax professionals since it is difficult to convince these ''crypto hobbyists'' to invest time in or to pay for a record keeping service.

Misinformation, Disinformation, and Fake News

It is no secret that the crypto space is riddled with media misinformation (false information presented as fact regardless of intent), media disinformation (deliberate false information presented with the motive to mislead or deceive), and fake news events (sensational and purposefully fabricated information presented to mimic mainstream news). For example, on September 13, 2021, a fake press release was circulated by GlobeNewswire, saying Walmart was going to accept Litecoin as a form of payment. Several reputed news organizations such as CNBC and Reuters published about it too, resulting the price of Litecoin skyrocketing.[10] However, Walmart was quick to deny the partnership with Litecoin, and GlobeNewsWire retracted the press release. This is just one of many incidences, where the unwarranted and uncontrolled spread of misinformation, disinformation, and fake news has affected the crypto space.[11] These information issues also extend to crypto tax reporting.

Legislators around the world are trying to maintain a delicate balance between clamping down on illegitimate actors in the crypto space and allowing legitimate crypto innovations and enthusiasm to thrive. The U.S. Congress is also trying to play catch up and improve crypto tax laws through their newly introduced *Virtual Currency Tax Fairness Act* in February 2022, which would exempt personal transactions made with cryptocurrencies when the gains are $200 or less.[12] This de minimis exemption for low value crypto transactions is sensible; however, it is a signal to the crypto community for now that the standards for crypto taxation and record keeping are lax compared to other securities and assets. Social media, which is currently the most fertile breeding ground for fake news on crypto, went berserk with excitement when the news of this legislation came out with many making wild and irrational extrapolations about what was coming next on crypto taxation.

There are several naïve and unsophisticated individuals in the crypto space that end up believing what these social media communities and forums lead them to believe. It is the responsibility of tax professionals to educate clients on what is true with respect to crypto tax reporting and to debunk any false notions that their clients might have developed. However, individuals that have developed pre-conceived notions about the future developments in crypto tax reporting by listening to and believing the bad information that was presented to them are a serious challenge. These individuals will not be as keen to participate in using crypto tax software platforms if they falsely believe that crypto is going to be truly free and unregulated at some point in the future (even from a tax perspective).

ETHICAL CONSIDERATIONS IF CLIENTS DO NOT PROVIDE ADEQUATE CRYPTO TRANSACTION RECORDS

When a client is unable to provide records for significant crypto transactions and refuses to allow their

---

[8] Executive Order 14067 of March 9, 2022, Ensuring Responsible Development of Digital Assets, 87 Fed. Reg. 14,143 (Mar. 14, 2022).

[9] Andrew Keshner, *A severely backlogged IRS with 'limited resources' temporarily halts a slew of tax-return notices*, MarketWatch (Feb. 10, 2022). Available at https://www.marketwatch.com/story/a-severely-backlogged-irs-with-limited-resources-temporarily-halts-a-slew-of-tax-return-notices-11644524860.

[10] Mathhew Goldstein, Ephrat Livni, and Michael Corkery, *Phony Walmart News Release Signals a Crypto Pump-and-Dump Scheme*, The New York Times (Sept. 13, 2021). Available at https://www.nytimes.com/2021/09/13/business/litecoin-walmart-crypto-hoax.html.

[11] Queenie Wong, *Cryptocurrency scams are all over social media. Don't get duped*, CUNT (Nov. 10, 2021). Available at https://www.cnet.com/personal-finance/crypto/cryptocurrency-scams-are-all-over-social-media-dont-get-duped/.

[12] H.R. 6582 — *Virtual Currency Tax Fairness Act of 2022* (introduced by Rep. Suzan DelBene (D-WA). Available at https://www.congress.gov/bill/117th-congress/house-bill/6582/text?r=2&s=1.

ISSN 0148-8295

records to be tracked through the aforementioned software platforms, one of the big ethical considerations for tax professionals is to determine whether their client is deliberately withholding information or whether it is just a case of sloppy record keeping.[13] Tax professionals may need to consider disengaging from clients that raise a red flag by exhibiting the former behavior. Tax professionals may also need to ensure that if they proceed with disengagement, it is done tactfully and professionally in a way that their practice is safeguarded from liability, and their client doesn't end up feeling antagonized with the decision to terminate the relationship. Tax professionals may need to come up with a plan to manage risks of client acceptance and continuance as such issues are expected to crop up at some point in the near future. They also need to develop proper procedures to establish a threshold for crypto tax records to be provided by clients or require clients to sign agreements to allow them to access client crypto transaction records through software platforms.

CONCLUSION

Record keeping is a significant problem for cryptocurrencies and other use cases of blockchain that have tax implications. Tax professionals can, either themselves or by creating awareness in their clients, minimize a great deal of pain before Tax Day 2023 by using the aforementioned software platforms to streamline record keeping. The use of these platforms can help tax professionals identify opportunities to minimize their clients' tax liabilities by avoiding mistakes associated with calculations of cost basis and tax-loss harvesting, plus it can also minimize errors in filed returns by ensuring that the tax code is applied appropriately to transactions. The software platforms won't reduce the complexities associated with crypto taxation; however, they definitely reduce the pain associated with it by reducing the burden of record keeping.

Tax professionals also need to keep in mind the challenges they face in convincing their clients to use these applications for record keeping or allow them to use the platforms on their behalf. The seclusion and concealment motivations due to the Silk Road Effect, the lack of will and interest in keeping records due to the Wild West mentality, and the development of false notions about the future evolution of crypto tax reporting due to misinformation/disinformation/fake news pose considerable challenges to the widespread adoption of these software platforms.

---

[13] Joseph Wolfe and Stanley Sterna, *Managing the Risks of Client Acceptance and Continuance*, The CPA Journal (Feb. 2020). Available at https://www.cpajournal.com/2020/02/12/managing-the-risks-of-client-acceptance-and-continuance/.

ISSN 0148-8295