Overview

As 2020 finally comes to a close, it is time to consider year-end tax planning. One bright spot this year has been the performance of cryptocurrencies. Bitcoin, in particular, is trading at or near all time highs, considerably above its previous peak at the end of 2017. Other cryptocurrencies, like Ether, have also had considerable returns this year. Taxpayers holding significantly appreciated cryptocurrency may be considering the best way to optimize their charitable giving. Below we describe the tax benefits of making donations of appreciated cryptocurrency, as well as other tax considerations for both donors and charities.

Tax Benefits of Donating Appreciated Cryptocurrency

By making an in-kind donation of appreciated cryptocurrency, donors may be able to get two tax benefits in one—avoiding capital gains tax and obtaining a charitable donation deduction. Consider a taxpayer who purchased one bitcoin in early 2019 for $5,000 to hold for investment. If the taxpayer were to sell this bitcoin for $25,000, or use it to purchase $25,000 worth of goods or services, they would owe capital gains taxes on the $20,000 gain. Because the taxpayer has held this bitcoin for over one year, the gain would (fortunately) be taxed at long-term capital gains rates. However, this still could mean as much as $4,760 in additional federal income taxes.

What if, instead, the taxpayer donated this bitcoin to a charity? There are two tax benefits the taxpayer might receive for such a donation. First, because they have gifted the bitcoin, rather than sold it, the taxpayer generally would not owe any capital gains tax as a result of the donation. Second, in the right circumstances, the taxpayer could receive a charitable contribution deduction that could reduce their federal income tax liability by up to $9,250. Together with the capital gains tax savings, that is over $14,000 in tax savings.

Additional Tax Considerations for Donors

In order to make the most of these tax benefits, there are several other tax considerations for potential donors.

Itemizing vs. Standard Deduction

Potential donors should consider whether they will be itemizing deductions or claiming the standard deduction. A donor who claims the standard deduction will not realize any benefit from the charitable contribution deduction arising from donations of cryptocurrency.\[1\]
Substantiation Requirements

A donor is required to keep records to prove the amount of charitable contributions made. Substantiation requirements for contributions not made in cash depend on the amount of the donation.

For donations of cryptocurrency under $250, the donor must get and keep a receipt from the charity showing the name and address of the charity; the date of the contribution; and the type and amount of cryptocurrency donated.

For donations of cryptocurrency over $250, the donor must get and keep a "contemporaneous written acknowledgment" from the charity. The acknowledgment must:

1. Be in writing.
2. Include:
   a. A description (but not necessarily the value) of the donated cryptocurrency,
   b. Whether the charity gave the donor any goods or services as a result of the contribution (other than certain token items and membership benefits or intangible religious benefits), and
   c. A description and good faith estimate of the value of any goods or services described in (b).
3. Be received by the donor on or before the earlier of:
   a. The date the donor files a tax return for the year of the contribution, or
   b. The due date, including extensions, for filing the return.

For donations of cryptocurrency over $500, the donor must complete IRS Form 8283, Noncash Charitable Contributions, and include this form with their tax return, and for donations of cryptocurrency over $5,000, the donor must also complete Section B of Form 8283 (and provide a qualified appraisal, as described below).

Valuation and Appraisal Requirements

To figure out the amount of a charitable contribution deduction for a donation of noncash property, like cryptocurrency, a taxpayer must first determine the property's fair market value. Fair market value is the price that property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts. For cryptocurrencies that are traded on a public exchange, the fair market value generally should be equal to the spot price at the time of the donation. If the donor is claiming a charitable contribution deduction for donations of cryptocurrencies totaling over $5,000, additional appraisal requirements generally will apply. In this case, a donor is required to obtain a qualified appraisal, which must be signed and dated by a qualified appraiser. In addition, the donor must complete Schedule B of Form 8283 and include this schedule with their tax return. The exception for publicly traded stock likely doesn't apply to cryptocurrency. The requirement to obtain a qualified appraisal may raise practical issues, since the IRS requires that the appraiser possess "verifiable education and experience in valuing the type of property being appraised." Because cryptocurrency is a new asset class, finding a qualified appraiser with the requisite education and experience may be difficult. In addition, donors may pay substantial amounts for such appraisals, notwithstanding the ease of obtaining spot prices on various exchanges.

Cryptocurrency Held for Less than One Year

In certain circumstances, a charitable contribution deduction will be limited to the donor's tax basis in donated cryptocurrency, rather than its fair market value. For example, if a donor has held cryptocurrency for less than one year, the charitable contribution deduction will be limited to the lesser of the tax basis or fair market value. A donor's tax basis in cryptocurrency typically will be equal to the amount paid for the cryptocurrency. However, the tax basis could differ in situations where a donor did not purchase the cryptocurrency but, instead, received the cryptocurrency as a gift, from mining or staking rewards, as compensation, or as a distribution from an entity treated as a partnership for tax purposes.

Dealer Status

Charitable contribution deductions generally will also be limited to basis if the donor is treated as a dealer in the donated cryptocurrency instead of as an investor. The determination of whether a donor is a dealer or investor is based on whether, under all of the facts and circumstances, the donor holds the cryptocurrency primarily for sale to customers in the ordinary course of a trade or business. A donor who primarily holds cryptocurrency for investment and does not engage in frequent sales of cryptocurrencies to customers generally will not be considered to be a dealer.

Identifying Donated Cryptocurrency
To optimize the tax benefits for charitable giving, a donor who has acquired different units of cryptocurrency at different times and prices will want to donate units of cryptocurrency with the lowest tax basis (i.e., the most appreciation). In order to do this, the donor should specifically identify which units of cryptocurrency are being donated. In general, a donor may identify a specific unit of virtual currency either by documenting the specific unit’s unique digital identifier such as a private key, public key, and address, or by records showing the transaction information for all units of a specific virtual currency, such as Bitcoin, held in a single account, wallet, or address. This information must show (1) the date and time each unit was acquired, (2) the basis and the fair market value of each unit at the time it was acquired, (3) the date and time each unit was donated, and (4) the fair market value of each unit when donated.

If the donor is unable to specifically identify the units of cryptocurrency donated, the units are deemed to have been donated in chronological order beginning with the earliest unit of the virtual currency acquired; that is, on a first in, first out (FIFO) basis.

Percentage Limitations

For donors making large charitable contributions in a single year, the percentage limitations may come into play. Charitable contribution deductions for donated cryptocurrency held for investment for more than one year generally will be limited to 30% or 20% of the donor’s adjusted gross income, depending on the type of charity that receives the donation. Deductions in excess of these limitations generally may be carried forward and used to offset income for up to five years. If the donor would like to make deductible charitable donations in excess of these limitations, the donor may choose to supplement a charitable gift of cryptocurrency with a charitable contribution of cash because cash gifts are subject to different percentage limitations.

Considerations for Charities

In light of the tax benefits for donors, charitable organizations may want to facilitate donations of cryptocurrency to encourage additional charitable giving. In addition to understanding the considerations for donors, described above, there are certain considerations these charities should keep in mind.

A charity will need to decide whether it will accept direct, in-kind donations of cryptocurrency or will require potential donors to make donations through another organization, such as one that sponsors donor advised funds. Organizations that specialize in charitable donations of cryptocurrency, like The Giving Block, may be able to help charities that wish to accept cryptocurrency directly. If a charity does not wish to accept cryptocurrency directly, it may want to point donors towards organizations like Fidelity Charitable or Vanguard Charitable that can assist with creating a donor advised fund to accept cryptocurrency donations.

If a charity decides to accept cryptocurrency directly, it may be called upon to provide the necessary substantiation, such as the contemporaneous written acknowledgment described above, to support a donor’s charitable contribution deduction. Additional requirements generally apply for donations over $5,000. In these cases, a charity generally will be asked to sign Part V of IRS Form 8283, acknowledging that the charity is a qualified organization under section 170(c) and that it received the donated property as described on the form. The charity must also report cryptocurrency donations as non-cash contributions on Schedule M, Noncash Contributions, of its Form 990, Return of Organization Exempt From Income Tax. Furthermore, if the charity sells, exchanges, or otherwise disposes of the cryptocurrency described on the Form 8283 (or any portion thereof) within three years after the date of receipt, it generally will be required to file an IRS Form 8282, Donee Information Return, with the IRS and give the donor a copy.

[1] Note that the provision in COVID-19 legislation that permits non-itemizers to claim an above-the-line deduction for charitable donations of up to $300 only applies to donations of cash.

[2] If the transaction is facilitated by a cryptocurrency exchange, the IRS permits taxpayers to rely on the amount recorded by the exchange. If the transaction is peer-to-peer or not otherwise facilitated by a cryptocurrency exchange, the IRS will accept as evidence of the fair market value the value determined by a cryptocurrency or blockchain explorer that analyzes worldwide indices of a cryptocurrency and calculates the value at an exact date and time.

Practices

Tax

Exempt Organizations

Blockchain & Cryptocurrency