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Foreign “Crypto Exchange” Reporting (FBAR) Due October 15th (extended automatically from April 15th)

Many U.S. Crypto Asset investors and companies may be subject to an often overlooked reporting requirement imposed by the U.S. Financial Crimes Enforcement Network (FinCEN).

In General – “FBAR” Form 114

United States citizens, residents and entities are required to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*, if

1. the United States person had a financial interest or signature authority over one or multiple financial account(s) located outside of the United States; and
2. the aggregate value exceeded \$10,000 at any time during the calendar year reported.

Financial Interest

Financial interest is generally determined by reference to the owner on record or holder of a legal title, even if the beneficiary is a person other than the legal owner. A U.S. person may have a reporting requirement for having a greater than 50% ownership in another corporation, partnership, trust or other entity with a foreign account meeting the aggregate value threshold above.

No Financial Interest, but Signature of Authority

Reporting requirements may apply to a U.S. person with signature of authority, but no financial interest, in a foreign account.

For example, an employee of a company may have a reporting requirement for just having signature of authority over the account, even without a financial interest. If an employee of a U.S. subsidiary has a signature of authority over a foreign parent’s bank account, this may result in a filing requirement for the U.S. employee, even when the U.S. subsidiary has no such filing requirement. Also, the term “signature of authority” is broad, as the simple control over the disposition of account funds creates signature of authority.

There are of course a list of filing exceptions, however, these exceptions are outside the scope of this article.

Due Date and Filing

Currently, the FBAR report is due October 15th (extended automatically from April 15th). The basis of determining reporting requirements and values is a calendar period January 1st to December 31st. The FBAR Form 114 is electronically submitted through the FinCEN's electronic filing system or through a tax preparation service provider's software.

The FBAR reporting requirement applies regardless of whether the activity in the foreign account resulted in taxable income to the filer. The filer will generally have to disclose their obligation to file an FBAR report on their income tax return (such as Form 1040, Schedule B for individuals).

Penalties for Non-Compliance

There are significant penalties for not filing the FBAR (without reasonable cause), including a penalty of \$12,459 for a "non-willful violation", and a penalty equal to the greater of \$124,588 or 50% of the foreign exchange balance for "willful" violations. These penalties amounts are in effect as of August 1, 2016 and typically would be subject to increases over time.

****Additional Potential Filing – Form 8938****

Form 8938, *Statement of Specified Foreign Financial Assets* is required to be filed as part of a U.S. person's income tax return if the reporting requirements apply. Form 8938 is required when the balance in a foreign account is significant (for example, the thresholds begin at a \$75,000 maximum daily value or a \$50,000 end of period value for unmarried filers). A taxpayer required to file FBAR may also be required to file Form 8938. The Form 8938 reporting requirements will not be reviewed in this article, but in practice should be assessed alongside the FBAR requirements.

Does FBAR reporting apply to Crypto Asset Investments?

In light of the rise of Bitcoin and other Crypto Assets in terms of adoption, utility, and valuation, the niche tax practitioners serving the blockchain/crypto industry are left fitting the round hole of crypto transactions into the square peg of existing tax law.

The IRS issued Notice 2014-21 in 2014 declaring that Bitcoin and other Crypto Assets ("convertible virtual currency") is treated as property for U.S. tax purposes. The IRS declares that Crypto Assets are not treated as a "currency" for U.S. tax purposes.

Although the IRS addressed Crypto Assets at a basic level for U.S. income and payroll tax reporting, they did not address the potential affect to all possible indirect taxes, tax credits and reporting requirements, such as the FBAR. In 2014, an IRS agent commented that FBAR reporting was not required for that specific year. However, the AICPA (and FML) believe the reporting requirements do in fact apply to U.S. taxpayers.

The common FBAR reporting challenges for Crypto Investors and Companies include:

- Determination of Domicile of Crypto Assets
- Valuation of Crypto Assets
- Gathering Appropriate Information from Foreign Exchanges

Determination of Domicile of Crypto Assets

Some Crypto Assets are traded on centralized exchanges domiciled in foreign countries. In this case, the account holders are typically not in possession of their private keys associated with their funds. In other situations, an investor's Crypto Assets are held in their private account wallets or through a decentralized exchange, each through direct ownership of their unique private key (or a wallet seed).

The AICPA suggested in its May 31, 2018 comment letter that Crypto Asset funds held in centralized exchanges are generally located where the exchange resides, as typically the funds are controlled by the exchange. On the other hand, when an investor is in possession of their private key, the wallet is located with the taxpayer. FML agrees and believes the following treatment is appropriate pending further guidance:

1. If a taxpayer holds Crypto Assets on a centralized exchange operating outside of the U.S., then FBAR reporting is applicable to the foreign exchange account.
2. If a taxpayer is in control of their "private key" of their funds, the wallet is considered in the location of the taxpayer (presumably the U.S.).

We believe the "centralized exchange" rule would also apply to cloud mining websites where a taxpayer is required to accumulate cloud mining revenue up to a minimum threshold prior to withdrawing it.

Valuation of Crypto Assets for Reporting

The maximum balance in a foreign account for a calendar period is required to be reported on the FBAR report. Periodic statements may be relied on to determine the maximum value of an account, if the statements appropriately reflect the maximum value. The instructions indicate the reported value of a foreign account must be determined based on its maximum account balance in its denominated currency, then be converted to US. dollars. If the currency is U.S. dollars, then then the maximum daily balance of the account is reported. However, for an account that is denominated in foreign "currency," a December 31 *foreign currency to U.S. dollars* exchange rate is applied to the maximum daily foreign currency balance to determine the appropriate U.S. dollar value to report. Last, nonmonetary assets are to be estimated at their approximate maximum U.S. dollar equivalent values on a daily basis.

As noted above, the IRS does not consider Crypto to be a legal "currency". Similarly, in applying the FBAR reporting instructions to Crypto Assets, we believe the appropriate valuation method is to treat a Crypto Asset as a nonmonetary asset and report the highest U.S. dollar converted balance on a daily basis.

For example, an account holder held 1 Bitcoin on a foreign exchange on May 1st through December 31st, and the Crypto Asset value of 1 Bitcoin was \$11,000 on May 1st and decreased evenly over time to \$6,000 on December 31st. Under the nonmonetary asset approach, the account holder would determine there is a reporting requirement to file FBAR, and accordingly report the May 1st value of \$11,000 under the nonmonetary asset rules; the account holder would *not* draw conclusions on reporting requirements/values based the year-end exchange value.

The alternative approach is to track an exchange account's daily balance as denominated in various Crypto Assets and apply the year-end conversation rates to determine the highest USD value; this method may be impractical due to the existence of multiple Crypto Assets in an exchange account at one time and significant volatility in coin values; undermining the simplification provided in the "Foreign currency" reporting and resulting in non-economic results (some coins increased 10-100X their value in December of 2017 and it may be unreasonable to apply this exchange rate to an account balance existing in an earlier portion of the calendar period that no longer existed on the account in December).

For example, on May 1st an account holder owns 1 Bitcoin valued at \$9,000. At the end of May, the 1 Bitcoin is removed from the foreign account and disposed of for \$9,000 U.S. dollars on a licensed U.S. exchange. In December, the value of 1 Bitcoin is \$20,000. Under the “foreign currency” valuation rule, it would seem 1 Bitcoin would be converted at \$20,000 based on the maximum Bitcoin held during the year – 1 Bitcoin on May 1st. Thus a reporting requirement is triggered even though the 1 Bitcoin asset was not valued above \$10,000 when the holder owned it or when the holder disposed of it. This is a non-economic result.

Nevertheless, a highly conservative taxpayer might assess their reporting threshold requirements under both the “nonmonetary” and “foreign currency” methods.

For an account that is many years old where the taxpayer no longer has access, or has a de minimis (“dust”) balance that cannot be withdrawn from the exchange, it would be appropriate to report the exchange on the FBAR with the “amount unknown” box checked, as to disclose all potential foreign accounts in existence.

Gathering Appropriate Information from Foreign Exchanges

For security reasons, many foreign exchanges do not disclose their full legal name and foreign address. This leaves taxpayers that are hoping to comply with FBAR reporting facing the challenge of determining the appropriate information to report.

We believe it is appropriate to review the exchanges websites and common discussion forums for Crypto to identify a reasonable amount of information to report (such as entity name, exchange name and country). The more information that is provided, the better. Also, be aware the FBAR line item instructions contain a list of non-permitted words that would result in rejection of an electronic filing submission (“Unknown,” “Various,” “Not applicable”).

We Can Assist You

FBAR and other foreign reporting disclosures to the IRS and FinCEN can tend to be complex, confusing and sometimes overlapping. Additionally, the requirements carry significant penalties for non-filing or inaccurate reporting.

FML CPAs is an assurance, accounting and tax firm located in Glastonbury CT. FML is experienced with international reporting requirements such as the FBAR and other foreign disclosures such as Forms 5471, 5472 and 8858. Additionally, our senior tax manager, Justin Wilcox, CPA, MST is the resident cryptocurrency tax expert at FML and can walk you through the complexities of FBAR reporting for crypto transactions.

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