MANAGEMENT
& *TAX CONCEPTS*

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TAX STRATEGIES FOR CRYPTOCURRENCY INVESTORS

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Tax strategies for cryptocurrency investors

If you own cryptocurrency, such as bitcoin or ether, there may be strategies you can use to reduce your tax bill. You may be familiar with some of these strategies if you invest in stocks and other securities. But cryptocurrency isn't subject to the wash sale rule (at least for now), which creates an attractive tax-planning opportunity for cryptocurrency investors.

HARVESTING LOSSES

Cryptocurrency is notoriously volatile. But remember, as its price fluctuates, your gains and losses exist only on paper until you realize them by selling or exchanging your investment. If you expect to realize net capital gains this year, an effective tax strategy is to harvest losses to offset those gains by selling cryptocurrency or other investments that have declined in value. A big advantage of selling cryptocurrency to harvest losses is that, as noted above, it isn't currently subject to the prohibition on wash sales.

In a wash sale, you sell an investment at a loss and immediately buy it back. This allows you to deduct the loss while continuing to hold the asset. The wash sale rule prohibits you from deducting a loss on the sale of a stock or other security if you purchase a substantially identical security within 30 days before or after the sale. In other words, if you sell an investment at a loss, you have to wait until day 31 to buy it back, potentially wiping out the tax benefits if the price increases during that time. Because cryptocurrency isn't subject to the wash sale rule, you can sell it at a loss and immediately buy it back, taking full advantage of the wash sale strategy. Note, however, that this may change if pending legislation is passed. (See "Proposal would apply wash sale rule to cryptocurrency" on page 3.)

To take advantage of loss harvesting, you must track and document your cost basis in cryptocurrency and other assets. That means keeping accurate, reliable records of the purchase price you paid for these assets and any adjustments that increase or decrease your basis over time.

KEEPING TRACK OF HOLDING PERIODS

Like securities, sales or exchanges of cryptocurrency can generate long- or short-term capital gains or losses. Long-term gains (on assets held more than one year) are taxed at 0%, 15% or 20%, depending on your tax bracket, while short-term gains are taxed at ordinary income rates as high as 37%. High-income earners also may be subject to the 3.8% net investment income tax on short- or long-term capital gains. Net capital losses can be used to offset up to $3,000 of ordinary income (for example, wages and interest), with the remainder carried forward to offset capital gains in future years.

To minimize taxes on cryptocurrency gains, it's important to keep track of how long you've owned cryptocurrency. Generally, you'll benefit by holding it more than one year to take advantage of long-term capital gains rates, which, for most investors, are more favorable than short-term capital gains rates.

You'll need to keep records that show the dates you purchased and sold cryptocurrency, the amount you paid for it, and any adjustments that affect your basis.

SELECTING THE RIGHT ACCOUNTING METHOD

The amount of capital gain or loss you realize on a sale or exchange of cryptocurrency is the difference between the selling price and your cost basis. For example, if you purchased one bitcoin in year 1 for $30,000 and sold it in year 3 for $35,000, you would realize $5,000 in capital gain. If you purchase cryptocurrency at different times for different prices, however, the accounting method you select to calculate gains and losses can have an enormous impact on your tax bill.

Proposal would apply wash sale rule to cryptocurrency

One of the advantages of cryptocurrency is that it's not currently subject to the wash sale rule, which prohibits owners of stocks and certain other securities from deducting a loss on a sale and immediately acquiring a substantially identical security. However, the Build Back Better Act, which at press time was stalled in the Senate, would extend the wash sale rule to cryptocurrency. The future of the act is uncertain, but if the cryptocurrency proposal becomes law, the wash sale strategy will become less effective.

Suppose you buy one bitcoin in year 1 for $30,000, one in year 2 for $40,000 and one in year 3 for $35,000. In year 4, you sell one bitcoin for $45,000. The first-in, first-out (FIFO) accounting method presumes that the bitcoin you sold was the one you purchased in year 1. Since your basis in that coin is $30,000, your taxable gain is $15,000. If you use the last-in, first-out (LIFO) method, then it's assumed that you sold the last coin purchased, with a basis of $35,000 and a taxable gain of $10,000.

Generally, the best approach is the highest-in, first-out (HIFO) method, which minimizes your taxable gain. In our example, under HIFO, we assume that the highest-priced bitcoin — the one purchased for $40,000 in year 2 — is sold, resulting in a gain of only $5,000.

GOOD RECORD-KEEPING IS CRITICAL

To make the most of the tax strategies discussed above, you'll need to keep records that show the dates you purchased and sold cryptocurrency, the amount you paid for it, and any adjustments that affect your basis. Whether you use an Excel spreadsheet or a more sophisticated software solution, detailed records are needed to support the positions you take on your tax returns. •

How to guard against payment app fraud

Payment apps have soared in popularity recently — especially since the pandemic began. Also known as peer-to-peer payment services, these allow users to make instant payments to individuals and businesses outside of the traditional banking system. Venmo, Cash App and Zelle are a few of the most popular payment apps in use today.

RISING FRAUD LEVELS

Unfortunately, the growing use of payment apps also has led to higher incidences of fraud associated with them. According to the Consumer Federation of America, payment apps have fraud rates that are three to four times higher than traditional payment methods like cards and checks.

Fraudsters are taking advantage of two of the biggest benefits of using the apps — speed and convenience — and are using them against consumers. Payment app transactions happen so fast that it's often hard for fraud to be detected.

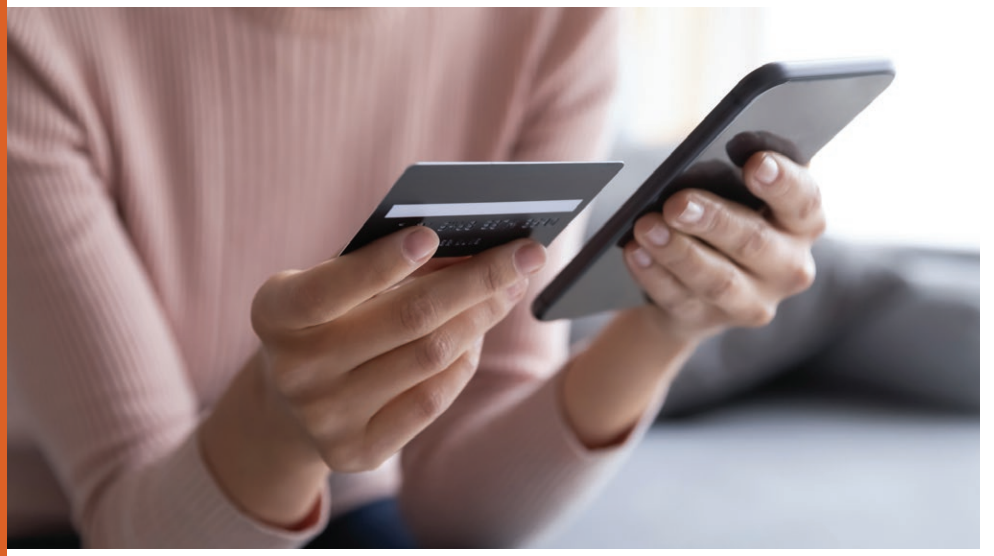
It's easy for scammers to set up new accounts on the apps — all they need is an email address or phone number. Using this, thieves can set up dozens of fraudulent accounts, link them to stolen credit cards and make purchases. Or they can send requests for money to unsuspecting victims.

In addition, payment apps usually don't offer the same level of fraud protection that bank debit and credit cards do. This means that once money has been stolen, there's often little victims can do to recover losses.

PAYMENT APP SCAMS

The Better Business Bureau identifies several common scams associated with payment apps. In one scam, thieves connect a stolen credit card to an app and then purchase big-ticket items online (like computers) using the app. After the seller sends the item, he or she is notified that the payment didn't go through because the card used to make it was reported stolen.

In another common scam, thieves tell victims that they've overpaid for items the victims sold online. The fraudsters then tell victims to return the supposed overpayments — and send the items as well. Or scammers use payment apps to overpay for items with stolen credit cards. In yet another scam, thieves send texts or emails to victims requesting money. Many people have lost money this way, because often email addresses from scammers are similar to legitimate addresses.



5 FRAUD PREVENTION TIPS

Rising rates of fraud make it crucial to be especially diligent when using payment apps. The Better Business Bureau offers these five tips to help protect yourself:

1. Follow the "friends and family" rule. In other words, only send and receive money from

individuals you personally know. And make sure their phone numbers and email addresses are correct.

2. Use enhanced security measures. Most payment apps offer additional security features such as multifactor authentication, fingerprint or facial recognition, or the use of a PIN. Keep in mind that you might have to go into account settings to turn these on.

3. Secure your mobile device. A lost or stolen smartphone or tablet can be a gold mine for a scammer. Choose a strong password or turn on fingerprint or facial recognition to keep your device locked should it fall into the wrong hands.

4. Don't send items too quickly. If you're selling items online, make sure the payment is in your account before you ship the item.

5. Know how to contact the payment app's customer service. If you ever have questions about a payment, go straight to the service provider's website to find a customer service number. Some scammers have set up phony customer service departments where fake agents tell victims to download software that can infect victims' phones and computers.

These steps can go a long way toward ensuring your payments are safe and secure.

> *Payment apps usually don't offer the same level of fraud protection that bank debit and credit cards do.*

FRAUD RISK AWARENESS IS KEY

There's no denying the convenience and speed offered by payment apps. But you should also weigh the potential fraud risks before using them. This will help you choose the right payment method for you. •

An invaluable tool

Use a valuation to help your business stay competitive

In a complex and volatile economic climate such as this, it's important to use all the tools at your disposal to ensure your business stays on top of its game — especially when seeking financing to support ongoing operations or future expansion. A professional business valuation can be invaluable — both in obtaining funding and in helping you analyze your business's current challenges, opportunities and expected cash flow.

BE PREPARED

A valuation professional also will turn up important company-specific information, including management's awareness of market conditions and specific risks you face. This will be the time to evaluate your contingency plan to mitigate those risks. Additionally, some company weaknesses may come to light during the valuation process. Armed with that information, you can then take steps to strengthen your "soft spots."

As a business owner, you never know what proverbial winds may blow your way. For example, your partner might, unexpectedly, want to leave the business. He or she might decide to retire early, or need to cash out for personal reasons. Or health concerns may enter the picture.

SUPPORT A BUY-SELL AGREEMENT

For these reasons and more, it's important to draft and maintain a buy-sell agreement. This contract among a business's owners sets guidelines for the transfer of their ownership interests. The agreement gives the remaining owners (or the business itself) the right to buy an exiting owner's interest if a triggering event takes place. In addition to an owner's desire to leave the company, such events include divorce, disability, retirement, death, or loss of a professional license or certification.

So, what does all of this have to do with a business valuation? A valuation of your company plays a key role in the creation and maintenance of a buy-sell agreement. Specifically, it could help you address the preferred valuation method, the appropriate standard of value, the effective valuation date, and the applicability of valuation discounts and premiums.

ASSESS TIMING FOR BUSINESS DECISIONS

There's no getting around the fact that a key reason for seeking a valuation is to prepare for a business transfer. Even if you aren't sure you want to buy, sell or gift a business interest, an evaluation may help you get a better sense of whether now is the time.

Most valuation advisors subscribe to transaction databases that report recent selling prices of similar private businesses. In conjunction with input from other professionals, the information gleaned from the valuation can help you come up with a creative deal structure — one that minimizes taxes, provides you with income to fund retirement and meets other transfer objectives.

WORTH AND VALUE

In so many ways, a professional outside valuation can more than repay its costs — whether you use it to support estate planning decisions, in due diligence for the purposes of a sale or merger, or just in gaining a better sense of your business's strengths and weaknesses for strategic planning. Consult us to help you evaluate how a business valuation could be useful to your business going forward. •

Selling business property? Don't overlook the purchase price allocation

If you own a rental property or other business real estate, you probably haven't given a lot of thought to the allocation of the property's value between the building and the land. But this allocation can have significant tax implications if you sell the property. That's because gain on the sale of business property — to the extent of depreciation taken or allowed — is taxable at ordinary income tax rates up to 25%. If you can demonstrate that most or all of the gain is attributable to increases in the value of the land, however, you may be able to reduce the tax burden significantly.

AN EXAMPLE

Dave and Sharon purchased a lakefront cottage in 2007 for $200,000. They allocated the purchase price 80/20 (a common rule of thumb) — that is, $160,000 to the cottage and $40,000 to the land.

In early 2022, they sold the property for $800,000. For purposes of this example, assume that the depreciation recapture portion of the gain is taxed at 25% and the rest is taxed at 15%. Further, assume that there were no closing costs, and that the couple have claimed a total of $80,000 in depreciation, reducing their basis in the property to $120,000.

With a conventional 80/20 allocation, splitting the sale price into the components, it's as though the cottage is sold for $640,000 and the land is sold for $160,000. So, their $680,000 gain ($800,000 less their adjusted basis of $120,000) is subject to a total tax of $110,000.

The entire $120,000 gain on the sale of land ($160,000 less $40,000 of basis) is subject to tax at 15%, or $18,000. The gain on the cottage is $560,000 ($640,000 less an adjusted basis of $80,000) and, of that amount, the $80,000 attributable to depreciation is taxed at 25% ($20,000) and the remaining $480,000 is taxed at 15% ($72,000), for a total tax of $92,000. The total tax on the sale, therefore, is $110,000. (Note that there may be additional factors to consider as well.)

A TAX-SAVING ALTERNATIVE

Suppose, instead, that Dave and Sharon are able to demonstrate that the purchasers were motivated only by the desirable lakefront location and had no interest in the cottage, which they planned to tear down. Under those circumstances, a different allocation of the sale price may be appropriate, say $80,000 to the cottage and $720,000 to the land. In this scenario, there's no gain on the building, and the $680,000 gain on the land ($720,000 – $40,000) is taxed at 15% for a total tax of $102,000.

By changing the allocation of the sale price, Dave and Sharon save $8,000 in capital gains taxes. Keep in mind that for this strategy to work, the relative values of the building and land must be properly supported and documented. •

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