Charitable Giving: Appraisal Requirements for Cryptocurrencies

By Elliot Rotstein, CAP®

Americans are stubbornly philanthropic. In 2016, we gave over $390 billion to causes that we are passionate about. Through recessions, wars, political stalemates, tax reform, and economic uncertainty, charitable giving has continued to increase. There is no reason to think the deeply rooted tradition of giving back will subside in the near future. With $41 trillion of wealth expected to pass to the next generation's philanthropists by 2055, we are sure to see more gifts and more dollars given to charities with each passing year.

Philanthropy is ever-evolving. The practice has become increasingly more accessible over the years with the growth of awareness surrounding such giving vehicles as Donor Advised Funds (DAF's), Private Foundations, Support Organizations, Gift Annuities, and Charitable Lead and Remainder Trusts. In addition to the growth in awareness regarding the various charitable planning vehicles which can be used to help organize and manage how we give, there has been a tremendous growth in awareness regarding what assets make the most sense to give.

Historically, individuals have supported the causes they care about by donating cash or appreciated securities such as stocks, bonds, and mutual funds. More recently, donors are being well informed by their professional advisors and other charitable organizations that there may be a more tax efficient asset category from which to fund their philanthropic efforts: illiquid, non-publicly traded assets. These interests include closely held C- and S-corporation stock, LP/LLC interests, restricted stock, interests in hedge/private equity funds, real estate, cryptocurrencies and other privately held assets.

With so much wealth tied up in these illiquid, privately-held assets, the notion of using these interests to fund philanthropic efforts not only allows the donor to take advantage of tremendous tax benefits associated with the donation, but more importantly enables them to take what has traditionally been a non-working asset and put it to work in support of a good cause.

<u>Hot Topic – Cryptocurrency:</u>

Growing awareness and rising prices of cryptocurrencies such as Bitcoin have resulted in a growing number of charities opening their doors and virtual wallets to gifts of this type. Some early backers of crypto have seen their initial investments increase exponentially in the recent months and many are choosing to use their cryptocurrencies to fund their charitable giving efforts. We'll focus below on Bitcoin.

A Bitcoin is a digital asset that is issued by, and transmitted through, the decentralized, open source protocol of the peer-to-peer Bitcoin Network. The Bitcoin Network hosts the decentralized public transaction ledger, known as the Blockchain, on which all Bitcoin is recorded. No single entity owns or operates the Bitcoin Network, the infrastructure of which is collectively maintained by a decentralized user base.

Bitcoin can be used to pay for goods and services or can be converted to fiat currencies, such as the U.S. Dollar, at rates determined on Bitcoin exchanges or in individual end-user-to-end-user transactions under a barter system.

Under IRS Notice 2014-21, Bitcoin is defined as a “virtual currency” and the notice provides the following guidance as to the determination of fair market value of virtual currencies: For U.S. tax purposes, transactions using virtual currency must be reported in U.S. dollars. Therefore, taxpayers will be required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt.

If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into U.S. dollars (or into another currency which in turn can be converted into U.S. dollars) at the exchange rate, in a reasonable manner that is consistently applied.

The Bottom Line:

There are many technical requirements to consider and often times the process surrounding these types of gifts can be quite complex. When contemplating a charitable gift of illiquid privately-held assets or cryptocurrency, it is important to engage a charitable organization that has experience facilitating these types of gifts. It is equally important to work closely with a professional advisor who is well informed regarding other important considerations which can include timing, tax deductibility, and valuation.

The Fair Market Value (FMV) of an illiquid privately-held asset gifted to a charity is reported on IRS Form 8283. To meet IRS requirements, any contribution of property other than publicly traded securities worth more than $5,000 must be substantiated by a “qualified appraisal”. If the value of the donation exceeds $500,000, the complete appraisal report must be attached to Form 8283. The appraisal must be done no earlier than 60 days before the date of the gift and no later than the filing date of the return for the year of the gift. In order to meet the requirements of a qualified appraisal, the following requirements must be met:

- Appraisal must be prepared, signed, and dated by a qualified appraiser
- Includes a statement that the appraisal was prepared for income tax purposes
- Includes the appraised FMV of the property on the date or expected date of the contribution

- Includes the specific basis and methodology used in determining FMV for the property
- Includes a description of the appraised property
- Includes the qualifications of the qualified appraiser

Americans are incentivized to make charitable contributions through the ability to claim generous income tax deductions. Failure to properly document and report charitable gifts, particularly when the donation consists of illiquid privately-held assets can result in penalties, reduction in value, and even complete disallowance of the gift.

The results of a few recent cases which were summarized in a prior version of this article (Rothman v. Commissioner T.C. Memo 2012-165, Mohamed v. Commissioner T.C. Memo 2012-152, Evenchik v. Commissioner T.C. Memo 2013-34) have proved that the tax court intends to be strict in supporting IRS substantiation requirements of Section 170. Section 170 of the Internal Revenue Code governs, amongst other items, reporting requirements for charitable organizations, contributions, and gifts.

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