



SPECIAL REPORT

A Primer on Charitable Contributions of Virtual Currency

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The explosive growth in virtual currency (also referred to as cryptocurrency, digital assets, tokens and digital currency) is evidence of increasing popularity and acceptance of it as a new investment asset class.¹ With the huge appreciation in the value of many investors' positions, there has been an increased interest in charitable contributions. While there are now more than 8,000 different virtual currencies,² not all of them are suitable for charitable contributions. Only virtual currencies that are convertible into a fiat currency are of value to charities because most charities will want to convert the contribution to US dollars or another fiat currency as soon as possible.

Not all charities will accept virtual currency donations. The GivingBlock website identifies some charities that accept virtual currencies, although many charities that accept such donations are not identified on that website.³ These include, for example, the Red Cross,⁴ UNICEF⁵ and Heifer International.⁶

To ensure that they are able to accept virtual currency donations—and that this is known to the potential donor population—charities are implementing and publicizing virtual currency donation programs. These programs create a positive buzz among the prospective donor base.

In addition to individual programs, an entire industry has developed recently to assist charitable organizations to solicit and accept virtual currency donations. Third-party providers streamline the administration of

donations, making the process easier for donors and recipients. One way they do this is by hosting donor advised funds (DAFs) capable of accepting donations of virtual currencies.⁷ In a DAF, the donor contributes virtual currency to a giving account at the third-party charitable platform. The donor can then recommend the charitable recipients of donations from that giving account. Once the DAF acquires the virtual currency, it immediately converts it to US dollars (or another fiat currency). The donor receives an immediate charitable tax deduction upon contribution of the virtual currency to the DAF, and the charitable recipient receives a donation of actual (not virtual) currency from the DAF giving account.

As virtual currency becomes more popular and acceptance of it as a new investment asset class grows, individuals accumulating substantial portfolios are likely to explore options under which they can use virtual currencies to make charitable contributions. Donors and charitable organizations in the United States must take steps to address specific issues and ensure that donations made and received meet Internal Revenue Service requirements.

¹ Luke Conway, *Why Does the Price of Bitcoin Keep Going Up?* Investopedia, <https://www.investopedia.com/why-does-bitcoin-keep-going-up-5092683> (last updated Dec. 17, 2020). Daniele Bianchi, "Cryptocurrencies As an Asset Class? An Empirical Assessment," *J. of Alternative Investments*, 23(2), Fall 2020, 162-179, <https://doi.org/10.3905/jai.2020.1.105>, site visited April 29, 2021; David Lee Kuo Chuen, Li Guo, Yu Wang, "Cryptocurrency: A New Investment Opportunity," *J. of Alternative Investments*, 20(3) Winter 2018.

² CoinMarketCap, *Today's Cryptocurrency Prices by Market Cap*, <https://coinmarketcap.com> (April 24, 2021).

³ The Giving Block, *Join Us*, <https://www.thegivingblock.com> (Jan. 17, 2021).

⁴ Bitpay, *Donate bitcoin to American National Red Cross*, <https://bitpay.com/520663/donate> (Jan. 18, 2020).

⁵ UNICEF, *Press Release: UNICEF Launches Cryptocurrency Fund*, <https://www.unicef.org/press-releases/unicef-launches-cryptocurrency-fund> (Oct. 9, 2019).

⁶ Heifer International, *Donate with Digital Currency*, <https://www.heifer.org/give/other/digital-currency.html> (Jan. 17, 2021).

⁷ Fidelity Charitable, *What is a donor-advised fund?*, Fidelity Charitable, <https://www.fidelitycharitable.org/guidance/philanthropy/what-is-a-donor-advised-fund.html>. Schwab Charitable, "Strategies for Maximizing Your Charitable Impact in 2021," Feb. 9, 2021.

DONORS

By making a charitable contribution, donors can avoid reporting and paying capital gain tax they would need to report if they had sold their appreciated virtual currency, and they also receive a charitable deduction for the full value of the appreciated virtual currency up to a percentage cap of adjusted gross income.⁸ Therefore, the most advantageous virtual currency to use as a charitable contribution is one that is a significantly appreciated capital asset that the donor has held for the long-term capital gain holding period (that is, one year plus one day).⁹ As with all charitable contributions of noncash property, a tax deduction is only available if it is itemized on the tax return.¹⁰

Potential donors of virtual currency can look to the Internal Revenue Service's (IRS) 2019 FAQs for guidance, as updated on March 3, 2021.¹¹ Question 34 states that the donation of convertible virtual currency is not a sale or exchange of a capital asset. In other words, such a donation is treated as any other noncash contributions of property.¹² Question 35 addresses how a donor calculates the charitable deduction.¹³ For capital assets held for the long-term capital gain holding period, the deduction equals the fair market value of the virtual currency at the time of the donation.¹⁴

If the donor has not held the virtual currency for the long-term holding period, the deduction is limited to the lesser of the donor's tax basis or its fair market value.¹⁵ If the virtual currency is an ordinary asset in the donor's hands, the donor's charitable deduction is

limited to the fair market value of the property minus any appreciation (basically, the donor's tax basis).¹⁶

If the taxpayer has a loss on the virtual currency, meaning that the donor's tax basis is greater than the fair market value of the virtual currency, the deduction is limited to the virtual currency's fair market value. In addition, the difference between the taxpayer's tax basis and the fair market value cannot be treated as a capital loss. Therefore, if the taxpayer is in such a loss position, it is more tax efficient to sell the virtual currency, report the capital loss for tax purposes, and donate cash to the charity equal to the fair market value of the virtual currency sold at a loss.

Recordkeeping and Reporting Requirements

In Notice 2014-21, the IRS said it views convertible virtual currency as property for tax purposes, not as foreign currency.¹⁷ As a result, convertible virtual currency is subject to the general tax rules that apply to noncash property.¹⁸ The IRS has not provided any guidance with respect to virtual currencies that are not convertible into US dollars or other fiat currencies, or that can be used to pay for goods and services. Accordingly, virtual currency donations are treated as noncash donations. Donors, thus, must carefully document the amount and type of their contributions, with required recordkeeping and documentation getting more detailed as their donations increase in value:

⁸ Although there have been beneficial changes to charitable deductions under the 2020 CARES Act which have carried over to 2021, deductions of noncash property are capped to a percentage of an individual taxpayer's adjusted gross income. Deductions for contributions to DAFs are also capped.

⁹ Code §1222(3).

¹⁰ The 2020 CARE Act (as extended in to 2021) permits taxpayers that do not itemize their deductions to deduct up to \$300 in charitable contributions that are made in cash to charitable organizations. This above the line deduction does not apply, however, to noncash donations (such as virtual currency). Based on IRS guidance to date, it is unlikely that a stablecoin would be treated as cash for this (or other) tax purposes.

¹¹ IRS Frequently Asked Questions on Virtual Currency Transactions, <https://www.irs.gov/individuals/international->

[taxpayers/frequently-asked-questions-on-virtual-currency-transactions](#) (last updated March 3, 2021) (hereafter FAQs).

¹² FAQ 34.

¹³ FAQ 35.

¹⁴ FAQ 35.

¹⁵ FAQ 35.

¹⁶ FAQ 35, See also IRS, "Charitable Contributions," Publication 526.

¹⁷ Notice 2014-21, I.R.B. 938.

¹⁸ Notice 2014-21, I.R.B. 938.

- For donations valued at less than \$250, donors need to keep a contemporaneous receipt from the charity showing the charity's name and address.
- Donations of more than \$250 require a contemporaneous written acknowledgement from the charity. This acknowledgment must be obtained before the donor files the tax return, or before the date—including extensions—when the tax return is otherwise due.¹⁹
- Donations of more than \$500 require a completed IRS Form 8283 (Noncash Charitable Contributions) to be filed with the donor's tax return.²⁰
- Donations of more than \$5,000 require a qualified appraisal from a qualified appraiser. In addition, the charity must sign the donor's IRS Form 8283 (Noncash Charitable Contributions) to substantiate the deduction.²¹ The charity's signature does not mean that it agrees with the appraisal value.²² Rather, it simply acknowledges receipt of the virtual currency on the date specified.

Qualified Appraisals

Donations of more than \$5,000 require the donor to complete IRS Form 8283, Section B, and to obtain a qualified appraisal that meets generally accepted appraisal standards.²³ The appraisal must be signed and dated by a qualified appraiser; that is, someone who is a recognized appraiser with at least two years' of experience in valuing the type of property that is being appraised.²⁴ Because of this requirement, it may be difficult and expensive for a taxpayer making a virtual currency contribution to find such a qualified appraiser.

¹⁹ FAQ 36. See also Publication 1771 (REV. 3-2016) Charitable Contributions, <https://www.irs.gov/pub/irs-pdf/p1771.pdf>.

²⁰ FAQ 36.

²¹ Form 8283.

²² FAQ 36.

²³ FAQ 36; Jeremy Naylor and Brianna Reed, *IRS Issues New Guidance for Virtual Currency Donations*, National Law Review, Volume X, Number 30, <https://www.natlawreview.com/article/irs-issues-new-guidance-virtual-currency-donations> (Jan. 30, 2020).

Fair Market Value

In determining gains and losses, as well as the amount of charitable deductions, taxpayers must determine the fair market value of their virtual currency. Virtual currency that trades on an exchange is likely to have a fair market value equal to the spot price (if such a price is available) on the date and time the virtual currency is donated. If a spot price is not available, but a third party tracks and values that virtual currency, fair market value is likely to be the value assigned on the applicable dates and times by that third party. For virtual currencies that are convertible, one or the other of these methods of determining fair market value will almost certainly be available. Some virtual currencies only trade on exchanges that only permit exchanges of virtual currencies for other virtual currencies (also known as crypto trading pairs), as opposed to exchanges that also permit the purchase and sale of virtual currencies for fiat currency. In such instances, the taxpayer must determine an appropriate pricing methodology. Different methods potentially apply, such as those based on a weighted average price,²⁵ or a method that is based on the price at which the virtual currency trades in its "principal market." The latter price is the one that is used by S&P in its crypto indexes (and which is based on Lukka Prime).²⁶

Identification

If the taxpayer does not identify virtual currency units for donation, or the taxpayer cannot meet the specific identification requirements, the units donated by the taxpayer are treated as sold under the first-in-first-out (FIFO) method. Taxpayers that want to benefit from making a specific identification of virtual currency units acquired at different dates and at different prices are likely to want to donate those units with the lowest

²⁴ Allyson Versprille, *IRS Update Reignites Concerns About Crypto Donation Appraisals*, Bloomberg Tax, <https://news.bloombergtax.com/daily-tax-report/irs-update-reignites-concerns-about-crypto-donation-appraisals> (Jan. 10, 2020).

²⁵ FAQ 27. The FAQ can be considered a safe harbor, as opposed to one that would be permitted under general tax principles or US GAAP. This is because pricing based on unadjusted industry averages is generally frowned upon for tax and accounting purposes.

²⁶ Valuation methods like Lukka Prime are used and which are based on ASC 820 GAAP principles.

tax basis and the largest unrecognized appreciation. To make such an identification, the taxpayer must specify the units held in an account or wallet.²⁷

CHARITABLE ORGANIZATIONS

Charities must address several issues in accepting donations of virtual currency: the legitimacy of such a donation in the first place, the protocol for acceptable virtual currency, and the ways in which specific virtual currencies can be converted to US dollars or another fiat currency.

Suitability Considerations

Charities must determine the suitability of accepting virtual currency donations. Considerations may include whether such donations are acceptable under applicable laws, permissible under their enabling documents or mission, and suitable given their financial situations.

Evaluating Whether to Accept Direct Donations

In evaluating whether to accept direct donations of virtual currency, charities should take the following into account:

- Donations through a third-party provider or DAF means that the charity receives US dollars (or another fiat currency) so the charity does not need to set up a virtual currency account or wallet, and need not assume the risks and expense of converting virtual currency to fiat currency.
- Donations through a third-party provider or DAF might allow the charity to insulate itself from undesirable donors that could hurt its mission or pose a reputational risk to the charity.
- Direct contributions might attract potential donors that do not want to use a DAF.

- Direct contributions might allow the charity to benefit from market-value increases or to suffer from market-value declines.

Policies and Procedures

Charities should consider the following internal policies and procedures with respect to the acceptance of virtual currency donations:

- Determine whether the charity will work with a third-party processor or platform to set up its program.
- Determine which virtual currencies it will accept.
- If the charity decides to accept virtual currency donations, determine whether it will immediately convert the virtual currency to US dollars or identify any circumstances under which it would be willing to hold the virtual currency.
- Determine whether it will accept anonymous or pseudonymous gifts. Because virtual currency transactions are often anonymous or pseudonymous, virtual currency donations can also pose a problem for those charities with policies against accepting anonymous gifts. Under a charity's disclosure policies, donors might be required to provide information about themselves, creating compliance complications for charities and disincentives to donors seeking anonymity.
- Identify procedures to protect the charity from security breaches and hackers. For example, the charity should not post its digital wallet address on its website where transfers are visible to everyone. This could result in a "redirect hack" where a hacker changes the wallet address posted on the website to an address that the hacker

²⁷ FAQ 40 and 41.

controls.²⁸ The charity might, instead, require potential donors to complete an information form before providing the donor with a wallet address, and donations can be assigned unique digital addresses.²⁹

- Consider engagement with a blockchain analytics firm, such as Chainalysis or Elliptic. They have software products that analyze transactions and wallet addresses for purposes of determining if there is money laundering, terrorist financing or other criminal or reputational risk.³⁰

Documentation of Donations

If a charity accepts virtual currency donations, it needs to provide donors with all of the documentation needed for recordkeeping and reporting obligations:

- For donations valued at less than \$250, the charity should provide the donor with a receipt that includes the charity's name and address.
- Donations of more than \$250 require a contemporaneous written acknowledgement.
- For donations of more than \$5,000, the charity needs to sign IRS Form 8283, Part V, acknowledging that the charity is a qualified

charity under Code § 170(c) and that it has, in fact, received as a donation the noncash property described on the form. By signing the form, the charity does not agree with the appraised value.³¹ Rather, the charity is acknowledging receipt of the virtual currency and that it meets its information reporting requirements when disposing of the virtual currency.³²

IRS Reporting Obligations

Charities must report the virtual currency they receive as noncash contributions on Schedule M (Noncash Contributions) of their IRS Form 990. If they dispose of all or any portion of the virtual currency within three years after the date of receipt, they must file IRS Form 8282 (Donee Information Return) and provide a copy to the virtual currency donor.³³

CONCLUSION

As more people accumulate substantial portfolios and as more charities establish policies to accept virtual currencies, we are likely to see more charitable contributions of this type. There are several tricky issues that need to be considered by donors and recipients. These hurdles can be addressed and overcome, but they require careful attention.

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²⁸ Andy Greenberg, *Hacker Redirects Traffic from 19 Internet Providers to Steal Bitcoins*, Wired, <https://www.wired.com/2014/08/isp-bitcoin-theft/> (Aug. 7, 2014).

²⁹ Third party service providers are available to serve as middlemen for such transactions. Jane M. Searing and Deby Macleod, *Cryptocurrency gift strategies for not-for-profits*, Journal of Accountancy, <https://www.journalofaccountancy.com/issues/2019/feb/cryptocurrency-gift-strategies-for-nfp.html> (Feb. 1, 2019).

³⁰ See "Top Blockchain Analytics Companies and What They Do," Analytics India Magazine, July 24, 2020, <https://analyticsindiamag.com/top-blockchain-analytics-companies-and-what-they-do/>. (Visited May 12, 2021).

³¹ FAQ 36.

³² FAQ 36.

³³ Form 8283.

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