

A Gift of Cryptocurrency?

Quick-Take: The transfer of cryptocurrency comes with lots of complications, including a risk that a gift of the cryptocurrency is incomplete for federal gift tax purposes.

Background: The IRS has announced that cryptocurrency is property, not currency, nor is it 'money.' As such, the value of cryptocurrency must be reported when crypto is used in a transaction, either as a gift, or if it is sold, or if it is traded, so that in some situations the transfer of crypto could trigger a capital gain. [IRS Fact Sheet 2024-23; IRS New Release IR-2024-173.]

Gift of Cryptocurrency: If the gift of cryptocurrency exceeds \$19,000 (the annual exclusion amount) a federal gift tax return (Form 709) will have to be filed by the donor. A gift of cryptocurrency also means that there will be 'carryover' income tax basis in the currency held by the donee, and if the donee subsequently sells or uses that the currency within one year of the gift, he/she will pay the tax on the gain recognized an ordinary income tax rates.

Process of a Gift: The gift of cryptocurrency can either be straightforward, or it can quickly become complicated. The simple way to make a gift of cryptocurrency is to transfer the cryptocurrency from the owner's digital wallet or exchange account to the donee's own digital wallet 'address.' However, as is always the case when dealing with cryptocurrency, an abundance of caution needs to be taken to use the correct digital wallet address and the selection of the correct blockchain network, since cryptocurrency transactions are irreversible.

Transfers of Cryptocurrency: Other ways to transfer cryptocurrency include:

Hardware Wallet: A hardware digital wallet, i.e., an offline storage device, can be preloaded with cryptocurrency. This is a good way to provide additional security. The donee would then set up his/her own recovery phrase from the hardware wallet..

Gift Cards: Bitcoin gift cards from services like 'Fold' are a practical option if the donee is new to cryptocurrency and he/she has not yet set up a digital wallet.

ETF Fund: If the donee has a traditional brokerage account, the donor can gift shares of spot Bitcoin exchange traded fund (ETF) which tracks the price of Bitcoin without the need to manage a digital wallet.

Completed Gift? The completed gift of cryptocurrency often requires care in the handling of digital wallet keys. The donor must take deliberate steps to show that the intended transfer will be respected as a *completed gift* for gift tax purposes. More to the point, there could be problems if the donor of cryptocurrency still holds the private keys to the digital wallet, or when he/she purports to make the transfer of the cryptocurrency to an LLC or to a Trust. In those situations, the claimed gift may be classified by the IRS as *incomplete* due to the donor's retained control over the cryptocurrency. This situation can sometimes arise when the donor's transfer of the cryptocurrency is made to an LLC that is owned by a trust, yet the donor retains control over the LLC as its manager, or the donor retains control in some capacity over the trust, e.g., the donor acts a trust director regarding the cryptocurrency investment that held in the trust.

Bearer Bond Analogy: Cryptocurrency might be analogized to the holder of *bearer* bonds. Whoever holds the physical *bearer* bond owns the bond. With cryptocurrency, whoever holds the keys to the digital wallet, controls the cryptocurrency asset, and thus will be deemed to be its owner.

IRC 2036: Consequently, when cryptocurrency is the subject of a gift, the donor needs to be careful to assure that control is fully transferred either to the donee or to an irrevocable trust that holds the cryptocurrency. If the transfer (with hindsight) is viewed as *incomplete*, and the donor retains an element of control over the cryptocurrency via the digital wallet, the donor could have the value of the cryptocurrency included in his/her taxable estate at death. [IRC 2036(1)(a).]

Transfer Strategies: In some situations, the donor may decide to transfer the cryptocurrency to either an LLC or to a trust that holds the membership interests in the LLC. If that is the case, it would be helpful to either:

- (i) Have the transfer of the cryptocurrency supported by a Nominee Agreement that confirms that the donor only holds rights solely as a nominee for the LLC or Trust; or
- (ii) Use a multi-signature digital wallet with a trust director, LLC manager, trustee, or as an investment advisor, each holding a fraction of the 'key' to the digital wallet so that total 'control' over the cryptocurrency is not deemed to have been retained by the donor; or
- (iii) Use a contractual arrangement, much like a private derivative approach, (this is sometimes used when an individual holds a 'carried interest' in a private equity investment that he cannot transfer) where the trustee or donee recipient acquires the right to future appreciation of the cryptocurrency, without actually owning the digital asset because of existing transfer restrictions.

Charitable Giving : Many charities are now finding themselves the recipients of cryptocurrency as part of a donor's philanthropy. As an example, the March of Dimes now accepts a wide range of cryptocurrencies. Other charities are positioning themselves to accept such currencies when you read their websites. Some charities and donor advised funds (DAFs) will accept cryptocurrency, often through third-party platforms like The Giving Block, or BitPay, while still other charities that are set up to accept cryptocurrency will often identify on their websites what types of currency that they will accept.

Tax Benefits: The gift of cryptocurrency to a 501(c)(3) charity can be efficient for tax purposes to avoid capital gains and enable the donor to claim a charitable income tax deduction based on the cryptocurrency's fair market value. However, the gifted cryptocurrency must be held by the donor for at least a year, otherwise the donor is only entitled to deduct his/her cost basis in the currency. In addition, as a noncash gift to charity over \$500, the donor must file IRS Form 8283 along with an appraisal if the gifted cryptocurrency is over \$5,000 to establish its fair market value. Note though, that even when gifting cryptocurrency to a charity, the charity must formally accept the gift before the donor is entitled to claim a charitable deduction.

Conclusion: Cryptocurrency is fast gaining acceptance in the business world, and charities are now having to become familiar with it as part of their fundraising efforts if a donor is inclined to make a gift using cryptocurrency. The transfer of cryptocurrency, deemed to be *property* for tax purpose, entails many challenging complications and different tax consequences than if just ordinary cash was the subject of the gift. And the unique aspect of a single digital wallet with a 'key' could cause the transfer to be treated as *incomplete* if the donor retains an element of 'control' over its 'key.'

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