Cradle to Crypt(o):

Tax Exempts and the Life Cycle of a Cryptocurrency Donation

Exempt Organizations Tax Journal

What follows are the May 13, 2022 remarks of Duke Kim, The Giving Block, Andrea S. Kramer, McDermott Will & Emery LLP, and Alexander L. Reid, Baker Hostetler, as delivered to members of the Exempt Organizations Committee of the ABA's Section of Taxation. The moderator of the panel was Eleanor Moran McWaters, Crowell & Moring LLP.

Summary: Cryptocurrency donations and the technologies that help facilitate them have been gaining attention around the world, and those of us in the tax-exempt organizations space are increasingly intersecting with cryptocurrency and the related technologies. This panel will help us get up to speed by exploring the tax and related legal considerations associated with the life cycle of a cryptocurrency donation, beginning with the donation of cryptocurrency to a nonprofit and ending with the nonprofit's disposition of cryptocurrency.

Learning Objectives: After attending the session, the participant will be able to:

• Learn the fundamental aspects of blockchain and cryptocurrency (what it is, why it has all become so popular, how it works)

• Identify the key tax considerations associated with the donation of cryptocurrency to nonprofits

• Explore the tax and legal issues that arise when a nonprofit holds onto and then disposes of cryptocurrency

McWaters: Hello everyone. We're here to talk about cryptocurrency and tax-exempt organizations. I'm joined by three experts with varying areas of expertise. We have Andy Kramer who's a partner at McDermott with years of experience in financial transactions who is now specializing in crypto and is a true thought leader in the NFT space. Prior to working on this panel I read a bunch of her publications and was thoroughly impressed so please direct all questions specific to crypto to Andy. She has also co-authored a very extensive treatise titled Financial Products: Taxation, Regulation and Design, and is also a member of the ABA Section on Taxation Cryptocurrency Task Force so again all questions on crypto to her.

We also have Alex Reid who is an expert in everything exempt organizations and your vice chair so all questions related to exempt org specifics, please ask Alex. Previously he worked as legislation counsel for the Joint Committee on Taxation and a fellow at the Office of Tax Policy at Treasury so very experienced.

Last but not least, we have Duke Kim from The Giving Block for a great logistical and boots on the ground perspective on crypto. Prior to joining The Giving Block, which I should back up and state is a payment processor or a platform that allows nonprofits to accept crypto donations, he worked as what he calls the Bloomberg Guy so everything and anything, credit derivatives, trader, regulatory and operations consultant so you have a wide range of expertise here.

With that I'll walk us quickly through the agenda so we can get to the meat of the panel. We're going to start by level setting. By we I mean Andy and level setting about cryptocurrency generally. I don't know if you all peruse the agenda for the whole conference but there are about five panels on crypto today and general confusion reigns so please enjoy the level set as we can all kind of get on the same page of what is crypto, how do you deduct this, what have you.

Once we level set Duke is going to kind of walk us through actual acceptance of crypto, how to advise your organizations to go about getting that crypto in the door, and then Alex is going to talk about what happens when you hold this, what happens if you need to dispose of it, and what happens if there's volatility in the market, which may or may not be happening now.

Kramer: Hello everybody. I'm Andy Kramer and what I thought I was going to talk about today is obviously not what I'm going to talk about today because the crypto world has gone sideways, upside down. It's probably fitting that right outside of the room here is the elevator and when I was waiting to come in it was going up, going down, going up. I thought that's probably a good way to start this morning.

Cradle to Crypt(o) is really a great title and there are a lot of people today who probably would like to crawl back into their cradle because the market has been so volatile. We don't know whether this is just a market correction or if the sky is falling, but today we're here assuming that it's a market correction and that the sky is not falling.

So what is cryptocurrency? It turns out that, depending on who the regulator is, they call them all sorts of different things and in fact the popular press was calling everything that was digital asset-y cryptocurrency. The IRS was calling it virtual currency and the other regulators were mixing between virtual currency, digital assets, some calling it coins, some calling them tokens.

What that's all about is that what we have is a contract that is transferred not through an intermediary so you don't go to the stock broker and say I want to buy one bitcoin. Instead, you set up a digital wallet where you then buy your one bitcoin.

How does that happen? What happens is it travels and is recorded on what's called a blockchain. The mechanisms that get it on to that blockchain result in the creation of other coins or tokens. We're not going to talk about that today, but if I own a bitcoin and you want to buy one and you say I want to buy one bitcoin and it happens to be my bitcoin, then it's going to go from my account to your account and it transfers. Once it's in your account, I can't get it back so that if I send it to you by mistake it's sort of tough luck unless you're nice to me.

So the bitcoin is one type of a virtual currency, a cryptocurrency, but there are thousands and thousands more. Of those thousands there's a handful, maybe 50, that are considered to be top tier where there's a lot of trading volume compared to the other ones. Some of these coins and some of them are called coins, that's the bitcoin side, but a lot of them are called tokens and so even though they're both going to be digital assets, cryptocurrency, they have different characteristics.

The tokens are actually what I refer to as smart contracts and a smart contract has embedded in its metadata information about what it provides, what its rights are, what its obligations are, and it goes along on a different chain basically.

That sounds all very kind of creepy — and legitimately — so there's a lot of questions about how am I going to be sure that I'm giving it to the right person because we have all sorts of laws about how we can't do business with people in sanctioned countries and we don't want to be taking in bitcoin or other currencies that are from dark pools, for those of you that know scary places where pornography or torture or money laundering goes on. So all of these things are very important to exempt organizations because you have to be sure that you're not getting something that's creepy.

If we go to the next PowerPoint, which is about NFTs, NFTs have been so popular. In 2021 the Collins Dictionary named NFTs as the word of the year and so it beat out everything else, word of the year, NFTs. That stands for non-fungible token so I told you that tokens go on a special chain with a smart contract and so NFTs are really artwork, very often music. I'm from Chicago so Michael Jordan just came out with his NFTs, it's got all of his wins and if you buy his NFT what you get with it is you could have an interview with somebody, you can get special rights. They're putting into these all sorts of experiences and what not, and so again it travels on a blockchain. It has the same concepts but they're unique and because they're unique, each one has its own number.

What people have been doing and Duke is going to do the heavy lifting on this, what you can do is you can easily give a bitcoin to charity, but what are you going to do about an NFT if it's unique? How are you going to value it? What's it worth unless it's an art museum and you're giving them a art project, a beautiful piece that they're going to put in their collection, very difficult questions there, so if we go to the next slide what we've got is talking about this one.

McWaters: Yes, the state of crypto today, so now that you understand everything, the fundamentals of crypto, and can explain it to everybody else who doesn't know, we're going to talk about why we're here in this exempt org panel today, which is basically how pervasive crypto has become.

Pervasive often has a negative connotation, but at least up here I think we'd say it's positive. 16% of Americans say that they own crypto or have dabbled in crypto, according to Pew research, so it's not just a handful of people. It's mainly millennials but it's also people who are investors.

Also up here you'll see that 45% of crypto owners or investors donated over $1,000 in 2020 as compared to only 33% of the general investor population. That shows that you are not only having more Americans having crypto but they are in fact donating this crypto and so large numbers, potentially not after today's volatility.

Kramer: At least I suspect not today. There's not going to be a lot of donations today.

McWaters: Yes, but otherwise before today or before Monday we were seeing a large amount of crypto donations so you know now a lot of Americans own it, you know they're donating it, and now inevitably they're deducting those donations so this is when we pivot back to Andy to talk about how do you go about deducting it.

Kramer: Let's say you have one bitcoin and you bought it from me for $11 and it was worth almost $60,000 a couple weeks ago. Today I think they were thrilled that it was leveling off at 30 so what you've got is, and I can see some of the reactions like, "Oh my goodness, this is pretty scary," but you bought it for $11 and you're now going to donate it when it's worth 30. Still, that's pretty good.

So if you think about it, what are the donation rules? What we know is that we have no regulations and we have no revenue rulings on the tax treatment of cryptocurrency. What we have are four IRS frequently-asked questions about the donation of cryptocurrency. That's all we've got.

This next PowerPoint has Question 34, which the answer to it is that it's going to be treated as a non-cash donation so your one bitcoin that you're going to give to Duke, who will tell you how you're going to give it, your one bitcoin is going to be a non-cash donation, not a sale of a capital asset, so you don't have tax on the transfer.

If you held it for the long-term holding period, then what you're going to do is you're going to get deduction for the fair market value, so you paid $11 and you've got a $30,000 deduction today. If you didn't hold it for the long-term period, then your deduction would be limited to your tax basis or your fair market value and if it was an ordinary asset it would be your tax basis basically.

Now that bottom one is particularly of interest today if a loss deduction is limited to your fair market value. Think about it. If you have a loss, if you bought the bitcoin for $60,000 and it's now worth $30,000, are you going to want to donate it to the charity today when you have a $30,000 loss. The answer to that is no. What you want to do is you want to sell it, take your loss, and then donate the cash because otherwise your loss is lost.

Now there are two other FAQs that really deal with the charity side and that is Questions 36 and 37 and basically that's talking about what the charity has to provide for contemporaneous written acknowledgements and their reporting requirements so we'll leave that to Alex.

What about the donor's tax considerations? I want to spend just a minute talking about what the general tax rules are with respect to cryptocurrency so I've given you like the world's fastest and probably most incomprehensible presentation as to what a blockchain is, but what happens is the IRS treats it, if it's convertible virtual currency, as property, and so what that means is that if you have a bitcoin that you bought from me for $11 and you decide it's worth $30,000 and you decide you want to change it to a different virtual currency, what you do is you're going to give that up for $30,000 and get $30,000 worth of coin or ether, which is another popular one, second largest.

You're going to have tax on the transfer of your bitcoin because it's basically a barter exchange so you have appreciation if you're transferring around appreciated property, you're going to have tax, and that's something that mere mortals don't understand so for all of those 16% or whoever of the population that has these, they get very surprised when they find that on the tax return after your name and address and your taxpayer ID number they have a question that you have to answer about whether you own cryptocurrency and the problem that my partners who deal with criminal tax stuff tell me is that that's a perfect way for the IRS to catch you because now if you had it and you check the box wrong, then you have actually a criminal tax issue to deal with.

Alex is going to talk about the types of returns and requirements for reporting, but I just wanted to spend a minute on NFTs because here, how do we find a qualified appraiser? If we're going to donate this stuff, we have to have a qualified appraiser and so what happens is, what's it worth? Dorsey's first tweet ever was put on an NFT and I think it sold for $2-1/2 to $3 million so his first tweet sold for $3 million. The person who bought it for $3 million was trying to sell it and I think the last bid for it was like $14,000 so NFTs are a willing buyer and a willing seller so that makes them creepy for charities because what are you going to do, you're going to get it and then you can't sell it, or you're going to sell it for 12 cents when you thought it was worth a ton more.

So what happens is that in the NFT world people are creating the NFTs and then once they create it, they then sell it where the proceeds go to charity, and there's a big market in that, and in fact for those of you that watched the Oscars they did a raise for charity at the Oscars and most of the money that came in was actually from artists selling their NFTs for charity. If you're at all interested in this and I assume you are since you're sitting here, I have a special report, a paper done on donating cryptocurrency and one about the weirdness about NFTs and how to deal with donating them. I think that Eleanor put a link to those in the back of the PowerPoints so that's my turn and now it is Duke's turn.

Kim: Thank you so much and good morning everybody. So methods of making a crypto donation. The first one sounds like it doesn't actually involve The Giving Block. Thankfully it kind of does so it's the use of a donor-advised fund. The way I tend to describe it is probably not up to snuff with this audience, but basically a charitable hedge fund that is really driven and focused on making charitable contributions.

Typically what we'll see with early crypto investors, what we call OGs that have been in the space for a long time that have a tremendous amount of appreciated capital, what they can do is create a donor-advised fund, fund it with cryptocurrency that can be then liquidated and applied just like any other donor-advised fund structure.

Kramer: Can I say one thing about that from the donor-advised fund, sometimes these people who have huge appreciation don't trust the fact that once they put it into the donor-advised fund that it's going to be liquidated right away, and so they're afraid that it's going to be liquidated today instead of next week when it might be back to 60. And so very often what we've seen is people will create LLCs where they will donate the LLC to the donor-advised fund so that the donor-advised fund manager can then pick the time for doing the sale.

Kim: You were just about to remove the middleman then Andy so we're actually working with a partner at The Giving Block that specializes in DAF platforms and formation to pretty shortly enable investors to contribute to a DAF with appreciated cryptocurrency. Right now this is a big point in ethereum and that actually custody those assets to actually allow for appreciation over the longer term.

Kramer: You just got rid of the lawyer.

Kim: I think it's going to be pretty amazing so that's the donor-advised fund. There are plenty of them out there that do publicly accept crypto, some privately accept crypto, we work with a number of them.

Next is use of a processor so this is The Giving Block. Just as a very quick shill for our platform, founded in 2018 in Washington, D.C. Fast forward to today, we support about 1,600 nonprofits globally, doing about $100 million in crypto donation volume processing, and these were purchased by a public company called Shipfor, which is a credit card payment processor, and so I think the synergies that will be unlocked should be pretty self-evident to some degree.

We specialize in enabling nonprofits to accept crypto. We take all of the operational headache away from them, as Andy mentioned. The way that crypto is taxed from the nonprofit perspective, the tax exempt, as well as from the donor perspective, we enable that donor to move his or her intangible property to an account held by that nonprofit so the donor is making a capital transfer but not a capital event.

The 501(c)(3), the tax-exempt organization that uses our software to then sell that crypto, also doesn't have a capital event on their side and they receive the dollar proceeds so they can continue on doing the great work that they do. There are other processors out there. Typically people in the cryptocurrency space may have heard of BitPay or Coinbase commerce and so these platforms you can consider them like Stripe for crypto or you can just kind of embed them into a website.

It's really we will take some amount of crypto currency and convert that for dollars, send that down to what they would consider the merchant in this case so that's really kind of wrapping to the payment processor that embeddable checkout experience again with typically crypto exchanges that have some sort of fiat kind of rail there and then obviously the nonprofit and, prior to platforms like ours spinning up over the last few years, there was also the concept of you could try to do this yourself.

There are a number of tax exempts typically that are probably focused on privacy information, security education that have that technical expertise to do all of this, but it does what we have found is really detract away from the true nature of that organization because they do need to have someone that is knowledgeable about cryptocurrency that can handle the operations, that understand the tax considerations, et cetera, again which is why we exist to remove a lot of that heavy lift from the organization.

Moving on real quickly, just to come back to it on the DAF side. I guess there's been a lot of writing about this over the years in terms of the privacy implications so originally crypto investors were kind of introduced to the concept of DAFs really so that they can convert large sums of money, sustainably give to organizations and causes that they care about and, as I've been coming up to speed in this space over the last year, again from the nonprofit perspective, there certainly abstracted away from some of the process they're receiving dollar proceeds but then there's the traditional concern of who is the actual DAF account holder, where did this money come from, should you know what kind of risk that does to us as a tax exempt have from taking that donation.

As an organization we hold ourselves arm's length away in a lot of those discussions, but really say if the nonprofit is comfortable accepting anonymous donations, then they should be comfortable accepting cryptocurrency donations. That's kind of how we've approached that perspective. Just in terms of the processor piece we spend a little bit more time around some of the what we will call creepy coin considerations that Andy mentioned. . . .

Kramer: Because it'll be the next coin out there that's going to go up to a billion dollars.

Kim: Definitely sounds like an energy project. We use institutionally rigorous platform partners alongside with what The Giving Block does so if we are held out as purely the processor we work with crypto currency exchanges such as Gemini, regulated in the US, in New York State, to actually create corporate accounts for our nonprofit clients.

So again, from a donor experience perspective, the donor is taking her property, giving it to a receptacle held in the name of that nonprofit, we execute the sale and transfer dollar proceeds over to them. The other piece that we do then because of the partners we work with is actually offer, just through the process, real time transaction monitoring through partners such as Chainalysis.

So again if nonprofits tend to have this objection or this concern around how do we make sure that this stuff didn't come from a dark net hacking group, North Korea, sanctioned countries, OFAC-listed members, etc., we have partners and this is the beauty of blockchain. All of it is in a distributed ledger that's publicly viewable.

Thanks to the magic of the Internet, there are ways to actually figure out who is the actual person at the end of that exchange transaction so again groups like Chainalysis are used heavily and reliably across the industry to make sure that coins that are coming from bad places really can't enter back into the mainstream marketplaces so we offer that same protection for nonprofits so again they don't have to get spun up as a KYC officer and understand OFAC rules. We take care of that stuff for them.

Reid: Next is the do-it-yourself approach. First I'd like to make a point about software engineers. They are discovering the world like newborn babes through the lens of software. They create code, and once the code replicates something in the real world, it now becomes a thing in the software world. It becomes "reified" (res from Latin, reification). Software makes "it" into a "software thing." If you prefer a cosmology analogy, "it from bit."

Now, turning to cryptocurrencies, you can create a medium of exchange out of anything. For example, if you're in prison you can exchange cigarettes as a means of storing and exchanging value.

Kramer: Let's hope none of you get to that!

Reid: Indeed! The point is you can monetize transactions with cigarettes. Another example, early civilizations traded cowrie shells found on the beach as a means of storing value. So what software engineers realized is that you can also use a notebook as a medium of exchange. In that notebook you can write down all of the transactions that have occurred and then literally trade the notebook back and forth. It's just like a cigarette or a cowrie shell or gold. The notebook or software ledger is a thing, that thing represents value, and it can be transferred back and forth. The underlying mechanics are important as we'll discuss because they help us tax lawyers understand how to treat crypto transactions. Is it a transfer of goods, services, currency, securities, derivatives? It matters because each has a different tax treatment.

All these analogies are somewhat imperfect, but to understand NFTs the analogy I prefer is that it's like a Trapper Keeper binder. Imagine a notebook with your ledger inside it. If you remember your Trapper Keeper from elementary school, it was a notebook that you could customize to show your personality. You could put a different cover on your notebook and show, for example, that you liked the Backstreet Boys. That's kind of what an NFT is. A cryptographic ledger plus an affinity to something else, and that statement of affinity is worth something. Just as your Trapper Keeper doesn't entitle you to anything concrete—you certainly don't own the Backstreet Boys, you don't even own the picture of the Backstreet Boys, but your Trapper Keeper has a huge currency in elementary school especially if you are the only one who has the Backstreet Boys image on your binder because you get to identify yourself with them.

As my friend the scholar Brian Frye observes, what you're buying when you buy an NFT is clout. You don't own anything but the affiliation with that item. I think that's really important because when we're talking about nonprofits they need to understand the value of their investments in order to comply with state law, particularly UPMIFA (the Uniform Prudent Management of Institutional Funds Act), and the public trust.

The state attorneys general rely on you to supervise the assets that are in your nonprofit. What are you holding and why and what's its value? So I think it's important to have those kind of basic understandings of what it is. It's more than just the transaction, the ability to transact in it, which doesn't tell you much about the thing itself.

Kramer: In the NFT world, which is as I said a smart contract, those are not fungible bitcoins. One bitcoin equals one bitcoin equals one bitcoin but in the NFT world each one has its own little metadata that has a separate number and that will tell you what you get and very often what you get is nothing but the NFT, which is nothing but something digital that you could put on your wall. You can have it on your computer.

It is I think a sort of bragging rights kind of concept because somebody paid $29 million for an art NFT and it was NFT number one, but the artist kept back the right, that what he could do is he could do 1 billion of those if he thought he could sell him and he still has the original art that he did and it all belongs to him. I think that's really an important point in thinking about what the charity is getting when you're talking about an NFT as opposed to a convertible virtual currency like bitcoin or ether where actually there's a market for it.

Kim: To close that loop then for a lot of the nonprofits that we work with over the last two years talking about NFTs, it is really encouraging for the donors as well as the tax-exempt organization to deal with the proceeds of the sale or auction of that NFT piece specifically for this reason, so I'm proud to say that I'm one of the earlier adopters in the NFT space.

You may have heard of crypto punks, which are very popular, they're completely on chain, so you're not pointing to a website somewhere. You're actually buying the code that can create that image right through the magic of the smart contract so it's kind of a unique thing that you're less sort of depending on others for, but the purpose of this discussion was actually about what's considered floor price so certain NFT collections that are very actively traded. . . .

Kramer: This is a popular one he's talking about.

Kim: Super popular. The minimum price to get clout with owning a crypto fund right now is about $100,000, probably off of a high of about $400,000 minimum to get any single one of them. I see a lot of shocked faces. You got a lot of it early.

Kramer: And what can you do with it? You can't eat it, you can't sleep under it, you can't drive it anywhere.

Kim: If you think about it, that's $400,000 in dollar terms but that was only 100 ethereum a few months ago, right, and so a lot of the early investors when they bought the ethereum at the pre-sale at ten cents, they didn't buy four of them. They bought 4,000, right, or 400,000 each at the time, and so we have a lot of ether whales that are proving clout by buying these sometimes outwardly expensive things, but the point is. . . .

Kramer: They have tax when they sell it.

Kim: They do, and we also can say that from a qualified appraiser perspective that there probably is not yet an entity on the planet that would actually give a crypto punk donor the floor price of the collection, right, because the floor price isn't a concept that exists across stock, grain silos, private equity LLCs, it doesn't really apply.

So what we argue from the donor's perspective and for her benefit is put the thing that you own up on auction or sell it and donate those proceeds. Same thing for the nonprofit unless that nonprofit is actively in the art space or art community or the creator community, probably doesn't do them much good to receive this NFT except cause additional operational headache.

Kramer: I think that's a terrific point because where are you going to get a qualified appraiser? There are a lot of objections to this rule that they're putting very burdensome requirements on donors of cryptocurrency that they don't put on donors of other things.

For a qualified appraiser, you have to have two years of experience appraising these sorts of things and have educational qualifications as well. I mean it's not like you go to the school of crypto appraisers. There's no such thing so I think that theoretically very few appraisers are prepared to appraise anything other than something like bitcoin or ethereum when they look at the market price on 12 different platforms and then they give you an average and tell you that that's what the value is.

Attendee: This is fascinating. Two questions following up on the NFTs and I think it's for a combination of Duke and Alex. I thought the whole point of blockchain is that it maintains total anonymity so how is it possible for anyone to pierce the blockchain and be able to tell you don't worry, this is not Kim Jong-un giving you a gift.

On the notion, as I understand, there's no meaningful way to get an appraisal of an NFT so as Duke said, auction it off and donate the proceeds. Under those circumstances, doesn't the artist have to take the auction proceeds into income and then claim an offsetting deduction or is the artist just giving the NFT to the charity, which then enters into the blockchain as the owner. The artist gets zero and then the charity is owning this thing, not knowing quite what to do with it. What would you do if you were given that self-created art?

Kramer: Let me do the Kim Jong-un thing first and then I'm going to pass the really tough one over to them. Duke said that there are companies like Chainalysis and Ellipsis is another one. What they do is they can track because every transaction is public if you have an Internet connection and you go to it and you look at it.

What they can do is they can track and identify not by name but they can track accounts and they can see where these accounts came from and where the things transferred from and so they've got all of this information that they can give you. They can't say this is the person whose account it was because the account itself has a secret key with all sorts of codes and they don't know who it belongs to.

But they've been able to identify that, for example, people who are trying to sell these NFTs for a gazillion dollars might sell them to different accounts and say, "Oh well, this is the last market price for this NFT, this crypto punk or whatever, is $100,000, and it turns out that those five accounts that they traded in and generated that were all owned by the same person. They can tell that. That's the kind of things they can tell.

Kim: Just to get really technical, there have been instances in which chain transaction companies have then combined on chain data with things like IP addresses and where the person is checking into like a website block explorer, right, again identifying the geographic region. Then they can compare against time zones and things like that. . .

Kramer: From the dark web.

Kim: And start figuring out more closely who is actually behind those transactions so it does get to a frightening level of we do leave a lot of metadata online and there are ways to track it both on chain and kind of traditional tracking ways.

Reid: Just on the tax I'll chime in on the transparency point that there's so much tracking data that it becomes invisible. Some people think that bitcoin was created by law enforcement, maybe by the CIA, because the original owner has never come forward to say who he is, but if you look hard enough, you can usually figure out who's there. It's just that there's so much data that is hidden.

On the on tax point, I think it's a gift and so you take a transferred basis in the asset. The basis for self-created property, especially software code like this, is going to be very low and so effectively the charity is going to take a transferred basis of very little in the asset and the donor is not going to be able to deduct very much because you're limited to basis on gifts of property.

Attendee: I think this straddles values and the law, which has given the ability to look back through, like how many steps back do you have to go if it's on an account in North Korea or Russia and also crypto is the favorite ransom of ransomware people. We certainly don't do this with cash, which could have been two pockets ago in the hand of a criminal, but we don't know that, we can't know that.

Crypto seems to represent an ability to know more and therefore on either values or a legal risk perspective to look back. What are you seeing on that, how far back do you go, and once you hit North Korea, are you done, or is that just it if you have a Russian oligarch? I'm just sort of curious if you guys think about these things.

Kramer: You wouldn't be able to do it yourself so you pay a company a fee to let them tell you and what they'll do is they'll give you a graph or whatever and you get to decide when it's enough so they're not going to tell you but they're just going to basically show you where everything went and you decide.

Attendee: Just on the tax I assume that if you give crypto to your girlfriend and it turns out to be. . .

Kramer: What does your wife think about this? [Laughter]

Attendee: It's probably mixed feelings [Laughter] so I assume that then the IRS will be advantageous about claiming gift taxes due if it's over $10,000 even though it was probably worthless at the time that you gave it.

Kramer: It would be at the time of the gift so you better fill out your gift tax return.

Attendee: I have a question on the tax side on how you value a donation, not in the context of artist creates a donation and gives to charity, but the charity creating the NFT and then selling it or using it as the gift you get for making a particular donation level.

Let's say the charity creates the NFT and if you donate $10,000, you get the NFT. To what extent do we figure out a fair market value for the NFT in terms of what portion of the $10,000 is charitable?

Reid: Is it a NFT of a tote bag? [Laughter]

Attendee: No, that would be great though.

Reid: We have the quid pro quo rules that say that your deduction for a gift is reduced by the value of any property or services that you receive in return and so there would be a question of the valuation of the NFT going back to the donor. I joked about the tote bag because there are these exceptions for certain low-cost items.

Attendee: But it seems like there's an aspect of, on the one hand you have to argue that it's kind of worthless like the tote bag, but on the other hand if it's the only way to get it is by giving $10,000 so perhaps the NFT is worth $10,000, the full amount of the donation.

Reid: For a raffle ticket you might take the expected value of the payout. For valuing NFTs I think that really is an open question because properties are a bundle of sticks, right, and the stick that you get with an NFT is a very small sliver. It's the clout, it's the value of the ownership, rather than the ownership itself, and so I think you could find a pretty low valuation, a means of finding a very low valuation. I don't know that short of observed market trades in that NFT. . .

Attendee: And it would be a newly created one.

Kramer: It wouldn't have any market value. I think most of the charities or people are treating them as is unless it's just the NFT as the tote bag, nobody is getting treated as having any value really, but if it's an NFT that comes with your $10,000 and the NFT gives you a picture of a tote bag and an opportunity to have dinner with the President of the United States and blah blah blah, then you have to start factoring that stuff in because these NFTs could have embedded things that can be valuable.

Reid: One important point about valuation, in terms of holding these assets, what is prudent is determined by modern portfolio theory, which is going to tell you that you want to have a diversified portfolio so you're going to want to have assets that are not correlated too highly with each other because that reduces diversification.

So what asset class do these belong to? Before yesterday I might have told you, well, these are kind of good inflation hedges, they may be more like gold or commodities, but it turns out that they are very highly correlated with tech stocks and might really be best put into that same asset allocation strategy.

When you have clients who are asking you, if I buy bitcoin, can I buy it? I'm a private foundation, can I buy it, should I buy it? If so, how much can I buy before it becomes a problem or jeopardizing? The answer is really to look at your overall portfolio and see how it correlates, but again these are so new it's hard to say.

Kramer: I think something interesting is that very often the people who are funding the creation of these new products, these new platforms, these new chains, these new tokens, are venture capital people, and so they're funding these and as part of their return they're getting back these tokens and things and so that's really another way that it is tied to the tech side because a number of the people who are benefiting from the appreciation in these tokens are the ones who've invested in those companies and when one goes south, the other ones going to go sideways or south also.

Reid: I think that's a really important point and something to really watch for your clients because of the number of cryptocurrencies out there. Adoption is a very important part of the marketing strategy for these different coins so if I have an obscure coin and I want other people to hold it and I want the market to take it, I might use a strategy of donating it to lots of different organizations so that they transact in it and so it kind of bootstraps its way into a thing.

Kramer: You might air drop them into everybody's account so that all of a sudden everybody who has one now has two.

Reid: Let's talk about that because if you have a hot wallet, you can get donations from people you've never heard of before.

Kramer: That goes to creepy squared.

Attendee: A simple question. A charity that receives a gift of virtual currency or an NFT, is it responsible for filing a Form 8282 when it disposes of that currency or non-fungible token?

Reid: Yes, a Form 8283 when it receives it and then the 8282 when it disposes of it. The 8283 is the charity saying to the donor, I've received this and the donor is supposed to attach that to their return and say I've gotten a qualified appraisal, this is the value, and all the charity is certifying to is this is what I got. I don't know what it's worth. I have no opinion about the validity of your appraisal. I'm not telling you to deduct it, nothing, but I did get it. So I think it's fairly safe to sign an 8283 as a recipient of currency and give that to the donor.

There are some knock-on effects that are kind of interesting though, which is first, if you hold it, how do you report it on your Form 990, Schedule B, and how do you report it on your list of assets on the Form 990. How long does it have to be there before you need to reflect it on your balance sheet? Schedule B is going to say I got this from somebody and you have to put a number, a value on it, for Schedule B.

Does your Schedule B number have to match your 8282 number? It's an interesting question. It may well be different and then you go to sell it and you file the 8282, which is the form that is basically intended to help the IRS determine whether the charity uses the tangible property in furtherance of its mission, so it's the thing that says, when you donate a used car to charity and the charity goes ahead and sells it, gotcha donor, you don't get the larger deduction for related-use property and the charity informs the IRS of this fact.

What's interesting about the 8282 is that you have to say who it was and you put a Social Security number on that so for our (c)(3), are you gathering the Social Security numbers of your crypto donors, especially if they air-dropped money into your hot wallet?

Kramer: That one raises two things I want to get to because we're running out of time. I think Alex probably has a few more things that he should be telling us, but we're referring you to the hot wallet. That means that it's connected to the Internet and that's the one where the bad guy could grab it and so one of the things to do is they have things that are referred to as cold wallets and lukewarm wallets of which you basically have custody or off the direct Internet and so if you take nothing else away from today, if you have $40 million of appreciation in your hot wallet, you want to take it out of the hot wallet to keep it safe.

Reid: Let's go back to the gift acceptance policy because I think of it as a way that management and the board provide some instruction to the development office about levels of risk that are appropriate for the organization to take. The development office is going to be out there and we'll take whatever in trying to get those donors excited, and some contributions create risk to the organization and really best not be taken or should be taken with adequate oversight up the chain.

The gift acceptance policy is a way to tell your frontline development officers when they need to check with the CFO, the CEO, the full board, before they accept a gift. It's also a way you can say, look, we just don't accept this type of gift right now so you can reflect that policy and turn it into cash right now.

With crypto donors some of them are not interested in taking a charitable deduction and so it's not actually the worst thing to ask them to go ahead and turn it into cash. They have to pay tax on it, but that's on them. They just don't know it so that is an important thing. I think it's worth looking into your gift acceptance policy and providing a procedure.

This risk analysis that you guys are talking about, the available services, that's a really helpful point and something that you might want to add to your gift acceptance policy, to employ the services of a company like that. There are different types of exchanges and wallets out there for accepting currency. Some are easier to use than others so I think you might direct your donations to the same vendor.

One risk that I'd like to reflect on briefly is there may be some additional risk that we didn't really know about before. It's in the press right now about whether when you accept a gift of bitcoin, is it subject to the bankruptcy risk of the entity that made it or of the bank that owns it and so there are some new questions out there.

Kramer: Well, it turns out that at my firm we have a bankruptcy practice that actually has done a lot in the digital currency space so if anybody has a problem, that's our pitch, but the reality is that that's one of the reasons to not keep everything in a hot wallet. You want to look and see what sorts of insurance the companies that you do business with have. So one of the things I find in reading on-boarding documents and all sorts of stuff I never thought I'd be looking at is to try and figure out what the protections are in one circumstance or another.

Reid: In other words, your hot wallet can go bankrupt.

Kramer: Theoretically. You could then be an unsecured creditor in some situations. In other situations you could be a secured creditor, * * * a technical legal term there, to deal with bankruptcies.

Kim: Which is why the philosophical underpinning of bitcoin as a sovereign coin is so important. I may have to use an exchange to buy my crypto. I don't want to leave crypto or cash sitting there because it's a centralized entity. I don't want to actually remove or withdraw those assets into a self-custody wallet. The key is protected as long as the seed phrase and the password is known only to me, no one can take that away from me.

Kramer: You could put it on a thumb drive and lock it in a drawer.

Reid: That is not a hot wallet.

Kramer: That is a cold wallet. That's very cold. It could take you three days to get it back onto the chain and sell it or move it or something else so people who are active in the marketplace don't like to do that, but there are companies that will custody them for you where they can turn it around a lot faster.

Reid: So they can put it on a physical thumb drive which you then can lose. . .

Kramer: That's why you pay some company to put it in their vault.

Reid: Another point, just as we're wrapping up, I want to mention it because I think it's really interesting, and that is DAOs or "decentralized autonomous organizations." We've talked about smart contracts that this is another time of software engineers rediscovering the world through the lens of software so a decentralized autonomous organization is a contract. It's a thing. I think of it as kind of like a partnership.

Kramer: Bite your tongue.

Reid: it's kind of like a partnership.

Kim: You can't throw something like that out at the very end.

McWaters: We're out of time.

Kramer: If anybody cares, DAOs hold themselves out as being nothing and no entity at all and there has been some litigation where at least one DAO was told that they are actually an entity.

Reid: With that we will stick around for any questions.

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