The 38th Annual TEI-SJSU High Tech Tax Institute Conference on Nov 7 – 8, 2022

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The 38th Annual TEI-SJSU High Tech Tax Institute Conference on Nov 7 – 8, 2022

**Crypto Opportunities and Compliance Considerations**

By Inessa Zlobina, MST Student

The 38th Annual TEI-SJSU, High Tech Tax Institute, took place on November 7 and 8, 2022 in Palo-Alto. This conference featured panels with representatives from government, industry, and academia.

One of the programs addressed “Crypto Opportunities and Compliance Considerations” and featured panelists Michael R. Fiore, Area Counsel, Office of Chief Counsel, IRS; Greg Broome, Partner, Wilson Sonsini Goodrich & Rosati; Andy Howlett, Member, Miller & Chevalier Chartered; Yu-Ting Wang, Tax Partner, Armanino. These panelists discussed the opportunities and challenges associated with virtual currency taxation.

As Professor Annette Nellen states: We are in the midst of a “Fourth Industrial Revolution” in which technology is advancing at an exponential pace, bringing us mostly digital tools and processes. In the tax world, “digital” translates to: “how do rules designed for a tangible world apply?”

Cryptocurrency is a great example to remind us that tax as well as other laws and compliance processes need to be fluid to keep our economy moving ahead. Inaction or inappropriate responses can shut down or decelerate advancements that benefit society and lead to further technological progress.

**Overview of Virtual Currency Taxation**

The IRS representative, Michael R. Fiore, described how existing general tax principles apply to transactions using virtual currency. He provided a broad overview of the IRS guidance issued up to date regarding digital transactions and how to report them on a tax return in order to stay compliant.

The first document to start off with is Notice 2014 - 21, which includes 16, easy to understand, questions and answers. The notice defines virtual currency as a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. The most important takeaway from Notice 2014-21 is treating virtual currency as property, and, therefore, the general tax principles relating to property transactions apply to transactions in digital assets.

The IRS is transitioning to using the term digital assets, which are broadly defined as any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.
On October 9, 2019, the IRS released Revenue Ruling 2019-24, which provides guidance with respect to hard forks and airdrops of cryptocurrency, and new frequently asked questions (FAQs), which provide guidance on other cryptocurrency issues.

For purposes of this revenue ruling an airdrop is the distribution of a new token to the whole of the legacy token at the time of the hard fork. Although that's not always the case as an airdrop doesn't always follow a hard fork. And there were two conclusions in this revenue ruling. One is that you don't have income if you don't receive new crypto in connection with the hard fork. And the next one is that you do have income if you receive the new currency, taxed at its fair market value. This ruling defines dominion and control as the ability to transfer the virtual currency.

Three Chief Counsel Advice (CCA) that have been issued to date. First, CCA 202035011 explains that convertible virtual currency received in exchange for performing a microtask in a crowdsourcing platform is taxable as ordinary income.

Next, CCA 202114020 clarifies the tax treatment of hard forks of virtual currencies as applied to the Bitcoin Cash hard fork that occurred in August 2017. The IRS position is that the receipt of the new property (due to the hard fork) represents an accession to wealth. Specifically, based on *Glenshaw Glass*, the CCA concludes that the taxpayer recognized taxable income from the receipt of virtual currency in a hard fork at the time the taxpayer obtained complete dominion over the currency received, which occurred when the new coin became available to the holder. Therefore, a taxpayer who received BCH in the hard fork event has taxable income in the amount of the fair market value of the Bitcoin Cash received at the time a person had control (the CCA does not state what that value was).

Finally, CCA 2021124008 describes the applicability of section 1031 to exchanges of Bitcoin for Ether, Bitcoin for Litecoin, and Ether for Litecoin. The IRS explains in the CCA that differences among these currencies, such as the availability of smart contracts with Ether but not for Bitcoin makes these three currencies fail to be like kind to each other.

Michael Fiore expressed hope to see some more CCAs in the future providing more guidance, at least what the IRS is thinking about some other cryptocurrency transactions. He carried on his presentation with a summary of transactions that could/ could not affect taxable income.

For example, selling virtual currency for U.S. dollars, exchanging one type of virtual currency for the other, which generally would result in a capital gain or loss. Sending or receiving virtual currency for services, mining virtual currency, getting block rewards or fees in connection with mining, that would be ordinary income.

On the other hand, transactions that don't affect taxable income include simply buying virtual currency for cash and holding onto it, it's no different than if you bought a car or stock.

Mr. Fiore explained that reporting crypto activity requires various tax forms depending on the type of transaction and the type of account. These forms include Form 1040, Schedule D, Form 8949, Schedule C, or Schedule SE to report crypto activity.
If you earn cryptocurrency by mining it, it's considered taxable income and might be reported on Form 1099-NEC at the fair market value of the cryptocurrency on the day you received it. You need to report this even if you don't receive a 1099 since it is taxable income and may also be subject to self-employment tax in addition to income tax.

Staking cryptocurrencies is a means for earning rewards for verifying cryptocurrency transactions. Earning cryptocurrency through staking might be viewed as similar to earning interest on a savings account. In exchange for staking your virtual currencies, you can be paid money that counts as taxable income. If staking is a business activity for an individual, self-employment tax might also be owed.

If you received other income such as rewards and you are not considered self-employed then you can report this income on Schedule 1, Additional Income and Adjustments to Income.

Cryptocurrency charitable contributions are treated as non-cash charitable contributions. A charitable organization may assist in documenting your crypto-charitable contribution by providing a written acknowledgement if claiming a deduction of $250 or more for the virtual currency deduction.

For crypto transactions you make in a tax-deferred or tax-free account, like a Traditional or Roth IRA, respectively, these transactions don’t get taxed like they would in a brokerage account (tax consequences are deferred).

By far, the most important thing an investor can do is maintain detailed records of their virtual currency. The records should summarize (1) when the currency was received, (2) the currency’s fair market value on the date of receipt, and (3) for what purpose the asset is held (investment, inventory, etc.). An effective way to track multiple batches of virtual currency is to store each purchase in a separate online wallet. Also, appropriate records should be maintained to show when each wallet was established. According to Mr. Fiore: “You want to keep note of all of those clicks and keep contemporary record keeping because it's gonna really save you a lot of headaches and frustrations at tax reporting time.”

**More Crypto Tax Issues**

Gregg Broome discussed certain crypto tax Issues such as information reporting (sections 6045 and 6050I); compensation; initial coin offerings; charitable donations; DAOs; and how we learn together in solving these issues.

In general, cryptocurrency exchanges make it easy for everyday consumers to buy and sell cryptocurrencies. Instead of having to interact directly with the blockchains that these digital assets are stored on, users can simply log into their preferred cryptocurrency exchange, click a few buttons, and purchase their very own cryptocurrency.

Being able to send cryptocurrencies to other locations and other wallet addresses is actually core to the whole premise of crypto. It’s a fairly easy mechanism of value transfer requiring no
third-party verification that makes the idea of cryptocurrency exciting. However, this core principle is also a challenge for reporting of cryptocurrency transactions.

Since the IRS treats cryptocurrencies as property for tax purposes, not as currency, just like with other forms of property—stocks, bonds, real estate—the owner incurs a tax reporting obligation when they sell or trade cryptocurrency.

A problem can arise when cryptocurrency exchanges provide customers with tax reports. Because some users are constantly transferring crypto into and out of exchanges, the exchange has no way of knowing how, when, where, or at what cost (cost basis) the customer originally acquired these cryptocurrencies. It only sees that they appear in your account.

In 2023, tax reporting will become more challenging for exchanges. With the new infrastructure act passed in late 2021, exchanges must file new Form 1099-DA with the IRS and customer but may not have access to the customer’s complete transaction history. That means the burden is on the taxpayer to accurately report taxes.

Industry participants are still not clear on who is a digital asset broker under the new digital asset reporting under section 6045. The revised broker tax reporting rules define a broker as including “any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.” This is a relatively broad definition and industry participants are hoping that guidance from the Treasury Department will narrow the scope of the definition.

Another crypto issue can arise when an employer pays compensation in cryptocurrency. Tokens as compensation offer many of the same benefits as stock options. Similarly, they also carry legal and tax implications, so any business that is considering using tokens as compensation should follow related best practices with respect to each area. Some of the key tax considerations include the need to withhold the appropriate taxes (e.g., income and payroll). While paying people in virtual tokens the IRS wants taxes withheld in old-fashioned U.S. dollars. This is difficult to implement since there is no cash in the transaction.

With regard to vesting schedules, things get a bit more complex. A typical token award is taxed at the fair market value when the award occurs (i.e., the recipient is fully vested, and there are no stipulations for vesting). If the awards are restricted and vest equally over, say, four years, the recipient is taxed once the token vests, which could be significantly greater than the value at the grant date. That’s where a section 83(b) election could be beneficial. A section 83(b) election may be filed so that a token recipient pays ordinary income tax on the fair market value of the tokens at the date they were granted, instead of over the four-year period that precedes their vesting. Section 83(b) offers two potential advantages: It could save the recipient taxes over the lifetime of the vesting as it starts the clock running sooner on qualifying the tokens under capital gain status. The downside is that if the recipient forfeits the awarded restricted tokens, they cannot get that prepaid tax they paid based on the value at grant date. Employees don’t have money to pay tax when holding crypto. Education of employees is required on how to vest tokens including market volatility issues and it is important to reach out to a tax pro.
In Letter Ruling 202019028, an entity formed to provide education on crypto was denied exempt status. The IRS explained that some sort of educational instruction must be present for a nonprofit’s purpose to be deemed educational within the meaning of section 501(c)(3). The IRS clarified that such instruction can be devoted to individual skills training or public education surrounding relevant issues. Acceptable forms of instruction include workshops, clinics, lessons, seminars, panel discussions, and lectures.

Case Discussion: Jarrett v. United States

Panelist Andy Howlett described the Jarrett case in detail and explained its importance. Some members of the cryptocurrency community had hoped to use the tax refund case of Jarrett v. United States, as the precedent to demonstrate that staking rewards received by a crypto validator only trigger gain upon the ultimate disposition of the reward, rather than constituting taxable income upon receipt. However, the IRS apparently decided it was not ready to fight that battle and sought to moot the taxpayer’s suit by actually refunding (without explanation) the amount of tax the taxpayer claimed to have (over)paid on his staking rewards on his amended return. A lot of useful information about this case can be found on the Proof of Stake Alliance website (https://www.proofofstakealliance.org), including the key briefs of the case.

So, what’s an issue here? Joshua and Jessica Jarrett initiated the closely watched lawsuit over Tezos tokens created by Joshua through the process known as staking, seeking a tax refund of nearly $4,000. The Jarretts argued that the tokens shouldn’t be taxed as income when received because they were newly created property - similar to a farmer growing crops or a baker baking a cake. If you’re a baker, you don’t have income just because you’ve created a cake; you must first sell it. In staking, cryptocurrency holders are rewarded with additional tokens for lending their tokens and computing power to validate new crypto on a blockchain. The Jarrett’s argument was that this was self-created property.

While the dispute concerns the 2019 tax year, the Jarretts claimed that they were entitled to a refund for all income taxes paid on the tokens. The IRS issued a refund in early 2022, and the couple rejected it. They continued to fight the issue in court, hoping to force a judicial ruling that staking gains only be considered income when new tokens are sold, as is generally the case for other forms of new property. The US District Court for the Middle District of Tennessee sided with the IRS, dismissing the case as moot with the issuance of the refund.

With the recent upgrade of Ethereum to proof of stake (from proof of work) and the exponential growth of digital assets involving staking rewards, taxpayers engaging in staking activities were hopeful that the Jarrett case would provide much-needed clarity on when staking rewards should be taxed. Presently, stakers are taking a wide range of positions with respect to the tax character and tax timing of staking rewards. For example, some stakers take the position that the receipt of staking rewards results in taxable income from the performance of services, while others assert that staking rewards are not taxable until they sell, exchange or otherwise dispose of the rewards.

With Jarrett’s dismissal, taxpayers continue to operate in uncharted tax waters. While recent legislative proposals have tried to bridge the gap between taxation and digital assets, including
the Responsible Financial Innovation Act introduced in June 2022, which permitted
cryptocurrency stakers to defer taxes with respect to such activities (including the receipt of
staking rewards) until those assets were disposed of, such legislative proposals have not yet
gained any traction in the Congress.

In the meantime, the IRS continues to remain silent on the issue with the only analogous
guidance (involving mining activities) implying that staking awards should be taxed as ordinary
income upon receipt. As a result, taxpayers should continue to proceed with caution.

**Business Challenges Involving Virtual Currency**

Yu-Ting Wang, Tax Partner from Armanino, discussed how the U.S. and other selected countries
regulate digital assets. She also highlighted business and tax challenges involving virtual
currency.

She started her presentation by pointing out that we all really need a set of rules to tame the
crypto "Wild West". As cryptocurrencies spread across the world, regulations are also being
put in place that attempt to regulate them. The landscape is constantly evolving, and it is not
easy to keep up with the rules of the different regions.

Existing guidance for cryptocurrency taxation has struggled to keep pace with the evolution of
the industry. There are a lot of uncertainties with the current regulations, but the worst thing a
taxpayer can do is not report cryptocurrency activity at all.

On March 9, 2022, the Biden Administration released an Executive Order (EO) outlining a
whole-of-government, comprehensive approach to the regulation of cryptocurrencies and
other digital assets. The EO focuses on six key priorities: (1) consumer and investor protection;
(2) financial stability; (3) illicit finance; (4) U.S. leadership in the global financial system and
economic competitiveness; (5) financial inclusion; and (6) responsible innovation. By creating a
predictable regulatory environment, the U.S. government can encourage growth in the
development of digital assets and assist American FinTech’s to compete in global markets.

In India, Union Budget of 2022 introduced specific proposals to tax virtual digital assets (VDAs),
including cryptocurrencies. For example, there will be tax on income from VDAs and
withholding.

In the UK, HMRC is working alongside leading crypto exchange platforms to gather information.
Capital gains tax usually applies on any profits realized for individuals holding crypto as personal
investment.

El Salvador adopted the cryptocurrency as official currency in 2021. Sanctioned countries, like
Russia and North Korea, might use cryptocurrencies to evade U.S. and other sanctions.

In the meantime, there are certain U.S. proposed legislation such as H.R. 6582, Virtual Currency
Tax Fairness Act of 2022. It proposes to exclude up to $200 of gain from disposition of virtual
currency in a personal transaction.
S. 4356, Lummis-Gillibrand Responsible Financial Innovation Act includes the following provisions:

- Gross income shall not include gain or loss from sale or exchange of virtual currency in a personal transaction if the gain does not exceed $200.
- Amends section 6045(c)(1)(D) broker definition and delays the effective date of broker reporting for digital assets.
- Decentralized Autonomous Organizations (DAO) shall be a business entity which is not a disregarded entity.
- Staking income is not recognized as income until disposed of.
- No qualified appraisal is needed for charitable contributions valued at more than $5,000 that are traded on established exchanges.

S. 4608, Virtual Currency Tax Fairness Act (Toomey and Sinema), proposes to exclude gain, up to $50, from sale or exchange of virtual currency in a personal transaction.

The lack of official guidance on crypto taxation makes tax practitioners unsure of what to do in many situations. A tax professional should strategically guide clients through the process of cryptocurrency use and reporting to get ahead of the challenges and changes of taxing a new currency. There is a massive demand in the market for crypto tax services.

Advisors need to know the language of crypto, what constitutes a taxable event and what doesn’t. For example, the sale of currency is taxed differently than mining. Clients need to make their tax advisors aware of various transactions they engage in to help them assemble the necessary information for every transaction.

Potential tax issues involving virtual currency are timing for recognition of loss and identifying types of loss sustained. Despite the potential and promises, many cryptocurrencies and NFTs have gone bust in recent months, with swaths of investors losing most, if not all, of the value. In some cases, the creators and promoters were simply unable to achieve the goals they promised. But others were scams in which the creators had no intention of repaying their investors and would disappear after taking the investors’ money, also known as rug pulls. What type of loss was sustained? Was it abandonment/ worthlessness, theft loss or capital loss?

The popularity and enthusiasm over digital currency continues to grow. To serve clients proficiently, a tax advisor, in addition to having an accounting degree, and having to pass CPA exams and pursuing continued professional education (CPE) every year, needs to gain actual work experience in the world of crypto and practice what they learned. The regulatory environment surrounding digital assets continues to evolve, and clients who invest in crypto need to be made aware of any updates to tax guidance. Having crypto tax knowledge and being able to serve crypto clients is no longer an option for tax practitioners, it is becoming a necessity.
Conclusion

Taxpayers involved in investing in, trading, or creating digital assets should use the available IRS guidance. While this guidance is helpful, more complicated technical questions are largely left unaddressed. As a result, taxpayers will have to continue to seek advice from their own counsel.

With more than $1 trillion in cryptocurrency value wiped out since the 2021 high-water mark, many investors may be tempted to enter the cryptocurrency orbit at a potentially attractive, lower price point.

Finally, taxpayers should always let their tax return preparer know when they engage in a virtual currency transaction. The IRS has been on the watch for those using virtual currencies to evade taxes. Keeping a tax preparer informed will allow taxpayers to properly report their virtual currency transactions.
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OCD Pillars One & Two – What Should Tech Companies Focus On?

By: Enas J. Al-Mais, MST Student

Limitations in the international tax rules created opportunities for base erosion and profit shifting (BEPS). Furthermore, digitalization of the economy enhanced those tax challenges. The OECD, G20 countries, and the Inclusive Framework members (more than 140 countries) reached a consensus-based solution, comprising two pillars: Pillar One, which focuses on nexus and profit allocation; and Pillar Two, which focuses on a global minimum tax.

The 38th Annual TEI-SJSU High Tech Tax Institute conference featured a panel of five subject matter experts tackling the contemporary topic of Pillars One and Two. The panelists: Lonnie E. Brist, Managing Director – Transfer Pricing at Anderson; Sirsha Chatterjee, Principal at Ernst & Young LLP; Wayne Monfries, Senior VP and Head of Global Tax at Visa; Zack Perryman, Managing Director at Ernst & Young LLP; Ben Shreck, Tax Counsel at the Tax Executive Institute Inc. The following is a summary of what was discussed in the presentation.

Pillar One: How to Split Up the Pot?

The OECD wanted to tax companies that have access to market jurisdictions with no physical presence. As a taxpayer, one must understand their own supply chain and where value is created – whether from a customer base, R&D contribution, or marketing expenditure. Therefore, a statement about how much tax is attributed to that market jurisdiction is based upon this rule: the splitting of the pot.

Pillar One – Amount A – is targeted at companies with 20 billion EUR of revenue in excess of 10% operating margin. Mr. Monfries noted that Pillar One would only affect about 100 companies worldwide. Ms. Chatterjee added that a significant portion of these companies are technology multinational companies, incorporated in the United States. Pillar One focuses on the allocation of revenue to market jurisdictions and is not based on transfer pricing principles. Mr. Shreck explained that Pillar One has nothing to do with “arm’s length”; it is best to think about it as a new tax and “you’re trying to get support for that market contribution”.

Amount A is based on financial statements. A number of things to consider for amount A: who are you going to tax, nexus and revenue sourcing rules, and what jurisdiction you are actually operating in.

Transfer Pricing and Pillar One

As explained above, Pillar One has nothing to do with transfer pricing. However, as Mr. Brist mentioned, when one layers in the complexity of the rules, the elimination of double taxation, the giving of safe harbor, and the computing of excesses, a new definition of profit arises. The public consultation guideline came up with a definition for what an entity level profit margin is going to be. Ms. Chatterjee elaborated that in the transfer pricing context, this profit margin
would be called segmented beginners, or the target operating margin for a legal entity. Now, a
new term is introduced: “elimination profit”, which is accounting profit with many adjustments.
Therefore, a multinational would have GAAP profit, taxable income, statutory tax jurisdiction,
and then they can compute the elimination profits.

Challenges of Pillar One

The panelists discussed the possible challenges with Pillar One implementation. There may be
controversy between jurisdictions, not just between taxpayer and tax authorities, especially
when it comes to taxing rights. Also, if unanimity isn’t reached, taxpayers may still have
unilateral imposition of different taxes and may not have tax treaty support to manage against
double taxation. Mr. Brist added that from a political perspective, he can’t see a lawmaker
“handing over taxation rights of their pot” to someone else. In addition, challenges may arise
because of compliance costs, implementation burden and operational burden. Furthermore,
Mr. Brist advised that the threshold of Pillar One needs to be taken into account if companies
are planning a growth strategy or even an exit strategy.

Probable Future of Pillar One

Pillar One requires full consensus. The United States must completely back it to pass. Ms. Sirsha
thinks that even if the U.S. doesn’t back Pillar One, “it will go through anyway in some hybrid
fashion format”. Moreover, the OECD rules have already laid out the blueprint of how
international taxation laws may change.

Pillar Two: What is Your Footprint?

Thresholds are a lot lower for Pillar Two than that of Pillar One (as described above). Pillar Two
will include multi-national corporations (MNC) with global revenue of at least €750 million.
Nevertheless, a jurisdiction can opt to impose an Income Inclusion Rule (IIR) on its
headquartered multinational enterprises (MNEs) regardless of threshold. A global anti-base
erosion regime (GloBE rules) applies through an IIR and an Undertaxed Payments Rule (UTPR).

The GloBE minimum rate is 15% for IIR and UTPR, applied based on effective tax rate in each
jurisdiction. The application of the IIR is done “top down” so that an IIR of the Ultimate Parent
Entity (UPE) of the group overrides lower-tier IIRs. If the UPE does not apply an IIR, through a
waterfall effect, its subsidiary can apply it and so on. This is done through the chain of
ownership stopping with the subsidiary that applies the IIR, if any. The application of the IIR will
turn off the application of the UTPR to any low-taxed subsidiaries that are subject to the IIR.

Pillar Two has rules that may allow one country to reach into another country’s tax jurisdiction,
only if that country is not taxing as much as it could. For example, if a UPE is in a low-taxed
jurisdiction and it has two subsidiaries in two different countries – Country A is high-taxed
jurisdiction and Country B is a low-taxed jurisdiction. If UPE has not adopted the IIR, Country A
can apply the UTPR to Country B. In addition, Country A (the high-taxed jurisdiction) can also
apply the UTPR to the UPE’s low-taxed profit, even if the UPE country has implemented the IIR!
What if GILTI is a "Qualified IIR"?

If GILTI is a “Qualified IIR”, it will prevent the waterfall effect of the IIR and turn off the application of the UTPR to foreign subsidiaries of US UPE. Furthermore, the qualification would prevent other countries from applying the UTPR to foreign subsidiaries of US UPE – like in Country B in the example above – but NOT to the US UPE itself. The final assessment is still outstanding on whether GILTI is a “Qualified IIR” or not. Articles 2.1 to 2.3 of the GloBE Rules may provide more background information on the possibility of qualifications of different US tax rules – for example, BEAT, GILTI or CAMT.

When will Pillar Two be enacted?

Unlike Pillar One, Pillar Two doesn’t need consensus to move forward on a global basis. Most recently, the OECD has recommended that Pillar Two rules become effective in 2024 and the UTPR in 2025. The implementation is generally optional for countries through changes to domestic laws and treaty provision for Subject to tax rule (STTR). Mr. Perryman explained that many countries around the globe, including Japan, Australia, and many EU countries, have put out some draft legislation to enact Pillar Two. He added that slowly all countries will follow suit. This is because it is in the best interest of these countries to enact rules to protect their tax base according to the Pillar Two guidance. While Mr. Brist agreed with Mr. Perryman that it may be advantageous for some countries, he argued that it may still be more advantageous for other countries to stay out of Pillar Two depending on the footprint.

Mr. Perryman continued that as part of the Pillar Two process, countries are incentivized to enact rules which consider qualified investment to protect their tax base. The “Qualified Domestic Minimum Top-up Tax” (QDMTT) can be looked at as an incentive as it would turn off other elements of Pillar Two rules, like the Global Anti-Base Erosion (GloBE) elements.
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IRC Section 6050W - Form 1099-K Reporting Requirements

By: Aizhan Toibazarova, MST Student

One of the topics presented at the 38th Annual TEI-SJSU High Tech Tax Institute, on November 7, and 8, 2022, was Form 1099-K reporting requirements. The speaker panel was represented in full array by IRS and CPA firms’ advisor representatives: David M. Carl, Sr. Counsel IRS Office of Chief Counsel, Small Business/ Self-Employed Division; Vivian Cheng, CPA, Industry Subject Matter Expert for Telecommunications and High Technology Industries; Aureon Herron-Hinds, Principal, RSM US LLP; and Candace B. Ewell, Principal, PwC.

Ms. Ewell started off briefly mentioning the topic of discussion regarding the possible 1099-K reporting information issues due to an increase in reporting volume for the tax year 2022. Ms. Herron-Hinds announced the agenda, the focus of which were the rule changes regarding the reporting threshold for third party settlement organizations and what issues can be expected with these reporting changes.

Who is Required to Report 1099-K

The Form 1099-K was initiated in 2011 and governed by Section 6050W. Ms. Cheng reviewed the basic filing requirements under Section 6050W, which generally requires payment settlement entities (PSEs) to file information returns to report payments made to participating payees in settlement of payment card transactions and third-party network transactions. The payment card transaction is any transaction in which a payment card is accepted as payment, including gift cards. Payment card transactions exclude ATM withdrawals, cash advances, and convenience checks. The third-party network transactions are any transaction settled through a third-party network. There are three characteristics of the third-party payment network:

1) Any agreement or arrangement between a central organization and a substantial number of providers of goods or services unrelated to such organization to settle transactions for provided goods and services in accordance with agreement or arrangement.

2) Standards and mechanisms for settling the transactions; and

3) Guaranteed payment to the provider of the goods or services.

Further Mr. Carl covered the types of transactions that are reportable: payment card transactions and third-party network transactions. These transactions are reported by the following PSEs:

1) Merchant Acquiring Entity defined as a bank or other organization that is contractually obligated to pay merchants to settle the transaction.
2) Third Party Settlement Organization defined as the central organization that has the contractual obligation to make payments to participating payees of third-party network transactions.

Mr. Carl emphasized the meaning of “make a payment.” It does not mean who has funds rather, who gives the instructions to transfer those funds to the payee account. A careful analysis must be done in determining who the PSE is in any transaction by looking at the agreement and payment obligations and is the first hurdle to approach.

Ms. Ewen explained the reporting exceptions where reportable transactions are settled through intermediaries that include aggregated payee and electronic payment facilitators. An aggregate payee is a person that contracts with a PSE to receive payments on behalf of one or more participating payees and distributes the funds to them. In this case, a PSE is required to report the payment to the aggregated payee, which in turn issues a 1099-K to each participating payee. Ms. Ewen used an example mentioned in Reg. Section 1.6050W-1 where an aggregated payee was a large franchising organization who contracted with the merchant acquiring entity for the whole organization.

Electronic Payment Facilitators (EPFs) are third parties that make payments on behalf of a PSE. This kind of arrangement shifts filing requirements to the EPF, which submits instructions to transfer funds to settle transactions. EPFs do not need to have an agreement/arrangement with the participating payee, and a payment can come from another account not belonging to the EPF.

Ms. Herron-Hinds emphasized the special rule when two or more PSEs are involved in a payment chain. The PSE who makes the payment are required to file a 1099-K despite the agreement designating another person to file.

**Possible Issues with 1099-K Reporting Change**

The American Rescue Plan Act of 2021 lowered the federal reporting threshold for third party settlement organizations from $20,000 to $600 with no minimum transaction volume. This rule change will cause a surge in filing volume of Forms 1099-K. Additionally, some states have their own reporting thresholds and require separate sets of forms to be filed that might not necessarily be accepted electronically.

Also, there is a risk with withholding. It is very important to have a compliance program in place that outlines the policies, procedures and controls regarding reporting and collecting all necessary information to prevent backup withholding liability, which is 24% of the gross amount that was paid. Emphasis must be placed on team training to collect the TINs and all necessary information for proper reporting compliance of 1099-K.

Form 1099-K reporting requires two key elements: the gross amount of reportable transactions and the participating payee. The participating payee, defined broadly, is any person, including the government and tax-exempt entities, who receive payment settlements of a payment card.
or third-party network transaction. The gross amount is an aggregate payment transaction for the calendar year that the form covers determined by the date of transaction.

Mr. Carl remarked that reporting challenges can arise when there are changes in the settlement amount or a portion of the payment is a sales tax, which is not reportable. Furthermore, there is concern with the system’s ability to identify what transactions are reportable when the payments are not for goods or services and carry a personal purpose. For instance, splitting a dinner bill with someone or sending a monetary gift for their birthday. Mr. Carl acknowledged that identifying those reportable transactions would pose difficulty for taxpayers and advisors and there is a reliance on the payee to determine those payments.

Certain transactions may get reported on more than one form and will need to be reconciled. To prevent double reporting the “tiebreaker rule: in the Section 1041 regulations relieves payors from filing Form 1099-MISC or Form 1099-NEC when they make a payment through a PSE. The PSE is a payor and files Form 1099-K. However, in a case of a merchant-acquiring entity, every card transaction would be reported on 1099-K without regard to the nature or character of the payment. Payments like rent and royalties will end up reported on Form 1099-K. Therefore, it is important to utilize the available tools to reduce the amount of information required to be reported and using a PSE can be a good start to limit the reporting.

Some of the merchant-inquiring entities or PSE, facilitate payments to merchants that choose to accept a digital currency might issue 1099-K, 1099-MISC, or 1099-NEC. These transactions could be an exchange transaction and not related to the purchases of goods or services. Ms. Herron-Hinds warned that tax advisors need to be diligent while dealing with the 1099-K due to a strong likelihood of misreported amounts.

Non-compliance Consequences

Mr. Carl covered additional filing requirements. Form 1099-K must be filed with the IRS by February 28 if filed on paper. The due date is extended to March 31 for electronically filed forms. To receive a possible 30 day extension, Form 8809 must be filed accompanied with a letter explaining the need for additional time to file. Each participating payee must be furnished with a payee statement by January 31.

Two types of penalties can be assessed:

- IRC 6721 for failing to timely file a correct information return, which are missing TIN and discrepancy in the name or TIN.

- IRC 6722 – failure to furnish a timely or correct payee statement.

If errors are corrected within 30 days of the due date, a reduction of penalty can be granted, or the penalty can be abated based on reasonable cause.

The Form 1099-K can be furnished to a payee either by mail or electronically. However, the IRS has specific requirements on acquiring the consent of a payee to deliver their 1099 forms.
electronically. Consent must be an affirmative consent listing the options of delivery such as mail, email, access to website or a dashboard. Additionally, there is a language requirement for information presented. Not having proper consent might increase the chance to be penalized for failure to deliver the information return to payees.

**Conclusion**

The decreased threshold of $600 will increase the volume of Form 1099-K reporting. Additionally, the lack of proper policies and procedures in place or technical inability to discern the reportable and unreportable transactions can further contribute to a greater volume of Forms 1099-K. This will lead to increased risk of penalties for mismatches and obligations to support people who received Form 1099-K for transactions that were not supposed to be reported in the first place. These can cause frustration in settling the misreported transactions with the IRS and expose clients to additional IRS inquiries and fees.

**Update**

On December 23, 2022 the IRS issued the Notice 2023-10 announcing a delay in implementation of new reporting requirements of Form 1099-K by third-party settlement organizations for 2022. The IRS and Treasury Department’s decision was driven by professional public concerns regarding the compliance issues. Calendar year 2022 will be a transition period to provide sufficient time to help all parties get ready for the increased filing requirement. Reporting for 2022 will use the prior threshold for third party settlement organizations of aggregate payments over $20,000 and the number of transactions over 200.

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The 38th Annual TEI-SJSU High Tech Tax Institute Conference on Nov 7 – 8, 2022

U.S. Tax Legislation Affecting ASC 740: IRA and CHIPS Act

By: Tiago Iorio, MST Student

Tax Changes

In August 2022, President Biden signed into law the Inflation Reduction Act of 2022 (P.L. 117-169). This legislation includes approximately $400 billion of tax incentives to promote clean energy, and significant changes to credit requirements and utilization. The U.S. Congress also passed the CHIPS and Science Act of 2022 (P.L. 117-167), which will provide $52 billion in subsidies for U.S. chip manufacturers.

The effect of these tax changes on income tax provisions was covered at the 38th Annual TEI-SJSU High Tech Tax Institute Conference, on November 8, 2022. The presenters: Cort Yoder, partner at Deloitte; Jared Huish, partner at KPMG; and Spencer Brock, partner at Grant Thornton. This article summarizes some of the key points made by these presenters.

Corporate AMT

The IRA adds an alternative minimum tax (AMT) of 15 percent of the average annual adjusted financial statement income of domestic corporations (excluding Subchapter S corporations, real estate investment trusts, and regulated investment companies) that exceeds $1 billion over a specified 3-year period. This new tax is effective in taxable years beginning after December 31, 2022.

Although a company may expect to be subject to the corporate AMT for the foreseeable future, ASC 740-10-30-11 states that “no one can predict whether an entity will always be an alternative minimum taxpayer”. So, a company may elect to either disregard or take into consideration its AMT status (comparable to the treatment of GILTI status) when evaluating its existing deferred tax assets under the regular tax system. Some relevant questions include:

- Is the corporation within the threshold to be considered a corporate AMT taxpayer?
- Should the corporation recognize a valuation allowance on the deferred tax asset if it is subject to the corporate AMT?
- Can the corporation elect to have corporate AMT status?

Refundable Credits

Some tax jurisdictions allow for a refundable credit (such as fuel tax credits for U.S. federal income tax and R&D credits in certain state and foreign jurisdictions) that do not depend on the tax position of a company (for instance, a company may receive a refund even though having a loss for the tax year). Tax credits whose realization does not depend on the generation of taxable income (such as refundable credits) are not in the scope of ASC 740. So, a company should not
record such tax credits as a reduction of income tax expense, but instead treat them as a type of
government grant.

The CHIPS Act allows a credit of 25 percent for capital expenses for manufacturing of
semiconductors and related equipment. Because this credit is refundable even if the taxpayer
had no taxable income, such credit is outside the scope of ASC 740.

**Transferable Credits**

The IRA also allows an eligible taxpayer to transfer (by selling) eligible credits to an unrelated
taxpayer. In certain situations, a company may not have enough taxable income to use such tax
credit, or it could take many years until it can use it, so selling the credit can be the best option.
The important point is that if a credit is not refundable, and the credit can be used only to lower
an income tax liability either of the company that generated such credit or the company to which
such credit is transferred to, ASC 740 would apply. To the amount in which the tax credit does
not lower current taxes payable, the company must recognize a deferred tax asset or DTA for the
tax credit carryforward.

The company that purchased a transferable credit should record such credit as a DTA and it
should also record a deferred credit for the difference between the DTA recognized and the
amount paid in conformity with ASC 740.

**Stock Buyback Tax**

The IRA also imposes a new non-deductible 1 percent excise tax on the fair market value of stock
repurchased by a publicly traded corporation after 2022, including purchases of corporate stock
by certain corporate subsidiaries and foreign corporations. Taxes that are not based on income
are not in the scope of ASC 740.

**Next Steps**

Certain provisions of these new tax laws will be subject of further guidance from the Treasury
Department and IRS. As the guidance continues to evolve, a VP of tax or a CFO of a large company
should understand how this new tax legislation will affect its effective tax rate and reporting of
income tax on its financial statements.