

Joint Advanced Communications and Information Technology Committee Meeting August 1, 2023

Taxation of Digital Payments and Digital Currencies
Department of Finance and Administration





✓ What is a digital payment?

✓ How is it taxed?

✓ What is digital currency?

✓ How is it taxed?

Presentation Main Points



What is a digital payment?



A digital payment, sometimes called an electronic payment, is the transfer of value from one payment account to another using a digital device such as a cell phone, POS (Point of Sales) or computer, or a digital channel communications such as mobile wireless data.

It is USD currency.



Apple Pay



Cash App



Dwolla



Google Pay



PayPal



Samsung Wallet



Venmo



Zelle



Walmart Pay



Amazon Pay

The Evolution of Digital Payment Industry—From Online Banking to Digital Wallets

Initial Online Payment

An online CD is sold by an entrepreneur through a credit card. Coca-Cola vending machines accepted payments through text messages.

Mobile Payments

The first mobile payment system was created by M-PESA.

Mobile Wallets

WeChat Pay in 2013, ApplePay in 2014, GooglePay, Amazon Pay, and others onwards were introduced.



E-Wallets

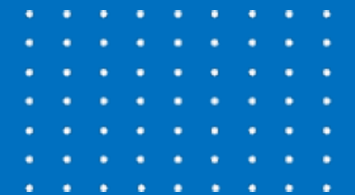
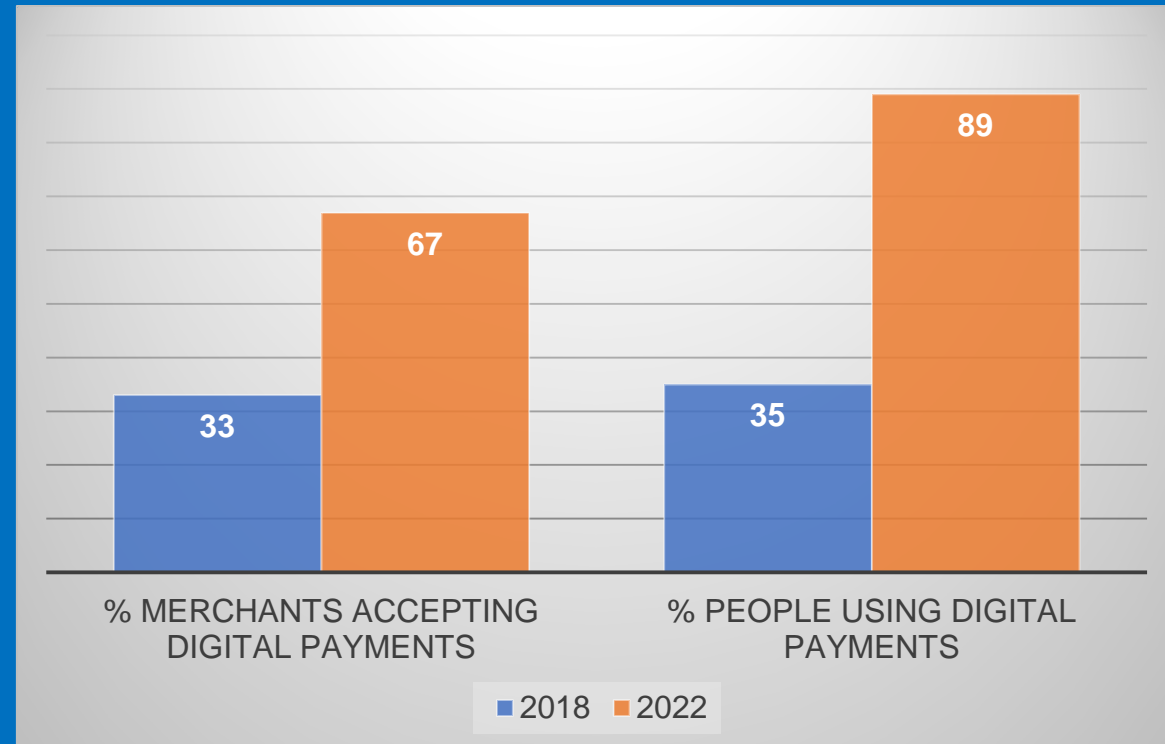
Elon Musk and Capitalist Peter Thiel had introduced a digital money transfer service, PayPal. Stripe, Square, and some of today's leading digital payment services providers were introduced.

CryptoCurrency

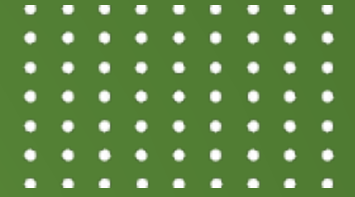
Bitcoin was launched and introduced secure and untraceable payments using a decentralized payment system.



Here are Some Stats :



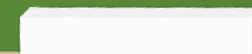
Why Pay Digitally?



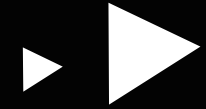
The transition to digital payments and receipts has some clear benefits, especially for small businesses.

Consumers and businesses now expect the digital payments to be made available for faster and more secure payments with little risk and minimal charges compared to traditional debit/ credit card processing.

The payer has a cell phone which provides additional authentication via fingerprint or other verification or biometric method, minimizing risk.



Benefits to business for going cashless



Cash management is eliminated.



Lower risk of theft and reducing the cost of security and storage.

Digital payments are often quicker transactions.



Shorter lines and customer's in-shop experience is enhanced.

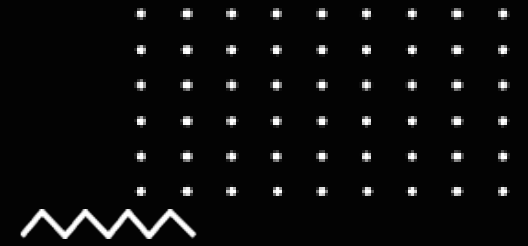
A clear trail is available for easier accounting.



Simplifies operations and tax compliance.



How are digital payments taxed?



Payment companies, beginning in 2023, will be required to send a **1099-K** to any merchant/ person receiving more than \$600 worth of payments through their service. Taxpayers who have received payment for goods and/ or services filing a Schedule C will include that amount on Line 1 "Gross Receipts or Sales."

Any personal transactions will not need to be included in that amount.



FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. DRIVING COMPANY 123 CAR STREET SAN FRANCISCO, CA XXXXX		FILER'S TIN XX-XXXXXXX		OMB No. 1545-2205 2018 Form 1099-K		Payment Card and Third Party Network Transactions Copy B For Payee This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.	
		PAYEE'S TIN XX-XXXXXXX					
		1a Gross amount of payment card/third party network transactions \$ 6,200					
		1b Card Not Present transactions \$		2 Merchant category code			
Check to indicate if FILER is a (an): Payment settlement entity (PSE) <input checked="" type="checkbox"/> Electronic Payment Facilitator (EPF)/Other third party <input type="checkbox"/>		Check to indicate transactions reported are: Payment card <input type="checkbox"/> Third party network <input checked="" type="checkbox"/>		3 Number of payment transactions 250		4 Federal income tax withheld \$	
PAYEE'S name ARTHUR READ Street address (including apt. no.) 562 MAIN STREET City or town, state or province, country, and ZIP or foreign postal code ELWOOD CITY, DC, 12345 PSE'S name and telephone number		5a January \$ 1,000		5b February \$			
		5c March \$ 1,000		5d April \$			
		5e May \$ 1,000		5f June \$			
		5g July \$ 1,000		5h August \$			
		5i September \$ 1,000		5j October \$			
		5k November \$		5l December \$			
		6 State		7 State identification no.		8 State income tax withheld \$	
Account number (see instructions)							

Report your income
from Box 1a





Cryptocurrency

A **cryptocurrency**, **crypto-currency**, or **crypto** is a digital currency designed to work as a medium of exchange through a computer network that is not reliant on any central authority, such as a government or bank, to uphold or maintain it.

2014 IRS Notice

Virtual Currency – “A digital representation of value that functions as a medium of exchange, a unit of account, and/ or a store of value.”

Convertible Virtual Currency – “Virtual currency that has an equivalent value in real currency, or that acts a substitute for real currency.”

For Federal tax purposes, convertible virtual currency is treated as property and not as currency.

Federal Regulation of Digital Assets

The Commodity Futures Trading Commission (CFTC) has taken the position that Bitcoin, Ether, Litecoin, Tether, and Binance are subject to the agency's regulatory authority.

The Securities and Exchange Commission (SEC) has pending litigation and enforcement actions related to digital assets that the SEC has determined are securities subject to SEC regulation.

Arkansas Data Centers Act of 2023 – Act 851 of 2023 - Definitions

"Digital asset" means cryptocurrency, virtual currency, and natively electronic assets, including without limitation stable coins, nonfungible tokens, and other digital-only assets, that confer economic, proprietary, or access rights or powers;

"Digital asset miner" is an individual who mines for digital assets; "Digital asset mining" means use of electricity to power a computer for the purpose of securing or validating a blockchain network.

"Digital asset mining business" means a group of computers working at a single site that consumes more than one megawatt (1 MW) on an average annual basis for the purpose of generating digital assets by securing a blockchain network.

Arkansas Data Centers Act of 2023

A digital asset mining business may operate in this state if the digital asset mining business complies with:

- (1) State law concerning business guidelines and tax policies;
- (2) Any ordinance concerning operations and safety;
- (3) Any rule or rate for utility service provided by or on behalf of a public entity; and
- (4) State and federal employment laws.

A digital asset miner shall:

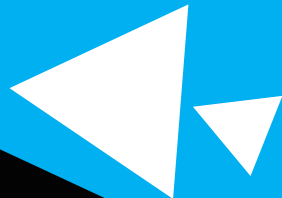
- (1) Pay applicable taxes and government fees in acceptable forms of currency; and
- (2) Operate in a manner that causes no stress on an electric public utility's generation capabilities or transmission network.

FUN

FACTS



One cryptocurrency (DogeCoin) was actually created as a joke and is still publicly traded today.





Stable Coins

Designed to maintain a fixed value over time. The value is typically pegged to a specific real currency, often the US Dollar.

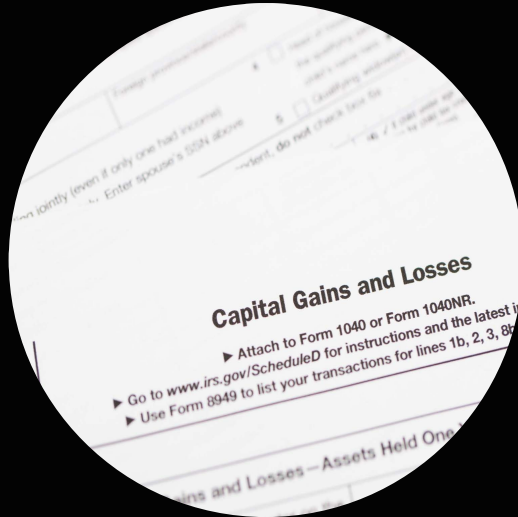
Examples are Tether, USD Coin, and Binance USD.

Volatile Coins

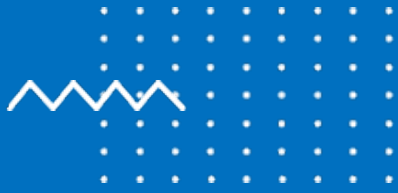
Value varies greatly because they are not backed by anything of set value. Their price is set by supply and demand and speculation of future worth.

Examples are Bitcoin and Ethereum.





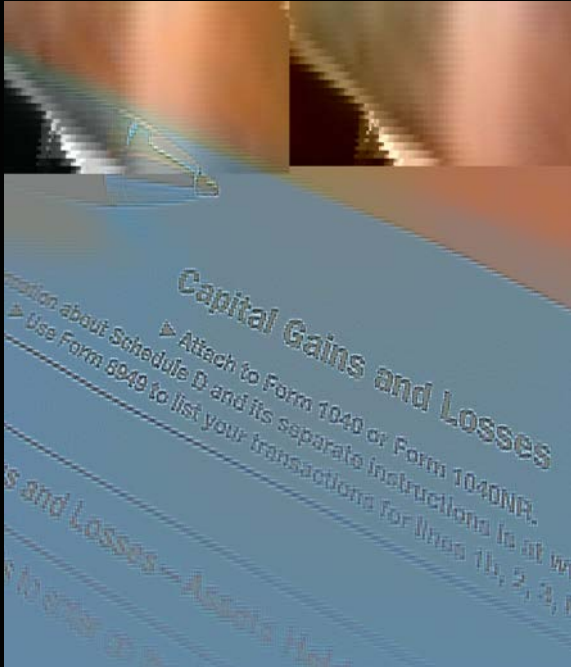
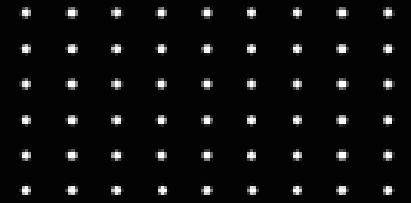
IRS treats crypto as an asset subject to its rules on capital gains and losses, like stocks or income, like salaries or bonuses. When you buy cryptocurrency or stocks, the original purchase price of the asset becomes its cost basis. When you sell that asset, you're taxed based on the difference between the cost basis and the sales price.



How Cryptocurrency Transactions Are Classified



Capital Gains/ Losses:



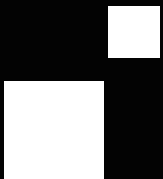
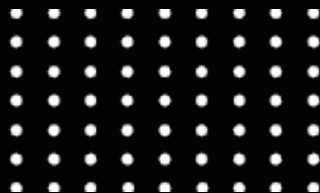
- Selling cryptocurrency

Anytime you sell cryptocurrency the gain or loss in value has tax implications. This type of transaction tends to be straightforward, especially if you aren't frequently buying and selling crypto, and is classified under capital gains.

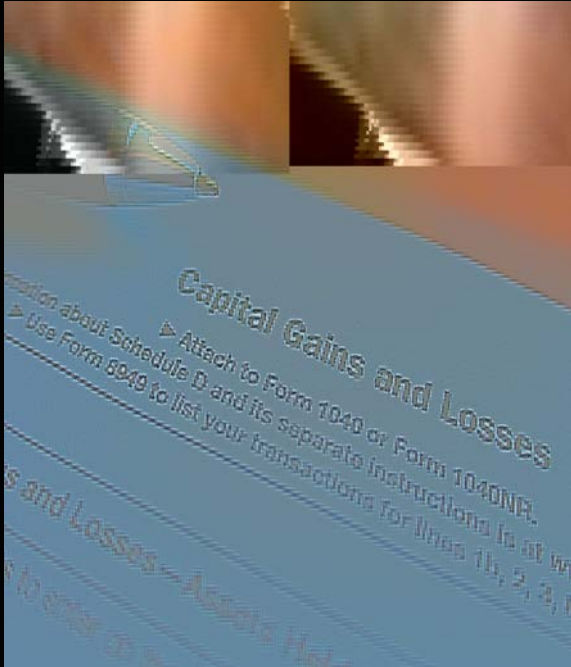
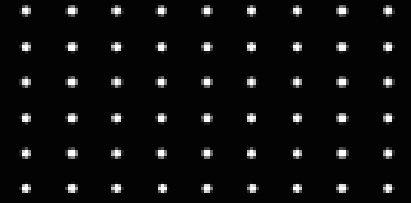
- Exchanging one cryptocurrency for another

A crypto swap is when you directly trade one cryptocurrency for another without exchanging your crypto for cash.

Many people mistakenly overlook this type of transaction when it comes to taxes because no cash was realized. If you exchange Bitcoin for Litecoin or Ethereum for Bitcoin, it is a taxable event.



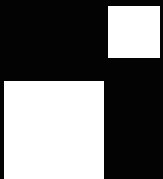
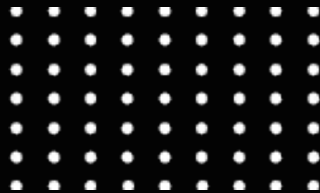
Capital Gains/ Losses: (cont.)



- Spending crypto for goods or services

Using crypto to buy goods or services has the same tax implications as selling it. It could be as little as you're going to Starbucks and spending a fraction of a Bitcoin to buy something and that could result in a taxable gain.

When you're buying anything with crypto, the taxable gain or loss is based on what you paid for the cryptocurrency and its value at the time of the transaction.





Calculating Gains/ Losses

Capital gains and capital losses are based on the net total of all transactions that year. If you sold five different assets for a total gain of \$10,000 and three other assets at a total loss of \$15,000, then you have \$5,000 in capital losses.

You can claim up to \$3,000 a year in capital losses from your taxable income and can carry over losses exceeding that annual limit to future years. For example, if you had \$5,000 in capital losses in 2022, you could reduce your taxable income by \$3,000 in 2022 and apply the remaining \$2,000 in losses to 2023.





Long Term vs. Short Term

A short-term capital gain results from the sale of an asset owned for one year or less. While long-term capital gains are generally taxed at a more favorable rate than salary or wages, short-term gains do not benefit from any special tax rates. They are subject to taxation as ordinary income.

As regular taxable income, short-term gains are subject to the tax appropriate for your marginal income tax bracket. There are currently seven U.S. federal tax brackets, with rates ranging from 10% to 37%.

Net capital gains are calculated based on your adjusted basis in an asset. This is the amount that you paid to acquire the asset, less depreciation, plus any costs that you incurred during the sale of the asset and the costs of any improvements that you made. If an asset is given to you as a gift, then you inherit the donor's basis.

The tax on a long-term capital gain is almost always lower than that for a short-term capital gain. Because of this difference in taxation, you can minimize your capital gains tax by holding assets for more than a year.



Income:

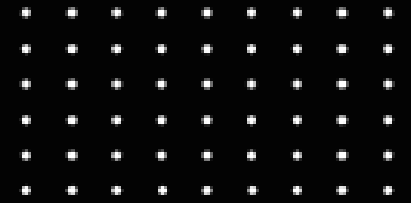


- When you earn cryptocurrency

When you earn cryptocurrency, it is considered taxable income based on the value of the coins at the time of receipt. This includes crypto earned from activities such as:

- Mining cryptocurrencies (Reported on Schedule C)
- Crypto staking income (Reported on OI and Schedule 1)
 - similar to interest on a CD or savings account
- Yields on crypto accounts (Reported on OI and Schedule 1)
 - similar to dividends paid on stock ownership
- Crypto earned as regular pay or bonuses (Reported on OI or Schedule 1)
 - figured on cash value at the time of receipt

Income: (cont.)

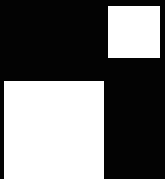
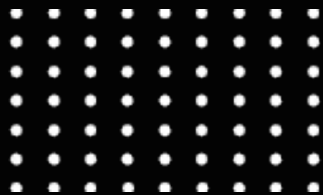


- When you receive free coins

There are instances where you may receive free crypto and the value of the digital coins you receive is considered income. Two common scenarios where you may receive free crypto are airdrops and hard forks.

An airdrop is when cryptocurrencies are given away for free, and it's typically used as a marketing tool for new cryptocurrencies.

A hard fork is a bit more complicated but to simplify it, it's essentially when a cryptocurrency splits into two types of tokens or coins. When this happens, you'll have your original coin and a new coin, with a separate value. The value of the cryptocurrency you receive from a hard fork is taxable income





Summary



Digital payments are when you exchange money in your bank or in a digital wallet for goods and services. It is money that can be withdrawn physically and used as cash.

Digital payments received as payments for goods or services are taxable income.

Cryptocurrency is not regulated by a bank and cannot be withdrawn in a physical form. It can increase and decrease in value, but a transaction must take place before it is taxable.

Whether your transaction is a gain or loss is dependent on the cost basis at the time of accrual of the cryptocurrency and the value at the time of the transaction.



Summary



“Suspended basis” ends when the original owner dies if cryptocurrency is bequeathed. If there is a remaining carry-forward of loss, it cannot be claimed by the beneficiary of a will.

Federal Form 7203 may be sent to show the cost basis for cryptocurrency.

You cannot claim a loss bigger than your investment.

Since cryptocurrency is not regulated by the banks or Federal Reserve, they are not covered by the FDIC and can be hacked and stolen.

1099 Reporting

1099-K

Used to report digital payments to recipient to claim as income for goods and services.

1099-MISC

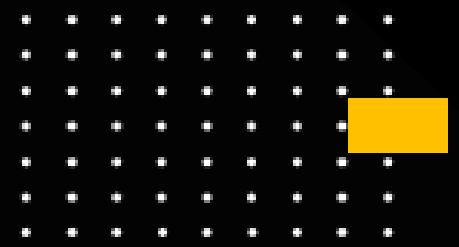
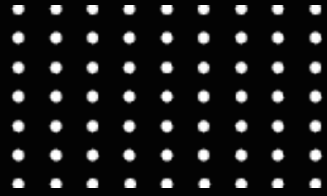
Used to report interest earned on cryptocurrency investments.

1099-NEC

Used to report income earned from mining of cryptocurrency.

1099-B

Used to report Capital Gains from trading or selling of cryptocurrency, including using it to pay for goods/ services.



Questions?

Individual Income Tax Section – (501) 682-1100

Corporation Income Tax Section – (501) 682-4775

Revenue Legal Counsel – (501) 682-7030

dfa.arkansas.gov