Cryptocurrencies as Charitable Gifts: Should Your Charity Say Yes?

With the increased notoriety of cryptocurrencies, many charities are exploring the option of accepting Bitcoin, Ripple, Litecoin and nearly 2,000 other virtual currencies for donations. In fact, Fidelity Charitable reports that charitable donations of cryptocurrencies increased ten-fold between 2016 and 2017, and currently there are about 11 million Bitcoin in circulation alone. While adding this as an option for donors may increase the organization’s reach and its reputation for being on the leading edge, it comes with some cautions and important safeguards.

What is it? Cryptocurrency is a digital or virtual currency designed to work as a medium of exchange. Like paper money (cash), we exchange it for goods and services and it has value because we believe and agree that it does; there is no inherent value in the pieces of paper we carry in our wallets. Unlike cash, cryptocurrency is exchanged electronically and uses cryptography to secure and verify transactions, as well as to control the creation of new units of a particular cryptocurrency. Essentially, cryptocurrencies are limited entries in a database that no one can change unless specific conditions are fulfilled. The concept closely resembles peer-to-peer networks for file sharing.

Cryptocurrency has six defined characteristics:

- **100% Digital:** Cryptocurrency only exists on computers. There are no coins and no notes. There are no reserves for crypto in Fort Knox or the Bank of England!

- **Decentralized:** Cryptocurrencies don’t have a central computer or server. They are distributed across a network of (typically) thousands of computers. Networks without a central server are called decentralized networks.

- **Peer-to-Peer:** Cryptocurrencies are passed from person to person online. Users don't deal with each other through banks, PayPal or Facebook. They deal with each other directly. Banks, PayPal and Facebook are all trusted third parties. There are no trusted third parties in cryptocurrency! Note: They are called trusted third parties because users must trust them with their personal information in order to use their services. For example, we trust the bank with our money and we trust Facebook with our holiday photos!

- **Anonymous:** This means that you don't have to give any personal information to own and use cryptocurrency. There are no rules about who can own or use cryptocurrencies.

- **Trustless:** Involving no trusted third parties means that users don't have to trust the system for it to work. Users are in complete control of their money and information at all times.

- **Encrypted:** Each user has special codes which stop their information from being accessed by other users. This is called cryptography and it's nearly impossible to hack. It's also where the crypto part of the crypto definition comes from. Crypto means hidden. When information is hidden with cryptography, it is encrypted.

- **Global:** Countries have their own currencies called "fiat" currencies. Sending fiat currencies around the world is often difficult. Cryptocurrencies can be sent all over the world easily. This may be especially attractive to donors and charities, as an organization that accepts cryptocurrencies can accept donations from anyone, anywhere in the world without paying international exchange fees, changing currencies, or dealing with international banks.

Tax Considerations. The IRS rules regarding charitable donations of purchased cryptocurrencies are very similar to the rules regarding donations of appreciated securities. A gift of cryptocurrency will be valued at the time of donation at its fair market value. (A charity must sign a donor's IRS Form 8283 in order for the donor to receive a charitable deduction if the property is valued at $500 or more. For amounts greater than $5,000, an appraisal is required by a certified appraiser.) Additionally, selling cryptocurrency leaves investors subject to the rules governing capital gains: they'll pay capital gains tax on any increase in value since they bought the cryptocurrency. (If the cryptocurrency has been held for a year or less, investors will pay short-term capital gains taxes at their ordinary income rate. Selling cryptocurrency held for longer than a year will trigger long-term capital gains taxes at rates ranging from 0% to 20%, depending on the investor's ordinary income tax bracket.)

Donations of cryptocurrencies result in a win-win scenario for both the donor and the charity. On one hand, donors receive a larger tax benefit because the entire FMV of the donation can be deducted and they don't have to worry about liquidation of their tokens. On the other hand, charities receive the entire amount of cryptocurrency and, ultimately, a larger gift.

For example: Donor A is in the 25% tax bracket and bought a Bitcoin for $1 back in 2010. Currently, it's worth $19,001. If Donor A sells the Bitcoin, she'll have a capital gain of $19,000. If she is also in the top tax bracket, then she'll pay long-term capital gains tax of 15% on that gain, costing her $2,850 in taxes. That leaves $16,150 to go to her favorite charity, for which she will get an itemized deduction that could reduce your tax bill by $4,038. At the end of the day, Donor A will end up with a net tax savings of $1,188, and the charity will get $16,150 in cash.

However, if that same Bitcoin is donated directly to the charity, Donor A's gift will be $19,001, for which she'll get a full deduction because she owned the bitcoin for longer than one year. This charitable gift won't trigger any capital gains tax and will provide Donor A with an itemized deduction of $4,750. When the charity sells the Bitcoin for cash to support its mission, it will receive the entire $19,001 and, as a tax-exempt organization, will not be liable for any capital gains tax.

It's important to note that receiving payments in cryptocurrency in exchange for products or services or as salary is treated as ordinary income at the fair market value of the coin at the time of receipt. Charitable donations of earned cryptocurrency are treated as gifts of cash and are not subject to capital gains tax.

Accepting Cryptocurrencies. Despite high processing fees that lower the net donation received, charities began accepting gifts via credit and debit cards many years ago because of the convenience factor for donors. With cryptocurrency, there are no banks or credit card companies involved in the transactions, resulting in a much lower processing expense.

The process for accepting donations cryptocurrencies is relatively simple. A charity establishes an account with a third-party processing company, such as Bitpay or Coinbase, and then incorporates the cryptocurrency payment option into its online donation site. Charities can then accept incoming cryptocurrency donations and then exchange them for cash at the time of a transaction via the third-party processors.

The primary considerations with virtual currency exchanges are:

- What is the process, information requirements and timeline to open an account?
- Does the exchange allow charities to trade on their platforms?
- Does the exchange trade the virtual currencies the charity will receive as donations?
- Does the exchange allow US-based customers and withdrawals of USD (many large China-based exchanges do not)?

- Can the charity quickly sell through the donated cryptocurrency and withdraw the USD received in exchange or are there limits?

- If the virtual currency will take more than a short period of time to sell, is the charity comfortable keeping it in the charity's account on the exchange?

Incorporating Cryptocurrency into an Existing Gift Acceptance Policy. Because cryptocurrencies are viewed as property, much like securities, many nonprofit organizations have similar gift acceptance policies for both. It is considered a 'best practice' for a recipient charity to sell the cryptocurrency immediately upon receiving it, and this protocol should be clearly stated within the organization's policy. The gift acceptance policy should also be updated to include the charity's position on acknowledgement, and compliance protocols for gifts of cryptocurrencies and whether donors are required to provide personal information (name, address, Social Security Number, etc.) in order to guard against criminal or fraudulent activity.

For financial reporting purposes, cryptocurrencies should be treated as a financial asset, and if held, should be reported at fair value in an organization's statement of financial position; it is reasonable to expect that the fair value would be determined based upon the trading price of the Bitcoin on the applicable exchange on the date of the transaction.

Risks and Legal Vulnerabilities. Despite its growing popularity as a philanthropic option, there are still many uncertainties around cryptocurrencies:

- The value of cryptocurrencies is highly volatile; in fact, in February 2018, the price of Bitcoin dropped to $7,000 from its high of $19,000 in December 2017 and it has continued to fluctuate.

- Although cryptocurrencies share characteristics with both legal tender and traditional securities, they are not currently backed or regulated by the Federal Deposit Insurance Corporation (FDIC) or any other sovereign government. This lack of regulatory oversight does not provide the sort of guarantees that exist with currency regulation (a guarantee of value) or securities regulation (a guarantee of compliance with reporting procedures and standards).

- Currently, cryptocurrency transactions can be completely anonymous, if the donor so chooses. This makes it difficult for fundraisers to steward (or further solicit) the donors.

- Unlike traditional currencies, which are regulated by the Securities and Exchange Commission (SEC), there are no profit or sell disclosures, making cryptocurrency transactions difficult to trace.

Changes to minimize these risks are on the horizon, however. Pending anti-money laundering statutes will require cryptocurrency purchasers to share more of their personal information and provide more state verifiable documentation when registering for an exchange. It is also likely that users may need to divulge more information on the recipients of their transactions (or any other otherwise related parties).

Also, charities accepting cryptocurrencies as gifts may have to navigate SEC and state security licensing requirements if the charity chooses to hold them for investment purposes. Theoretically, this means a charity that delays selling donated cryptocurrencies may have to deal with the potential complications of federal and state securities regulations; however, heavier regulation should ease the fears of charities wary of accepting virtual currency from unknown origins and significantly minimize the risks of unintended association with cybercrime and other unlawful elements.

Cryptocurrency and Estate Planning. Unlike bank accounts which can be accessed after death by an estate's executor, digital assets typically require a variety of private information to be accessed. This information (and an investor's digital assets) may be lost forever if an investor fails to record it or share it with a trusted third party during their lifetime. To avoid this, it is crucial that investors physically record any private access information and provide for custody of this information in their wills.

The federal estate tax is based on the value of one's assets less liabilities at one's date of death and is imposed at a rate of 40%. One important exception that is critical to understanding how the federal estate tax works involves the estate and gift tax exemption. This exemption is the amount that one can transfer to anyone during one's lifetime or at death without incurring a gift or estate tax. The Tax Cuts and Jobs Act of 2017 (TCJA) increased the exemption to $11.18 and this amount will be indexed annually for inflation until 2026 (when the exemption amount is scheduled to revert to $5.49 million, with an adjustment for inflation). For wealthier owners of crypto-currency assets, implementing certain estate planning techniques, such as leaving all or part of it to charity rather than leaving potentially highly-taxed assets to heirs, would be beneficial.

Cryptocurrency is coming to philanthropy. A charity's ability to accept cryptocurrency donations and then convert them into cash will prove to be a valuable asset for nonprofit organizations going forward. Charities open to exploring this gift option should consult with their banks and financial advisors to see if enhancing their fundraising efforts with cryptocurrency will work for their specific organizations.