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Private Foundations Bulletin

Cryptocurrency – Is Your Foundation Ready

Digital assets have become a topic of conversation almost impossible to ignore. One only had to tune in to the Super Bowl this past month to see numerous commercials touting several trading companies that are offering the opportunity to invest in various digital assets. Digital assets include several subcategories. Three of the most popular are non-fiat digital currency (colloquially, cryptocurrencies), non-fungible tokens (NFTs) and fiat digital currencies anticipated to be issued by respective central banks in the future. This article discusses cryptocurrencies.

Accounting for Cryptocurrency

Although cryptocurrencies, such as Bitcoin, have been in existence for a little over a decade, it has only started to become a more recognized asset class in the last several years. If your foundation is currently transacting with cryptocurrency, or has had conversations to start doing so, you should ensure your foundation has a robust policy covering cryptocurrency. This policy should detail how the foundation intends to receive, hold and sell its cryptocurrency. The next step is to understand the current accounting treatment for cryptocurrency. Currently, the Financial Accounting Standards Board (FASB) Codification does not provide specific guidance over accounting for digital assets, which includes cryptocurrencies. However, the Association of International Certified Professional Accountants (the Association) has issued a practice aid to develop nonauthoritative guidance on how to account for cryptocurrency under U.S. generally accepted accounting principles (US GAAP).

For an organization that does not apply specialized industry guidance (for example, it is not applying FASB *Accounting Standards Codification* 946, *Financial Services — Investment Companies),* the Association has recommended that organizations account for cryptocurrency as indefinite-lived intangible assets in accordance with FASB ASC 350, *Intangibles — Goodwill and Other*. For the purposes of the Association's practice aid, the term crypto asset is specific to the type of digital assets that has the following characteristics:

- Function as a medium of exchange, and
- Have all the following characteristics:
  - They are not issued by a jurisdictional authority (for example, a sovereign government).
  - They do not give rise to a contract between the holder and another party.
  - They are not considered a security under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Under this guidance, examples of cryptocurrency meeting the above characteristics include Bitcoin, Bitcoin cash, and etherium. When a foundation purchases or receives this type of cryptocurrency, it is initially measured at cost and subsequently tested for impairment annually or more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. If a foundation concludes the fair value of the cryptocurrency is less than the carrying value, an impairment loss is recorded at that time. Subsequent reversal of previously recorded impairment losses on indefinite-lived intangible assets is prohibited; meaning there is no write-up on the cryptocurrency for unrealized gain in value and a recovery on the loss of value is not recognized until the time of sale. Because crypto assets are not accounted for at fair value, additional disclosures to provide information to users of the financial statements are necessary.

The following is a sample of such disclosure:

> "*As of December 31, 20XX, the carrying value of the Foundation's cryptocurrency, net of impairment, was $500,000. The fair value of such cryptocurrency held as of December 31, 20XX was $675,000.*"

Tax Matters

Additionally, there are also tax considerations that a foundation will want to be aware of in preparing its Form 990-PF. Similar to the FASB, the Internal Revenue Service (IRS) has not issued comprehensive guidance on the tax treatment of cryptocurrencies. However, the current position of the IRS is to treat cryptocurrencies as property rather than a currency. For foundations that receive contributions in the form of cryptocurrencies, it is treated as a contribution of noncash property and the donee receives the donor's carryover basis of the asset.

Upon the sale of the cryptocurrency, the foundation is required to recognize a capital gain or loss. In addition, as a best practice, the foundation should send the donor an acknowledgment upon receipt of the cryptocurrency donation. The foundation should also remind the donor of the donor's responsibility to complete a Form 8283 for this donation and the possibility of an appraisal if the value of the donation is greater than $5,000.

The value of cryptocurrency could also impact a foundation's annual 5 percent minimum distribution requirement (MDR). In determining how to value cryptocurrencies for purposes of calculating a foundation's MDR, if determined to be treated as property, it would be included in the "other assets" line of the Form 990-PF. Property classified as an "other asset" is typically valued annually on the same date each year – as opposed to valuing monthly – and averaged throughout the year as cash and traditional investments would be.

As we've seen over the past several years, cryptocurrency is known for potentially extreme unpredictability in terms of short-term price swings. This could lead to a substantial impact on a foundation's MDR if valued on an annual basis. For the purposes of calculating MDR, we would suggest that, until further guidance is issued, it would be prudent to value the cryptocurrency monthly solely for the purpose of calculating MDR. This methodology would smooth out the volatility of price swings in the value of the cryptocurrency asset and result in an MDR calculation more reflective of the cryptocurrency's value.

Updates to Follow

The realm of cryptocurrency and the related underlying technology is constantly evolving and, as such, regulators and future FASB and IRS guidance may change accordingly. It is something that we will be monitoring closely and will provide further updates and guidance as it becomes available.

PKFOD Webinar

We welcome you to join our next Private Foundation Quarterly Webinar on March 8, 2022 at 12 noon with leading experts from our Firm, as they discuss the basics and pros and cons of crypto assets and how they pertain to private foundations.

Contact Us

We welcome the opportunity to answer any questions you may have related to this topic or any other accounting, audit, tax or advisory matters relative to private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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