Initial Coin Offerings (ICO)

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Craig Smalley • Nov. 28, 2017

I have been involved in the cryptocurrency space for a long time, with direct experience in bringing coin[1] to market for numerous firms. As with any growing industry, there are always new aspects and I want to share with you a few interesting topics that I’ve been exposed to recently so we can explore the taxation of these events:

1. Simple Agreement for Future Tokens (SAFT)
2. Initial Coin Offerings (ICO)

A SAFT is basically the commercial instrument used to convey an investor’s rights in the token before the token has its full functionality. For instance, let’s say that a company wants to bring a token to market. Before that token is fully functional, the company issues these SAFTs to accredited investors to raise money to develop the token. This money raised is a liability to the company until such a time as the token is released and developed.

When a cryptocurrency startup firm wants or needs to raise more money, they usually do so through an Initial Coin Offering (ICO). The ICO most often will create the plan through a whitepaper or some other type of medium, that states:

- What the project is about.
- What needs the project will fulfill upon completion.
- The amount of money that is needed to take on the operation.
- How many tokens the pioneers[2] will keep for themselves.

- The type of money that will be accepted during the ICO.

IPO, there are several differences. For instance, an ICO is only loosely regulated by the SEC. Further, no shares of the company issuing the ICO are given to any enthusiast or supporter.

Let's take a second and unpack the way the IRS taxes cryptocurrency. In Notice 2014-36, the IRS effectively treats the taxation of cryptocurrency as property. Are you thinking what I am thinking?

When issuing an ICO, the cryptocurrency is pegged to the US dollar. If I were to receive this cryptocurrency for my ICO, I would have a taxable event because of the conversion rate.

Typically, what can happen here is an IRC §1031 Exchange is done for the cryptocurrency received in the ICO, or the SALF for the most accepted cryptocurrency in the market (being Bitcoin). You simply set up a Qualified Intermediary that receives the cryptocurrency. Then the company has 45 days to identify up to three cryptocurrencies, and then 180 days or the due date of the tax return including extensions, whichever comes sooner, to take possession of the replacement property. Note, if any hard currency is exchanged in the ICO or the company wants to convert some to cash, then that portion is taxable.

The exchange of choice is Bitcoin, because so many companies and people accept it as payment. You have just made the entire transaction, less the fiat, non-taxable. The tokens received by the owners of the coin that have been exchanged can be 1031'ed as well, setting up a completely tax-free event.

There is one thing to note here. In the Republican Tax Plan, they are stating that 1031 exchanges can only be done with real property. However, until that goes through (if it goes through), ICO start-ups can make the most of this token strategy with a little help from a knowledgeable tax pro.