



CHECK BOOK IRA
— A RETIREMENT GUARDIAN —

Purchasing Cryptocurrencies with Retirement Funds

With the value of Cryptocurrencies flying high, many investors have looked to take advantage of this trend and own cryptocurrencies in tax-advantaged retirement plans, such as a Self-Directed IRA or Solo 401(k) Plan. We will explore the main points an investor should know when using retirement funds to buy cryptocurrencies.

What is a Cryptocurrency?

Cryptocurrency refers to a decentralized digital currency that employs principles of cryptography (communication that is secure from view of third parties) to ensure security, privacy, and anonymity.

Consequently, the value of a cryptocurrency is not set by anyone other than market participants, who engage in the process of buying and selling on an exchange platform.

Bitcoin has become the leader in shepherding in a wave of cryptocurrencies built on decentralized peer-to-peer network and is the primary standard for cryptocurrencies. The currencies inspired by Bitcoin are collectively called Altcoins and have tried to present themselves as modified or improved versions of Bitcoin.



The five most popular cryptocurrencies are Bitcoin, Ethereum (ETH) & Ethereum Classic, Litecoin, ZCash and Dash. There are close to 1000 types of cryptocurrencies, so this list can vary over time.

How does the IRS Treat Cryptocurrencies from a Tax Standpoint?

Even though Bitcoin is labeled as a “cryptocurrency,” from a Federal income tax standpoint, Bitcoins and other cryptocurrency are not considered a “currency.”

On March 25, 2014, the IRS issued Notice 2014-21, which for the first time set forth the IRS position on the taxation of virtual currencies, such as Bitcoins. According to the IRS Notice, "Virtual currency is treated as property for U.S. federal tax purposes." The Notice further stated, "General tax principles that apply to property transactions apply to transactions using virtual currency."

In other words, the IRS is treating the income or gains from the sale of a virtual currency, such as Bitcoins, as a capital asset, such as stocks or real estate, subject to either short-term (ordinary income tax rates) or long-term capital gains tax rates, if the asset is held greater than twelve months (15% or 20% tax rates based on income).

By treating Bitcoins and other virtual currencies as property (capital asset) and not currency, the IRS is requiring the investor to maintain detailed transaction records (i.e. basis, holding period, etc.) in order to determine the amount of tax from the cryptocurrency transaction. Many investors have not done this only recording the value of their holdings and not the individual gains and losses from trades.

This is getting the eye of the IRS for with our rising debt they are looking in all cracks and crannies to find taxable dollars.

There are strong opinions that in the future exchanges will be required to report individual trades and discerning between long term and short-term gains. This brings up the big question

Could I purchase Cryptocurrencies with a Retirement Account?

The Internal Revenue Code does not describe what a Self-Directed IRA or Solo 401(k) Plan can invest in, only what it cannot invest in. Internal Revenue Code Sections 408 & 4975 prohibits Disqualified Persons from engaging in certain types of transactions.

The foundation of the prohibited transaction rules is based on the premise that investments involving an IRA and related parties are handled in a way that benefits the retirement account and not the IRA owner.

The rules prohibit transactions between the IRA and certain individuals known as “disqualified persons.” The definition of a “disqualified person,” (Internal Revenue Code Section 4975(e)(2)), extends into a variety of related party scenarios, but generally includes the IRA holder, any ancestors or lineal descendants of the IRA holder, and entities in which the IRA holder holds a controlling equity or management interest.

Because the IRS treats cryptocurrencies, such as Bitcoins, as a capital asset, such as stocks or real estate, a retirement account is permitted to buy, sell, or hold cryptocurrencies, subject to the prohibited transaction rules found under Internal Revenue Code Section 4975(c).

Why use a Retirement Account to Invest in Cryptocurrencies?

When purchasing cryptocurrencies, such as Bitcoins, with a Self-Directed IRA or Solo 401(k) Plan, all income and gains generated by your pre-tax retirement account investment would generally flow back into the retirement account tax-deferred or tax-free in the case of a Roth IRA.

Instead of paying tax on the gains of the crypto investment, tax is paid only at a later date or never at all, in the case of a Roth IRA, leaving the crypto investment to grow unhindered without tax. This makes it very attractive to hold your cryptocurrencies in a retirement account.



How to Use Retirement Funds to Buy, Hold, or Sell Cryptocurrencies?

In general, the ways to purchase cryptocurrencies with retirement funds is through a Self-Directed IRA, Checkbook Controlled IRA with a LLC or Solo 401(k) Plan.

Below is a step-by-step summary of how to purchase cryptocurrencies with a Self-Directed IRA, Checkbook Controlled IRA with an LLC (Checkbook IRA) or Solo 401(k) Plan.

Self-Directed IRA

With a Self- Directed IRA, you would open a ROTH or Traditional IRA with a Custodian that has a relationship with an exchange.

You then would instruct the custodian what Crypto you would like to buy and hold. This is the simplest method for its like putting an order in at Ameritrade, Schwab, etc. for a stock you want to buy.

You must realize, though, that you are limited to the types of Crypto the custodian deals in. One large custodian only deals in Bitcoin and the other coins are not available so you would have to find another custodian if you wanted other Cryptos.

The self-directed custodians will also require you store your coins, keys etc. with them. If you want to buy and sell your Crypto as the market ebbs and flows you would do it all through the custodian and be subject to their rules and whatever lag time they have to make purchase or sell.

Lastly, if you want to move accounts most of them that I know require you to sell the asset and transfer cash. Because of the volatility in Crypto this is risky and must be timed or a realization it could take a week or so to complete the move.

Checkbook IRA

This is a Self-Directed IRA where the IRA owns an LLC that you are the manager and the LLC would be the vehicle used to purchase the cryptos.

- 1** Establish a Checkbook IRA (ROTH or Traditional)
- 2** Rollover retirement funds, cash or in-kind, tax-free to the new IRA account.
- 3** The IRA assets will then be transferred to the LLC tax-free in exchange for 100% interest in the newly established IRA LLC.
- 4** You, as manager of the LLC, will open a bank account for the LLC at any local bank.
- 5** You, as manager of the LLC, will then have "Checkbook Control" over all the assets/funds in the IRA LLC to make the cryptocurrency investment.
- 6** A cryptocurrency account would be opened in the name of the IRA LLC.
- 7** You, as manager of the LLC, will then wire the IRA LLC funds to the new cryptocurrency account opened at a crypto exchange. The account will be opened in the name of the IRA LLC.
- 8** The cryptos can then be held at the exchange or via an online or offline wallet.
- 9** Since the LLC is owned 100% by an IRA, it will be treated as a disregarded entity for tax purposes. No Federal income tax return is required to be filed, although, some states may impose filing or franchise taxes on the LLC. Accordingly, in general, all income and gains from the cryptocurrency investment should flow back to the IRA without tax.

By having the Crypto assets in a LLC you can easily move the assets from custodian to another without having to sell the assets.

Solo 401(k) Plan

A Solo 401(k) Plan is a qualified retirement plan that is established by a business with no full-time employees other than the owners or their spouses.

- 1** Establish a Self-Directed Solo 401(k) Plan.
- 2** Rollover retirement funds, cash or in-kind, tax-free to new Solo 401(k) Plan account.
- 3** You, as trustee of the Solo 401(k) Plan, will then have "Checkbook Control" over all the assets/funds in the plan to make the cryptocurrency investment.
- 4** A cryptocurrency account could be opened in the name of the Solo 401(k) Plan or a special purpose LLC wholly owned by the Solo 401(k) Plan. Many investors seem to like using an LLC wholly owned by a 401(k) plan as a vehicle to own the cryptos as it generally helps expedite the account opening process at the more popular cryptocurrency exchanges.
- 5** You, as trustee of Solo 401(k) Plan or manager of the LLC, if applicable, will then wire the 401(k) funds to the new cryptocurrency account opened at a crypto exchange. The account will be opened in the name of the Solo 401(k) Plan or the LLC, if applicable.
- 6** The cryptos can then be held at the exchange or via an online or offline wallet.
- 7** Since a 401(k) plan is a tax-exempt qualified retirement plan, all income and gains from the cryptocurrency investment would flow back to the Solo 401(k) Plan tax-deferred or tax-free in the case of a Roth Solo 401(k) account. Whereas, a special purpose LLC wholly owned by a 401(k) plan would be treated as a disregarded entity

for tax purposes. No Federal income tax return is required to be filed, although, some states may impose filing or franchise taxes on the LLC. Accordingly, in general, all income and gains from the cryptocurrency investment should flow back to the 401(k) plan without tax.

It is very evident that the Checkbook IRA and the Solo 401(k) plans give you the most flexibility and control. They are more complicated, but many investors feel that the advantages outweigh the extra work. In fact, Self-Directed IRA's are late to the party for Investors with Checkbook IRA's and Solo 401k's have been investing in Crypto for some time.

The popularity has caught the eye of most custodians and large investment houses so they are developing IRA's and Custodian controlled Solo 401k's that have Crypto in them.

Frequently Asked Questions

1. What exchanges can I use to invest in Cryptocurrency?
2. What Cryptocurrency Assets can I Buy?
3. When I give the Custodian the value of my LLC how do I value My cryptocurrency assets?
4. Can I invest in Computers for Cryptocurrency Mining?
5. Can use my Cryptocurrency assets to or use as collateral for a loan to invest in other Cryptocurrency assets?
6. Is Staking permitted?
7. Can I Invest IN NFT's?

1. What exchanges can I use to invest in Cryptocurrency?

You can use any exchange you want or even buy from private parties as long as they are not a disqualified person (1st line relative or in-law). If you use an exchange the transaction records will be readily available, but if you buy or sell with an individual be sure to keep good transaction records and receipts. We are very partial to Kraken for one of our clients is a Senior account manager and will assist our clients in account setup.

When setting up an account with an exchange be prepared for confusing instructions and the lack of human interaction available. We are asked how long these accounts take to open and it really depends on the exchange and how prepared you are with documents. It can be from 2 or 3 days to a month. Our Administration Officer sends these instructions to our clients for their Checkbook IRAs

To get started, you **must** open the exchange/crypto account in the name of the LLC (Institutional account). You cannot use a previously setup personal crypto account or wallet for the LLC. Popular crypto choices are Kraken, Gemini, CoinMe, Coinbase, Bitstamp, etc. Please do your own due diligence when selecting a crypto exchange.

Regardless of where your Crypto Account is set up, we recommend having the following on file to help meet your documentation requirements.

1) Bank Letter for Business Proof of Residence

Once you have setup your LLC checking account, ask your Bank to draft a Letter stating that the LLC has an account with them. The Bank Letter should include Bank Logo, LLC Name, Address/Should Match LLC Address on Filings, Manager Name, Current Date.

2) Custodian Letter for LLC Structure Confirmation

Crypto companies may ask for a Certificate of Trust or some proof of the ownership structure of the Check Book IRA. They are using the wrong terminology and should refer to the Operating Agreement. However, to speed things along, ask your Custodian to draft a Letter stating that they custody an IRA on your behalf and that the IRA owns 100% of an asset, the LLC (make sure to have them spell out the LLC's name). The Custodian Letter should include Custodian Logo, Your IRA Name/Title, LLC Name, Current Date.

For the Solo 401(k) some people set up an LLC owned by the Solo 401(k) to do their Crypto Trading and the above instructions would be the same. If you are going to just use the Solo 401(k) to open the account you would need **Number 1**. Above and your **Adoption Agreement**.

2. What Cryptocurrency Assets can I Buy

As of today, all Crypto assets are in play. I say, “as of today,” for Crypto assets are like the Wild West and rules are being made up as they go along. At some time, Bitcoin and other coins might be recognized as a currency and not property then taxation rules could change.

3. When I give the Custodian the value of my LLC how do I value My cryptocurrency assets?

Crypto assets are very volatile and I’ve suggested that people use the value as of 11:59 PM 12/31. – Any exchange will have this value and if holding some cryptocurrency asset not readily traded find some source of value for that asset. While the real scrutiny comes when you convert a traditional IRA to a ROTH or take disbursements, you don’t want to be sloppy with record keeping or reporting.

4. Can I invest in Computers for Cryptocurrency Mining?

The Answer today is yes. There are different mining initiatives where you invest in a percentage of a mining setup or a computer someone else is running. You can also run your own mine, but there are opinions that running the mine yourself could be viewed as a business and trigger UBIT tax. Nothing in this arena has been tested in the tax courts, consequently it’s an individual choice to push the envelope or walk the middle of the road. Lastly remember all monies to purchase computers and assets must come from plans bank account and no personal funds be used.

5. Can use my Cryptocurrency assets to or use as collateral for a loan to invest in other Cryptocurrency assets?

At this time, it's a resounding YES. A cryptocurrency-backed loan uses digital currency as collateral, similar to a securities-based loan. The basic principle works like a mortgage loan or auto loan — you pledge your crypto assets to obtain the loan and pay it off over time. You can get this type of loan through a crypto exchange or crypto lending platform. While you retain ownership of the crypto you've used as collateral, you lose some rights, such as the ability to trade it or use it to make transactions. Also, if the value of your digital assets drops significantly, you may end up owing back much more than you borrowed should you default on the loan. People may consider crypto loans because of the benefits they provide and because they have no intention to trade or use their crypto assets in the near future. The acronym HODL, which stands for hold on for dear life, is a common refrain in crypto-focused online forums.

6. Is Staking permitted?

Yes, it is. Staking cryptocurrencies is a process that involves buying and setting aside a certain number of tokens to become an active validating node for the network. By simply holding these coins, the buyer becomes an important piece in the network's security infrastructure and is compensated accordingly.

Staking income is offered in the form of interest paid to the holder, while rates vary from one network to the other depending on several factors including supply and demand dynamics.

As the number of POS-based networks continues to grow, new alternatives to stake crypto have emerged including the launch of group staking, also known as staking pools, staking providers, and cold staking.

These initiatives aim to democratize access to opportunities in the staking space to retail investors who hold a small number of tokens of a certain blockchain.

7. Can I Invest IN NFT's?

NFTs (or “non-fungible tokens”) are a special kind of crypto asset in which each token is unique — as opposed to “fungible” assets like Bitcoin and dollar bills, which are all worth exactly the same amount.

Because every NFT is unique, they can be used to authenticate ownership of digital assets like artworks, recordings, and virtual real estate or pets. They can be Invested in as any other Crypto currency or asset and same rules apply.

Cryptocurrency investments, such as Bitcoins, are risky and highly volatile. Any retirement account investor interested in using retirement funds to invest in cryptocurrencies should do their diligence and proceed with caution. All statements made are as of August 27th 2021 and could change at any time.



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