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Welcome to the June 2024 issue of Peapack Private Planning Quarterly. In this issue, our authors discuss a range of topics. First, we cover the taxation of sales of cryptocurrency – what happens when you sell it? Second, the Corporate Transparency Act and its goal of addressing illicit corporate identity and activity is discussed. We offer an explanation of behavioral finance and how psychological factors influence financial decisions and market behavior. Lastly, read about downsizing for the transition into retirement by moving a smaller home or reducing expenses. Please explore the provided articles for more in-depth information on these topics and reach out to any of our authors with questions and feedback.

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The Taxation of Cryptocurrency and Other Digital Assets

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Virtual currency is treated as property, not as currency.

If you take a close look at your personal income tax return, you will see that front and center on page one of Form 1040 is the following question:

Digital Assets - At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? Yes or No?

Why is the IRS so concerned with digital assets that this question comes directly under your name, address, social security number and filing status? Tax dollars! They are trying to capture unreported income. Beginning in 2024, parties that facilitate the transfer of cryptocurrencies on behalf of another person, as a broker, must file Form 1099-B to report the proceeds of a sale or exchange transaction. This will greatly increase tax compliance in this area.

The IRS defines virtual currency as a digital representation of value that is not a representation of U.S. or foreign currency and that functions as a medium of exchange. Bitcoin, the pioneer of digital currencies, emerged in 2009 as the first convertible virtual currency. This means that it has an equivalent value in real currency or acts as a substitute for real currency. Its underlying technology, blockchain, has since paved the way for a multitude of other cryptocurrencies, each with its own unique features.

NFTs (non-fungible tokens) are also digital assets - these are digital collectibles that have artists, creators, and collectors buzzing with excitement. Whether it's a pixelated artwork, a rare digital witch, or a snippet of a famous tweet, NFTs have redefined ownership and proven that scarcity need not be physical. Are they just a fleeting trend? Regardless, let's explore the tax implications of owning, receiving, or selling digital assets.

The Taxation of Digital Assets:

Virtual Currency as Property:

- In 2014, the IRS issued guidance that for federal tax purposes, virtual currency is treated as property, not as currency. This means that general tax principles applicable to property transactions apply to transactions involving virtual currency.

Examples of Digital Asset Transactions:

- Receiving Digital Assets:
  - Received digital assets as payment for property or services provided.
  - Received digital assets resulting from a reward or award.
  - Received new digital assets resulting from mining, staking, or similar activities.
  - Received digital assets resulting from a hard fork, which is a term that refers to a change in the blockchain network that results in a split creating two blockchains, each working independently. A more detailed explanation of this is beyond the scope of this article.
- Disposing of Digital Assets:
  - Disposed of digital assets in exchange for property or services.
  - Disposed of a digital asset in exchange or trade for another digital asset.
  - Sold a digital asset.
  - Otherwise disposed of any other financial interest in a digital asset.
- You have a financial interest in a digital asset if you:
  - Are recorded as the owner of a digital asset.
  - Have an ownership interest in an account that holds one or more digital assets.

Calculating Gain or Loss:

- When you sell or exchange virtual currency, you'll need to calculate the gain or loss which is the excess of what you sell it for over what you paid for it (cost basis).
- Keep accurate records of your transactions, including dates, amounts, and descriptions.

Hard Forks and Airdrops:

- If you receive new virtual currency due to a hard fork or airdrop, it's considered income that is taxed at ordinary income tax rates.
- The fair market value of the new coins at the time of receipt becomes your cost basis.

Holding Period:

- The holding period for virtual currency determines whether it's short-term or long-term capital gain. Gains on assets that were held for one year or less are short-term and are taxed using ordinary income rates. Long-term gains have preferential rates.

Reporting on Tax Forms:

- Report your virtual currency transactions on Schedule D (Capital Gains and Losses) of your tax return.
- Use Form 8949 to provide details of each transaction.

Many aspects of the taxation of cryptocurrency and NFT transactions are still unknown. In June of 2023, the Joint Committee of Taxation issued a white paper to assist Congress in identifying these uncertainties. The applicability of the wash sales rules, the constructive sale rules, and the valuation of charitable contributions of digital assets are a few of these issues. The section of the white paper on the wash sale rules concludes that digital assets do not fall under the rules as they are not considered securities. Similarly, the report acknowledged that digital assets are not within the scope of the constructive sale rules.

Remember that tax laws can be complex, and they may vary based on your specific circumstances. Always consult a tax professional to ensure compliance with the latest regulations and to optimize your tax strategy.

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Downsizing in Retirement, or 'Rightsizing" Your Future

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Downsizing in retirement is a significant decision that can impact your lifestyle, finances, and overall well-being. It's a process that involves more than just moving to a smaller home; it's about identifying what is most important to you and how to maximize your enjoyment while being comfortable. Downsizing in retirement can be a liberating experience, offering freedom and flexibility, but it also poses potential challenges. In this article, we'll explore the benefits of downsizing in retirement, practical tips for making the transition smoother, and how to overcome common obstacles along the way.

Downsizing in retirement offers a range of benefits that can enhance your quality of life:

- **Financial Freedom:** One of the primary reasons for downsizing is to reduce expenses. By moving to a smaller home, you can significantly lower your mortgage or rent payments, property taxes, utility bills, and maintenance costs. This can free up more money for travel, hobbies, or building your retirement savings.
- **Simplified Lifestyle:** Downsizing forces you to declutter and to simplify your possessions, which can lead to a more organized way of life. Letting go of excess belongings can be liberating and could create space for the things that truly matter to you, like space to entertain or to set up a play area for grandchildren.
- **Improved Accessibility:** A smaller home often means fewer stairs and less maintenance, making it easier to navigate as you age. Accessibility features such as wider doorways, grab bars, and step-free entrances can also be incorporated into downsized properties, ensuring that your home remains comfortable and safe for years to come. After a long career, raising a family, and maintaining a home, it is time to sit back and smell the roses.
- **Community Engagement:** Downsizing can create new opportunities to live in communities specifically designed for retirees. These communities often offer amenities such as fitness centers, social clubs, and organized activities, enabling your new neighbors to become new friends.

Practical Tips for Downsizing - Here are some practical tips to help you navigate the transition smoothly:

- **Start Early:** Downsizing is not something that can happen overnight. Start the process well in advance of your retirement date to give yourself plenty of time to sort through your belongings, sell or donate items you no longer need, determine what type of property and the location you are interested in, and find the right smaller home.
- **Measure Your New Space:** Before you move, measure the rooms in your new home and plan your furniture layout accordingly. This will help you determine which items you can take with you and which ones you'll need to part with. Some people may be looking for a reason to freshen up their living space and view relocating as a fresh start, whereas others may struggle to leave behind their possessions that are near and dear to them.
- **Stay Emotionally Resilient:** Downsizing can stir up a range of emotions, from nostalgia for your old home to anxiety about the future. Practice self-care and lean on your support network for emotional support during this transition.

Downsizing forces you to declutter and to simplify your possessions, which can lead to a more organized way of life.

- **Consult with Professionals and Those You Trust:** Reaching out to reputable real estate professionals, financial advisors, moving companies, and friends and family can help guide you through this lifestyle change.

Overcoming Common Obstacles:

- **Timing is Crucial:** Factors like housing values, real estate market strength, interest rates, and your lifestyle goals play a role. This is especially relevant as both home values and mortgage rates remain elevated.
- **Attachment to Possessions:** It's natural to feel attached to your belongings, especially if they hold sentimental value. However, holding onto too many things can weigh you down physically and emotionally. Focus on keeping only the items that truly enhance your life and let go of the rest.
- **Fear of Change:** Moving to a new home and downsizing your possessions can be intimidating, particularly if you've lived in the same place for many years. Remind yourself of the positive aspects of downsizing and the new opportunities it will bring, such as financial freedom and a simpler lifestyle.
- **Concerns About Space:** Downsizing doesn't necessarily mean sacrificing space or comfort. With careful planning and organization, you can make the most of your smaller home and create a cozy and inviting living environment that meets your needs.
- **Establishing Associated Costs:** Determining the potential transaction costs of selling your current home, identifying new mortgage or rent costs, and pricing moving costs are all factors that should be considered when thinking about downsizing.

Downsizing in retirement is a significant life transition that requires careful planning, emotional resilience, and managing expectations. By focusing on the benefits, following practical tips, and overcoming common obstacles, you can successfully navigate the downsizing process and enjoy a more fulfilling and rewarding retirement. Embrace this opportunity to "rightsize" your life and create a space that reflects your values, priorities, and dreams for the future.

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Understanding Behavioral Finance: How Do We Make Our Financial Decisions?

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Every day, the average person makes around 35,000 decisions. These decisions range from choosing what to wear to work or what to bring for lunch. While it may feel like we are wracking our brains every morning pondering between wearing the blue pants or the tan slacks, it turns out that many of these everyday decisions happen automatically, or subconsciously, based on our preconceived notions of good and bad. You may ask yourself, what about more important decisions such as choosing where to live or what stock to purchase; there must be some rational deliberation that goes into making these decisions. You may be surprised to find out that this is not always the case. Harvard professor Gerald Zaltman states, "95% of our purchase decisions occur in the subconscious mind." This begs the question; how do we make our financial decisions?

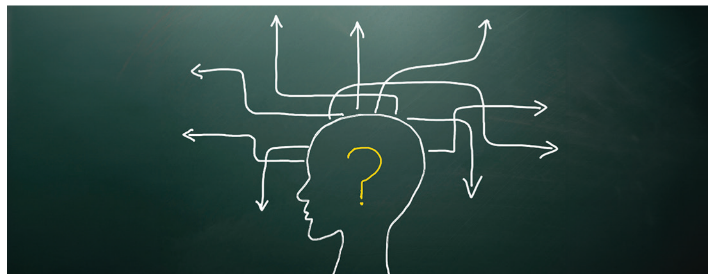
The emergence of a new field of study called behavioral finance, has brought this very question to the forefront. Behavioral finance challenges the long-standing belief of traditional finance, that states, in an efficient market, all investors make rational decisions. The study of behavioral finance asks us to reconsider this traditional theory by highlighting the significant role that human psychology plays in shaping our investment decisions. For us to gain a deeper understanding of our minds, and to make more informed investment decisions, we must further examine the various subconscious biases that factor into our decision-making processes.

- **Overconfidence:** Investors will often overestimate their ability to have success in the stock market. According to a Financial Industry Regulatory Authority (FINRA) study, 64% of investors rated their knowledge of investments as above average. After participating in a quiz that tests financial literacy, FINRA found that the participants who claimed to be above average investors, scored worse than those who were not as confident in their abilities as an investor. This natural tendency to be overconfident may stem from the ability to access a wealth of information online or just simple luck with successful investments in the past. Overconfidence bias may lead investors to make risky investment decisions and disregard expert advice that contradicts their own beliefs.

- **Anchoring Bias:** Anchoring occurs when investors rely too heavily on the initial information that they receive, such as the historical price of a stock. Anchoring causes investors to solely fixate on this reference point, without looking at the investment objectively. For example, if you purchased a stock well below the historic high price, you may only focus on that fact that the price could rise back to the high, and disregard other indicators that state otherwise.

- **Recency Bias:** Recency bias is a tendency where investors put too much emphasis on recent market events and extrapolate them into the future. For example, let's say stock XYZ far outperformed the S&P 500 index in 2022 and 2023. Investors may be quick to purchase that stock in 2024, under the assumption that the stock price of XYZ was a sure bet to continue to rise based on its recent success. Unfortunately, in this hypothetical scenario, XYZ's stock price dropped by 50% in 2024. Investors who purchased this stock in 2024 would have fallen for the trap of recency bias. It should be noted that accurately predicting future market movements using short-term trends is notoriously difficult, if not impossible.

- **Herd Mentality:** Herd mentality refers to the tendency to follow and to copy what other investors are doing. This bias often causes investors to avoid independent analysis due to their instincts telling them that the crowd must be right. One of the key drivers of herd mentality is the fear of missing out. When investors see others buying a particular stock, they may feel pressure to join the herd to avoid being left behind. Herd mentality does not only affect individual investors but can cause major problems for the whole market. Herd mentality often leads to exaggerated price movements and, in extreme cases, market bubbles and crashes.



While we are all vulnerable to the subconscious biases that drive our decision making, there are ways to overcome these negative tendencies. The first step towards overcoming these biases is by recognizing our own investment patterns. Chances are that, if you're reading this, you have already made the first step towards taking control of your decisions, by understanding the biases that influence you. The next step is to stay disciplined. Avoid impulsive decisions driven by emotional responses or short-term market fluctuations. The last step is to seek expert advice. Financial advisors can assist you with personalized guidance tailored to your unique financial goals and objectives. By following a gameplan, we can mitigate the complexities that drive our decision making and pave the road towards future financial success.

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The Corporate Transparency Act – Does it Apply to You?

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The enactment of the Corporate Transparency Act (CTA) is a pivotal moment in the United States's fight against financial crimes. Its primary objective is to establish 'transparency' in corporate ownership, a concept akin to unpeeling the layers of a Russian nesting doll, 'Matryoshka.' The United States is striving to enhance its understanding of both existing and newly-registered businesses, defined under the Act as "reporting companies." It's crucial to note that this move is a response to the need for the U.S. to align with other developed countries, ensuring that entities are not exploited for illicit activities.

…now is a good time to review the governing documents of your entities.

What does this mean for business owners?

Effective January 1, 2024, the CTA will require current and newly-registered businesses to provide information about their beneficial owners to the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN). The act defines a beneficial owner as someone who, either directly or indirectly, wields significant control over the entity or possesses or controls no less than 25% of the ownership interest. This could include individuals such as the business owners themselves, or executives who are authorized to act on behalf of the business. The following is to be reported to FinCEN: Full Legal Name, Date of Birth, Residential Address, and an identity document such as a passport or driver's license. Business owners must understand and meet this requirement, as failure to do so could result in significant penalties. A $500 per day penalty for businesses that are either current businesses that fail to file by the end of the year or new companies that fail to file within 90 days of creation.

Who are the beneficial owners of reporting companies owned or controlled by a trust?

Many businesses have ownership structures that include trust entities. Depending on the specific setup and corporate structure of a given business, a trust may, in whole or in part, own or control a business entity. However, since a beneficial owner must be an individual, a trust entity itself cannot qualify as a beneficial owner.

In regard to control-related considerations, a trustee may be considered to have "substantial control" of a reporting entity if they have authority over the appointment or removal of any senior officer of a given reporting company. Additionally, "substantial control" may include trustees who are responsible for important decisions made by the reporting company. Either of these considerations may qualify a trustee as a beneficial owner for a trust-owned reporting company.

As far as ownership is concerned, the provisions of a specific trust agreement will dictate who may qualify as holding "ownership interests" in a reporting entity through a trust vehicle. While each specific trust document is unique, some of the most common scenarios include 1) A trustee or other individual with the authority to dispose of trust assets; 2) A beneficiary who is the sole permissible recipient of trust income and principal or who has the right to demand a distribution or withdraw substantially all trust assets; or 3) A grantor or settlor who has the right to revoke or otherwise withdraw trust assets.

While the above are the most common considerations, the list is far from exhaustive. For specific questions related to provisions a given trust document, it is always best to refer to an attorney who specializes in Trust and Estate matters.

Are all businesses required to file?

While the CTA applies to all corporations, partnerships, and limited liability companies, it does provide for exemptions. Specifically, it provides for 23 exclusions, the majority of which already serve heavily regulated businesses, i.e., banks, insurance companies, investment companies, etc. While finding our entity type in those exclusions would be a relief, it's essential to understand that the law was written specifically to include as many companies as possible. One exclusion business owners could find themselves in is the "Large Business" exemption. This specific exclusion looks at a business that employs more than 20 employees on a full-time basis, has receipts over $5 million, and has a physical presence within the United States. What about a business that is no longer operating but holds $100 in a lingering checking account, is it required to file? Possibly! Our recommendation is to consult your legal counsel to understand your options further and alleviate any concerns.

Recent updates and looking forward:

On March 1, 2024, the US District Court for the Northern District of Alabama ruled that the CTA is unconstitutional because it exceeded the enumerated powers of Congress.

As a matter of background, the plaintiffs brought this action to challenge the constitutionality of the CTA in that the mandatory disclosure rules exceeded the authority of Congress under Article I of the Constitution, and it also violated the First, Fourth, Fifth, Ninth and Tenth Amendments. In the end, the plaintiffs were seeking an injunction preventing the government from enforcing the reporting requirements of the CTA against them.

Conversely, the government argued that the CTA was constitutional on several grounds including that Congress 1) has the power to regulate commerce; 2) may oversee foreign affairs and national security; and 3) the CTA is a necessary and proper exercise of its taxing power.

The Court observed that the CTA applied to all State-created entities, whether they were engaged in commerce or not. The Court held that the Commerce Clause does not allow Congress to regulate an entire class of entities just because some of them use the channels and instrumentality of commerce. In fact, the word "commerce" is nowhere to be found in the CTA.

The Court also held that the federal mandate to gather ownership information from these State-created entities to combat potential foreign money laundering was not sufficient to justify Congress to govern these entities under its power to regulate foreign affairs. Stated differently, the Court ultimately reasoned that the connection between criminal activity and the incorporation of a business is too attenuated to be constitutional.

Finally, the Court held that the CTA's civil penalties are not a tax because they were not paid to the Treasury, they are not subject to income thresholds, and they were not enforced by the IRS.

Once the Court determined that Congress lacked the constitutional authority to enact the CTA as currently drafted, it declined to consider whether it violated the First, Fourth, and Fifth Amendments. It also specifically held that the government is enjoined from enforcing the CTA against these plaintiffs.

On March 4, 2024, the government announced that it will not currently enforce the CTA against the plaintiffs in this case, which include "Isaac Winkles, (the) reporting companies for which Isaac Winkles is the beneficial owner or applicant, the National Small Business Administration and its members." The government then subsequently filed a notice to appeal the District Court's decision to the Eleventh Circuit and announced that other companies are still required to comply with the reporting requirements of this legislation.

It is not only important to keep an eye on the further developments of this case, but there are at least three other challenges that have been filed in the District Courts of Ohio, Michigan, and Maine.

Also consider that the CTA was enacted with bipartisan support, so enacting revisions to comply with the Constitution is extremely plausible. As suggested by the Court, one option is to subject an entity to the CTA disclosure requirements only when they engage in commerce.

Final thoughts:

In summary, whether the CTA is repealed or modified, now is a good time to review and understand the provisions of the governing documents of your entities. This includes ensuring that the director and officer designations are current and accurate and that all beneficial owners have been properly identified. If the entity is held in a trust, make sure to review the terms of the trust document to ensure the current and future beneficiaries are easily identified. Additionally, all assets owned by the trust should be properly documented.

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