

IRS Issues New Guidance on Cryptocurrencies for the First Time in Four Years

On October 9, 2019, IRS released Revenue Ruling 2019-24, 2019-44 IRB 1,¹ which provides new guidance on the Service's handling of cryptocurrencies and is the first of such guidance to be released since March 2014 when IRS issued Notice 2014-21.² The ruling was issued after prodding from a bipartisan congressional coalition.³ The ruling, and attached Frequently Asked Questions ("FAQs"),⁴ address three issues identified by members of Congress as being in "urgent need" of IRS clarification:⁵ (i) provide some clarity as to IRS' taxation of cryptocurrency forks and detail methods for (ii) calculating and (iii) assigning cost basis. When announcing the revenue ruling's release, IRS Commissioner Chuck Rettig stated that "IRS is committed to helping taxpayers understand their tax obligations in this emerging area," and that "the new guidance will help taxpayers and tax professionals better understand how longstanding tax principles apply in this rapidly changing environment."⁶

Revenue Ruling 2019-24, 2019-44 IRB 1 ("Crypto Ruling" or "Ruling") explains that a hard fork occurs when a cryptocurrency updates its protocol to permanently divert from the existing distributed ledger.⁷ Hard forks can be used to create a new cryptocurrency on a new distributed ledger, that exists in addition to the pre-existing ledger. After a hard fork has been implemented, fork creators will sometimes initiate an airdrop and provide units of the new cryptocurrency to addresses owning the pre-existing cryptocurrency. Recipients of the airdrop have both the new cryptocurrency as well as the pre-existing cryptocurrency.

Crypto Ruling Clarifies Airdropped Currency Created by Hard Forks is Taxable Gross Income

Before the publication of the Crypto Ruling, it was unclear whether cryptocurrency airdropped after a hard fork would be considered taxable gross income under Internal Revenue Code Section 61. However, the Ruling makes clear that new cryptocurrency airdropped after the creation of a hard fork becomes taxable once a taxpayer is capable of exercising dominion over the new cryptocurrency. The Ruling defines dominion as having "the ability to transfer, sell, exchange, or otherwise dispose of the cryptocurrency."⁸ The Ruling goes on to establish that, if a taxpayer can exercise dominion over the new airdropped currency, the airdropped

¹ Revenue Ruling 2019-24, 2019-44 IRB 1, available at <https://src.bna.com/LYN>.

² 2014-16 IRB 938.

³ Letter from Congress to Charles P. Rettig, Commissioner, IRS (April 11, 2019), available at https://emmer.house.gov/_cache/files/3/0/30fe0824-d905-403e-b1a5-1d7d6a03d7ab/59C7EB5D5798976182F614C1C62CED53.2019-irs-letter-final.pdf.

⁴ 2019-24, 2019-44 IRB 1 FAQ. available at <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>.

⁵ Letter from Congress to Charles P. Rettig, Commissioner, IRS (April 11, 2019).

⁶ *Virtual currency: IRS issues additional guidance on tax treatment and reminds taxpayers of reporting obligations*, IR-2019-167, IRS (October 9, 2019), available at <https://www.irs.gov/newsroom/virtual-currency-irs-issues-additional-guidance-on-tax-treatment-and-reminds-taxpayers-of-reporting-obligations>.

⁷ Revenue Ruling 2019-24, 2019-44 IRB 1, <https://src.bna.com/LYN>.

⁸ *Id.* at 3.

currency will be taxed as gross income pursuant to Section 61, with its basis being its market value at the time the taxpayer established dominion over the new currency.⁹

FAQs Detail Methods for Calculating and Assigning Cost Basis, and More

The FAQs¹⁰ provides 43 responses to questions related to the taxation of cryptocurrencies, ranging from the calculation of basis to the determination of the fair market value. The FAQs apply more broadly than the Ruling, in that they apply to all cryptocurrency, as opposed to cryptocurrency received by airdrop after a hard fork. The FAQs underline that IRS is applying traditional principles of taxation to what many consider a new form of property: the bases for many of these answers are publications previously published by IRS that have no specific references to cryptocurrency.

Some of the most important takeaways from the FAQs are:

- Answer 7: Cost basis is the amount spent to acquire the cryptocurrency, including fees, commissions and other acquisition costs in U.S. dollars. A taxpayer's adjusted basis is the cost basis increased by certain expenditures and decreased by certain deductions or credits in U.S. dollars.¹¹
- Answers 8–12: Cryptocurrency received as compensation in exchange for services rendered is treated as taxable income.¹² This compensation is subject to federal income tax for the recipient of the compensation¹³ and employment taxes for the employer.¹⁴ The taxable compensation is the fair market value of the cryptocurrency at the time it is received as compensation.¹⁵ A taxpayer's basis for cryptocurrency received in exchange for services performed is the fair market value of the services at the time the services were performed.¹⁶
- Answers 13-19: When paying for services or property with cryptocurrency, the taxpayer will incur a capital gain or loss, calculated as the difference between the fair market value of the services or property received, and the adjusted basis in the cryptocurrency exchanged.¹⁷
- Answers 30 & 31: Cryptocurrency received as a gift will only be recognized as income when it is sold, exchanged, or otherwise disposed.¹⁸ The basis rules for recognition differ if the disposal is at a gain or a loss. If disposed at a gain, the recipient's basis is the donor's basis increased by any gift tax paid by

⁹ *Id.* at 5.

¹⁰ Frequently Asked Questions on Virtual Currency Transactions, IRS, available at <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>.

¹¹ *Id.* at A7.

¹² *Id.* at A8.

¹³ *Id.* at A8 & A9.

¹⁴ *Id.* at A10.

¹⁵ *Id.* at A11.

¹⁶ *Id.* at A12 (referring to IRS Publication 551 for additional information on calculation of basis of assets).

¹⁷ *Id.* at A13-A15 (services), A16-A19 (property).

¹⁸ *Id.* at A30.

donor.¹⁹ If disposed at a loss, the recipient's basis is the lower of the donor's basis or the fair market value of the cryptocurrency at the time received as a gift.²⁰

- Answers 33 & 34: Cryptocurrency gifts to a charitable organization will not be recognized as income, gain, or loss. Such donations entitle the taxpayer to a charitable contribution deduction.²¹ If the taxpayer has held the cryptocurrency for more than one year, the value of the deduction is the FMV of the cryptocurrency at the time of the donation. If the taxpayer has held the currency for one year or less, the value of the deduction is the lower of the taxpayer's basis or the FMV at the time of the donation.²²
- Answer 43: Taxpayers are required to maintain detailed records of cryptocurrency holdings and trades to support positions taken on tax returns.²³

Guidance May Be Applied by IRS Retroactively

Because IRS has identified the Ruling and FAQs as merely applying “longstanding tax principles” to the field of cryptocurrency, and because the guidance has no effective date²⁴ the guidance will likely apply retroactively. For taxpayers and practitioners, this creates the likelihood that the Ruling spurs a spate of remediation for non-compliance with the new Ruling, and/or voluntary corrections. While IRS has promised to release additional guidance on cryptocurrency, it is not clear when—and in what form—that guidance will come.²⁵ All will need to consider how broadly to apply the new Ruling. For example, taxpayers and practitioners will need to weigh whether to apply the principles contained in the Ruling to airdropped cryptocurrency received for a reason other than a hard fork.

¹⁹ *Id.* at A31.

²⁰ *Id.*

²¹ *Id.* at A33-A34

²² *Id.* at A34.

²³ *Id.* at A43.

²⁴ *Supra* note 6.

²⁵ See Joshua Rosenberg, *Crypto Compliance Guidance in the Works, Top IRS Atty Says*, Law30 (Oct. 17, 2019), available at https://www.law360.com/tax/articles/1210498/crypto-compliance-guidance-in-the-works-top-irs-atty-says?nl_pk=d3472c91-fb0b-4005-81ba-ce7ef95128e4&utm_source=newsletter&utm_medium=email&utm_campaign=tax (reporting on statements made by IRS Chief Counsel Michael Desmond on October 17, 2019).