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CLIENT ALERT

IRS Releases First Cryptocurrency Tax Guidance Since 2014

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On October 9, 2019, the IRS released its first guidance on the taxation of cryptocurrency since 2014. This guidance includes a Revenue Ruling stating that “hard forks” of cryptocurrency do not create taxable income if the holder does not receive new cryptocurrency as a result of the hard fork. A “hard fork” occurs when changes to a distributed ledger underlying a cryptocurrency result in a split from the original distributed ledger, which may result in the creation of new cryptocurrency on the new ledger. Hard forks are sometimes followed by “airdrops” - a distribution of cryptocurrency units to the distributed ledger addresses of multiple taxpayers, in which a holder does receive new cryptocurrency for free. The Revenue Ruling states that an airdrop results in taxable income when the holder can exert dominion and control over the new cryptocurrency, and the holder’s basis will be the fair market value of the new cryptocurrency. The IRS also released a FAQ document that answers other questions regarding the tax treatment of cryptocurrency and affirms the IRS’s position, first stated in 2014 guidance, that cryptocurrency is treated like property for tax purposes. For example, the FAQs state that, as with other property held for investment, holding cryptocurrency for one year or less will trigger short term capital gains and losses and that cryptocurrency received in exchange for services are wages triggering withholding obligations.

IRS guidance on cryptocurrency has been sparse and we note that hard forks of Bitcoin occurred as far back as late 2014 (with the advent of Bitcoin XT). The most successful fork of Bitcoin was Bitcoin Cash in August 2017, followed by Bitcoin Gold in October 2017. The public and government officials welcome clarity on the IRS’s position on certain cryptocurrency reporting issues, albeit 5 years after the first hard fork. This latest release is one small part of a larger enforcement campaign by the IRS that includes training its staff on these issues, issuing “soft letters” to suspected holders of cryptocurrency, and increasing IRS Criminal Investigation’s focus on cryptocurrency investigations. It is hoped that the IRS and Department of Justice will not apply the new guidance documents retroactively. Moreover, an Executive Order also issued on October 9, 2019, (Promoting the Rule of Law Through Improved Agency Guidance Documents) states explicitly that “it is the policy of the executive branch, to the extent consistent with applicable law, to require that agencies treat guidance documents as non-binding both in law and practice.” As sub-regulatory guidance documents, the Revenue Ruling and FAQ (as opposed to the legal analysis therein) are not owed a high level of deference by courts, and therefore the practical and legal implications of such guidance is uncertain.

Although these documents clarify the IRS’s positions with regard to some issues, others remain open. The evolution of cryptocurrency products and markets has far outpaced the IRS’s issuance of guidance in this space.

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