

New Cryptocurrency Guidance

October 22, 2019

On October 9, 2019, the IRS released new guidance on virtual currency transactions in the form of Frequently Asked Questions (“FAQs”) and Revenue Ruling 2019-24, which specifically addressed the recognition of income resulting from a “hard fork” of a cryptocurrency. This long-awaited guidance follows the IRS announcement that it began mailing “educational letters” to more than 10,000 taxpayers in July 2019. The release of this guidance is particularly timely in light of the fact that the early draft of the Schedule 1 of the 2019 Form 1040 indicates that the taxpayers will be required to answer a direct question regarding whether or not they engaged in any virtual currency transactions during the taxable year.

The new virtual currency FAQs expand upon the guidance contained in Notice 2014-21 by providing answers to more nuanced questions, such as the tax implications of receiving a bona fide gift of cryptocurrency, and the manner in which gain or loss is calculated when disposing of such gift. The various examples of using cryptocurrency to acquire goods or services contained in the FAQs are generally consistent with the IRS’s positions announced in Notice 2014-21, with several important clarifications. Importantly, the FAQs clarify that taxpayers may choose a specific unit of cryptocurrency sold or disposed of in a transaction in calculating gain or loss from such disposition. To do so, taxpayers must document the specific unit’s unique digital identifier (e.g., private key, public key, and address) or have records showing the transaction information for all units of specific cryptocurrency held in a single account, wallet, or address. This guidance may help taxpayers with appropriate records mitigate their current capital gains. If a specific unit of virtual currency used in the transaction is not identified, the taxpayer must use the first-in, first-out method of accounting in calculating gain or loss.

In Revenue Ruling 2019-24, the IRS analyzes the tax ramifications of “hard forks” in cryptocurrencies. A “hard fork” occurs when there is no consensus among nodes — the devices participating in the block chain — regarding new operating rules. This creates a permanent divergence in the block chain where some nodes continue following the old protocol and others follow the new protocol — e.g., Bitcoin and Bitcoin Cash. Revenue Ruling 2019-24 provides that a taxpayer must recognize ordinary income when he or she receives an airdrop of new cryptocurrency following a hard fork. If the taxpayer is able to exercise dominion and control over the new cryptocurrency received, the taxpayer must include as gross income the fair market value of the new cryptocurrency at the time it is recorded on the distributed ledger. The IRS’s position creates a delicate situation for any taxpayers who did not recognize as gross income on their previously filed returns the fair market value of new cryptocurrency received from a hard fork. Taxpayers facing this situation, especially those that received an educational letter from the IRS, should discuss with their tax advisors whether the newly released guidance materially affects their previously filed tax returns.

Furthermore, the IRS has yet to release details on its ongoing criminal enforcement efforts, and its planned civil compliance approaches in coming years, with respect to the cryptocurrency transactions. Taxpayers engaged in cryptocurrency transactions, especially those who have received a communication from the IRS, should consult with professional tax advisors. For taxpayers who have material amounts of income that they failed to recognize in prior years there may be steps available that could mitigate risks of criminal or civil IRS action.

[Caplin & Drysdale](#) offers extensive experience in [criminal and civil tax controversy](#). Our lawyers regularly advise individuals and organizations facing criminal and civil tax exposure, including in connection with the cryptocurrency transactions.

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