Image not found or type unknown

News & Insights

New Cryptocurrency Tax Consequences

December 11, 2019

By: David T. Potts

The Journal Record

https://journalrecord.com/2019/12/11/gavel-to-gavel-new-cryptocurrency-tax-consequences/

The Internal Revenue Service ("IRS") is continuing to focus its effort to enforce tax compliance in the area of virtual currency by issuing new guidance to put taxpayers on notice of their tax obligations for tax year 2019. On October 9, 2019, the IRS issued Revenue Ruling 2019-24, concerning the income tax consequences of cryptocurrency hard forks and airdrops.

Virtual currency is a digital representation of value that functions as a medium of exchange. Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as blockchain, DAG or Tempo. A hard fork occurs when a cryptocurrency undergoes a radical change to the protocol of its distributed ledger resulting in a permanent diversion from the existing distributed ledger. In other words, a hard fork creates from one cryptocurrency a new cryptocurrency on a new distributed ledger in addition to the original cryptocurrency on the original distributed ledger. An airdrop is a means of distributing a cryptocurrency to a taxpayer's distributed ledger free of charge to increase the currency's user base causing a wider disbursement of the cryptocurrency. A hard fork followed by an airdrop results in the distribution of units of a new cryptocurrency to the holders of the original cryptocurrency.

Revenue Ruling 2019-24 addresses: (1) whether a hard fork of cryptocurrency creates taxable income if the taxpayer does not receive units of the new cryptocurrency, and (2) whether a hard fork with an airdrop creates taxable income when the taxpayer receives units of the new cryptocurrency. In its analysis, the IRS focuses on whether the taxpayer has "dominion and control" over the new cryptocurrency after a hard fork. Revenue Ruling 2019-24 holds that: (1) a taxpayer does not have income as a result of a hard fork if the taxpayer does not actually receive units of the new cryptocurrency since the taxpayer does not have dominion and control over the new cryptocurrency, and (2) a taxpayer does have income as a result of an airdrop following a hard fork as long as the taxpayer receives units of the new cryptocurrency and has dominion and control over the new cryptocurrency.

However, Revenue Ruling 2019-24 leaves many questions unanswered. For instance, the ruling does not provide clear guidance on how significant the changes resulting from a hard fork must be in order to rise to the level of taxability. Hopefully, the IRS will provide further guidance on cryptocurrency in the near future to make more taxpayers aware of the income tax treatment of virtual currencies.

Attorneys

- David T. Potts

Practices

- Tax