Recent IRS Guidance on Bitcoin and Other Virtual Currencies

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A Brief History Of How We Got Here

• 2009 - Bitcoin White Paper Published

• May 22, 2010 - Someone Orders Two Papa John Pizzas for 10,000 BTC (then BTC had $.05 market value vs $70,000,000 at today’s valuation)

• April 14, 2014 IRS Issues Notice 2014-21 (BTC Price $500 per BTC - Shot up from $100 to $1,000 in 2013 then collapsed by 50%)

• 2015 Ethereum was launched. Many other alt coins such as Monero, Tether, dogecoin are also in existence today

• 2017 Price explodes. Bitcoin hit a peak price of $19,000 in Dec 2017 Bitcoin collapses to $3,200 in Dec 2018. Currently in the $7,000 to $8,000 range. Bitcoin undergoes it’s most notable hard fork when Bitcoin Cash splits away

• As price increases so does number of developers. Some interesting aspects of the current market: stable coins, privacy coins, tracking/tax compliance programs, derivatives, potential ETF’s, etc, etc. New technologies continue to be created at a high rate

• October 2019 IRS releases RR 2019-24 as well as a series of FAQ’s
What We Need To Know From 2014-21

• 2014-21 was formatted as a series of FAQ’s to address novel virtual currency questions

• Virtual currencies are property

• No de-minims exceptions, standard basis rules apply, tax payments have to be made in US currency.
Revenue Ruling 2019-24

• Addresses the tax consequences of hard forks and airdrops

• Hard Fork - “A hard fork is unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger.”
Bitcoin

Keys Held Prior to Fork
Work With Bitcoin And
Bitcoin Cash

Change In Protocol

Bitcoin

Bitcoin Cash

Bitcoin Cash Key Won’t
Work With Bitcoin
Revenue Ruling 2019-24

Holding

• A Hard Fork followed by an Airdrop, or receipt of a new virtual currency, is an immediate taxable event. The recipient has ordinary income equal to the FMV of the virtual currency received at the time it was recorded on the distributed ledger. RR cites IRC 61(a)(3) for income, IRC 1011 for basis, IRC 451 for timing.

• Dominion and control is necessary. Revenue Ruling states that virtual currency holders who use exchanges that control the access (ie private keys) to the new virtual currency to not have gain until the exchange recognizes the new currency.
Revenue Ruling 2019-24
Assumptions

• A newly forked coin has value

• Dominion and control happens automatically as soon as the fork is recorded on the ledger

• The taxpayer has knowledge of the fork
What Still Needs Clarification

• Guidance on how value is determined
• Guidance on dominion and control
• Confirmation that 2019-24 is retroactive - Safe harbors for taxpayers that took a position contrary to the holding?
• Guidance on tax implications for wallet providers
• Guidance on terminology
Valuation

• FMV is what a willing buyer will pay a willing seller if both have reasonable knowledge of the facts. The underlying asset in crypto is a small amount of computer storage on a number of unknown computers.

• How is value established for a newly created virtual currency? At the instant of creation is there a willing buyer and willing seller?

• How reliable are the prices quoted by third party exchanges?
Dominion and Control

• Does the taxpayer have to act in some way to demonstrate intent to assert dominion and control?

• Does the taxpayer’s technological ability impact this analysis?

• What about situations where the taxpayer may not want the forked coin?

• What about situations where there is no knowledge of the forked coin?
Wallet Providers

• Taxpayers that hold virtual currencies in exchange provided wallets get some relief from the instant recognition of income. Until the exchange recognizes the new virtual currency there is no accession to wealth. This means either 1. deferral of the gain or 2. complete exclusion if the wallet does not adopt the new currency.

• What about the wallet provider? Do they have to recognize the income that they do not pass along to the end user?
Phantom Income

• Assume Forked Coin A has a FMV of $50 at the moment of the fork. Three possible outcomes for the fork tax year only one possibility matches economic impact to tax impact

1. Price goes up and there is a sale - Economics match tax

2. No sale - Phantom Income

3. Price goes down and there is a sale - Mismatch in character
At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?  

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Virtual Currency FAQ’s

• Issued as simple FAQ’s. It was not placed in Notice format like 2014-21. Problem for taxpayers is that FAQ’s are not substantial authority and can be altered at any time - In fact some FAQ’s have already been revised between October and December 2019

• Many of the FAQ’s are relatively straightforward applications of Notice 2014-21 and property law

• However, some of the FAQ’s appear to introduce new concepts, or state conclusions that up until now were only assumptions
New Concepts?

- FAQ 1 - Notice 2014-21 stated that it only covers “convertible virtual currency (FINCEN definition requiring the ability to convert in and out of fiat currency) FAQ 1 states “The IRS uses the term “virtual currency” in these FAQs to describe the various types of convertible virtual currency that are used as a medium of exchange, such as digital currency and cryptocurrency. Regardless of the label applied, if a particular asset has the characteristics of virtual currency, it will be treated as virtual currency for Federal income tax purposes.”
• Q39 - How do I identify a specific unit of virtual currency? - A39. You may identify a specific unit of virtual currency either by documenting the specific unit’s unique digital identifier such as a private key, public key, and address, or by records showing the transaction information for all units of a specific virtual currency, such as Bitcoin, held in a single account, wallet, or address. This information must show (1) the date and time each unit was acquired, (2) your basis and the fair market value of each unit at the time it was acquired, (3) the date and time each unit was sold, exchanged, or otherwise disposed of, and (4) the fair market value of each unit when sold, exchanged, or disposed of, and the amount of money or the value of property received for each unit.
New Concepts

• Q40 - How do I account for a sale, exchange or other disposition of units of virtual currency if I do not specifically identify the units?  - A40. If you do not identify specific units of virtual currency, the units are deemed to have been sold, exchanged, or otherwise disposed of in chronological order beginning with the earliest unit of the virtual currency you purchased or acquired; that is, on a first in, first out (FIFO) basis.
Confirmations

- Q 35 When my charitable organization accepts virtual currency donations, what are my donor acknowledgment responsibilities? - A35. A charitable organization can assist a donor by providing the contemporaneous written acknowledgment that the donor must obtain if claiming a deduction of $250 or more for the virtual currency donation. See Publication 1771, Charitable Contributions Substantiation and Disclosure Requirements (PDF), for more information. A charitable organization is generally required to sign the donor’s Form 8283, Noncash Charitable Contributions, acknowledging receipt of charitable deduction property if the donor is claiming a deduction of more than $5,000 and if the donor presents the Form 8283 to the organization for signature to substantiate the tax deduction. The signature of the donee on Form 8283 does not represent concurrence in the appraised value of the contributed property. The signature represents acknowledgement of receipt of the property described in Form 8283 on the date specified and that the donee understands the information reporting requirements imposed by section 6050L on dispositions of the donated property (see discussion of Form 8282 in FAQ 36). See Form 8283 instructions for more information. (12/2019)
Confirmations

• Q 37 Will I have to recognize income, gain, or loss if I own multiple digital wallets, accounts, or addresses capable of holding virtual currency and transfer my virtual currency from one to another? — A37. No. If you transfer virtual currency from a wallet, address, or account belonging to you, to another wallet, address, or account that also belongs to you, then the transfer is a non-taxable event, even if you receive an information return from an exchange or platform as a result of the transfer.
What is next?
Questions?