



Tax Consequences of Cryptocurrency Transactions



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Our latest Blue J Folio looks at the tax consequences of cryptocurrency transactions. We have gathered the most relevant IRC sections as well as the available IRS guidance on how they apply to tax on cryptocurrency. Key definitions and a brief introduction to the relevant technology are included to provide as much clarity regarding the tax consequences of cryptocurrency transactions as is achievable on this nascent topic. You will also find links to the key tax forms and selected commentary, e.g., from the ABA and AICPA.

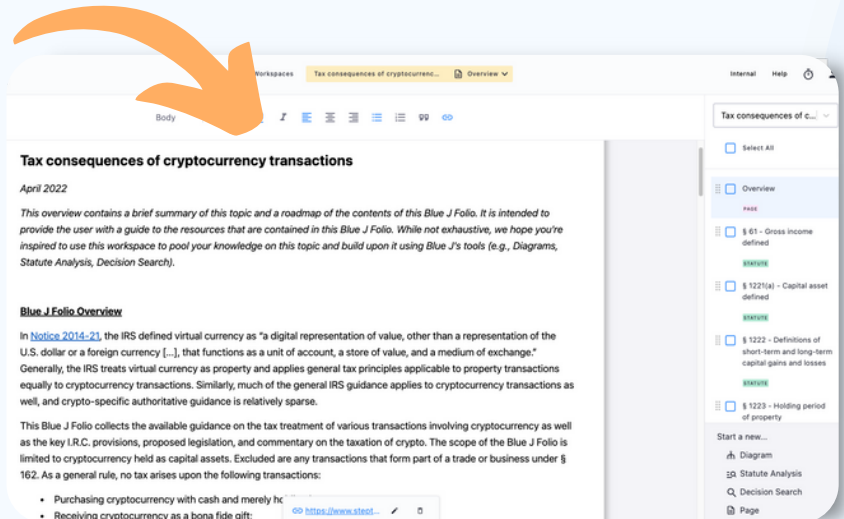
What are Blue J Folios?

Blue J Folios are workspaces that serve as focused starting points for your tax law research. Our tax experts have collected and annotated the relevant statutes, regulations, cases, and guidance from the IRS. They have also created diagrams illustrating the ownership structure or the transaction that is subject to the statute, regulation, case, or tax guidance, all providing you with a substantial head start.

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Each Blue J Folio provides an overview of everything that it includes, such as the statutes, regulations, cases, IRS guidance, and diagrams.

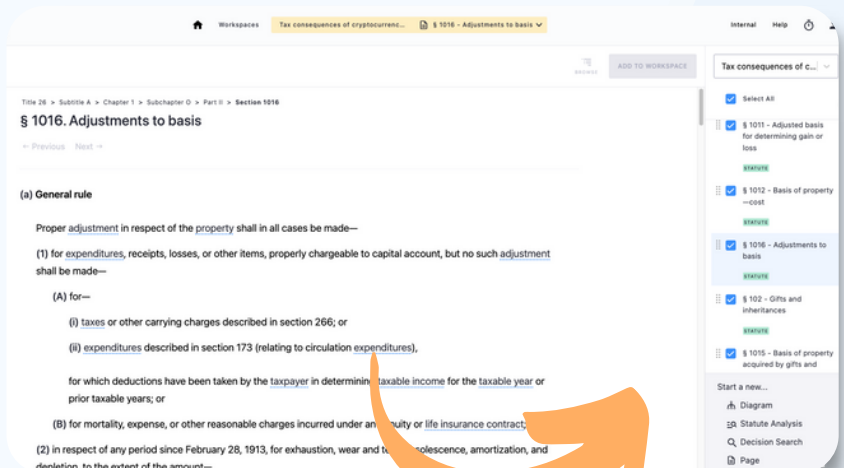
These overviews can also include explanations for key terms and factors that can impact a tax position.



2

To the right are the relevant statute sections and regulations, pre-annotated by our researchers to guide your analysis, as well as cases, IRS documents and complementary diagrams visualizing the issue at hand.

You will also find links to relevant resources that complement this Blue J Folio - such as tools and other Blue J Folios that you can open and use right away.

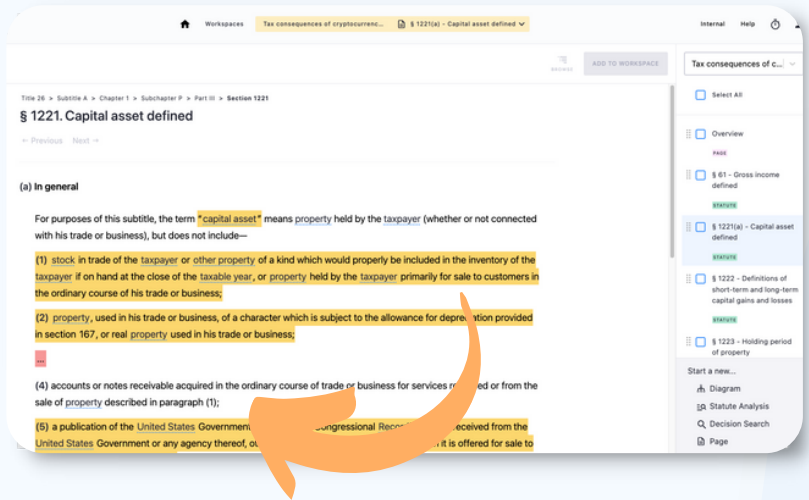


What are Blue J Folios?

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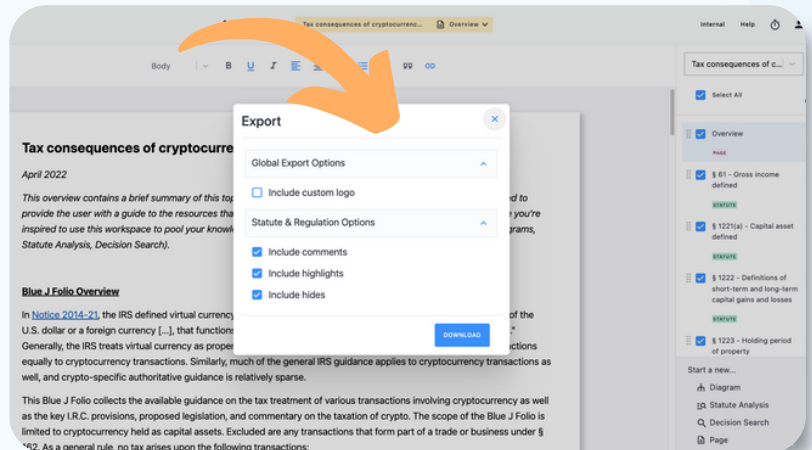
Once in a statute or regulation, you can highlight and leave your own comments on sections of interest, or hide ones that don't pertain to your particular scenario.

You can also create a new Page, our word processing tool, to gather valuable research results or map out your own analysis.



4

Once your research is complete, export the whole Blue J Folio as a PDF including the commentary and analysis, or select the boxes to export specific pieces.



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Blue J Folio Overview

Tax Consequences of Cryptocurrency Transactions

In [Notice 2014-21](#), the IRS defined virtual currency as “a digital representation of value, other than a representation of the U.S. dollar or a foreign currency [...], that functions as a unit of account, a store of value, and a medium of exchange.” Generally, the IRS treats virtual currency as property and applies general tax principles applicable to property transactions equally to cryptocurrency transactions. Similarly, much of the general IRS guidance applies to cryptocurrency transactions as well, and crypto-specific authoritative guidance is relatively sparse.

This Blue J Folio collects the key IRC provisions, proposed legislation, guidance, and commentary on the taxation of crypto. The scope of the Blue J Folio is limited to cryptocurrency held as capital assets. As a general rule, no tax arises upon the following transactions:

- Purchasing cryptocurrency with cash and merely holding it;
- Receiving cryptocurrency as a bona fide gift;
- Transferring cryptocurrency between one’s own wallets;
- Transferring cryptocurrency between different accounts held by the same owner on different exchanges, or from external wallets to an exchange account held by the same owner; and
- Donating cryptocurrency to a qualified tax-exempt charity or non-profit organization.

(For more information, visit: [I.R.S. - FAQs on Virtual Currency Transactions](#))

Basis and record-keeping is, of course, essential to determining future tax liabilities stemming from these transactions. Certain forms required to comply with the resulting income reporting obligations for taxpayers receiving income in the form of cryptocurrency are linked herein. This Blue J Folio does not address the IRS’s enforcement efforts on cryptocurrency reporting. The provisions below will allow practitioners to examine a plethora of topics including: trading, mining, staking, chain splits and airdrops, payment of wages, and the deductibility of itemized charitable contributions, exchange fees, and hardware expenses.

Overview of Statutory and Regulatory Provisions Included in the Blue J Folio

IRC § 61 - Gross Income Defined

The pertinent question when reporting cryptocurrency for tax purposes is whether various transactions involving cryptocurrency give rise to income as defined under this section. For example, according to the IRS, when crypto is received as wages, or for self-employment services this constitutes income that must be reported. Furthermore, receiving crypto from mining and staking as well as from hard forks and airdrops are taxable events reportable as gross income during the years the crypto was received, not merely sold.

IRC § 1221(a) - Capital asset defined

Most of the available crypto-specific IRS guidance only applies to cryptocurrency held as capital assets, as defined in this section. If cryptocurrency is held as inventory or other property held mainly for the sale to customers in a trade or business, it is likely not a capital asset.

IRC § 1222 - Definitions of short-term and long-term capital gains and losses

There are no special rules that apply to short-term or long-term holding periods of cryptocurrency. If the period is one year or shorter, the taxpayer will realize a short-term capital gain or loss, otherwise a long-term capital gain or loss. Short-term capital gains are taxed (less favorably) as ordinary income.

IRC § 1223 - Holding period of property

The holding period, defined in § 1223, starts the day after the cryptocurrency was received and ends on the day of the sale. An exception applies if the cryptocurrency is received as a gift. In that case, the holding period also includes the time that the cryptocurrency was held by the donor.

IRC §§ 1011, 1012, 1016 - Adjusted cost base

These sections apply when determining the adjusted cost basis for cryptocurrency received by the taxpayer.

IRC § 102 - Gifts and inheritances

When cryptocurrency is gifted, § 102 applies. Generally, no tax consequences arise when cryptocurrency is received as a bona fide gift. However, if the cryptocurrency is subsequently sold, it needs to be determined whether a gain or a loss arises upon that transaction. When determining whether a gain arose from the transaction, the cost basis is that of the donor plus the donor's gift tax, if any, under § 1015.

IRC § 1015 - Basis of property acquired by gifts and transfers in trust

This provision sets out how the cost basis of a gift is determined. To calculate the gain or loss, the difference between the adjusted cost basis of the virtual currency and the amount received, in the case of legal tender, or the FMV of the virtual currency or the service received in exchange must be determined in U.S. dollars for the time of the exchange.

IRC § 170(c) - Charitable contributions defined

Individual taxpayers may be eligible for a deduction of their donation to a charitable organization described in § 170(c). Given that the IRS treats cryptocurrency as property, this will be a property donation as opposed to a cash donation.

Treas. Reg. § 1.170A-1 - Charitable, etc., contributions and gifts; allowance of deduction

This provision governs the deduction allowable for charitable contributions. The charitable contribution deduction is generally equal to the FMV of the cryptocurrency at the time of the donation if the cryptocurrency was held by the taxpayer for more than one year. Under this provision, in cases of shorter holding periods, the deduction is the lesser of the taxpayer's cost basis of the cryptocurrency or the cryptocurrency's FMV at the time of the contribution.

IRC § 67 - 2-percent floor on miscellaneous itemized deductions

If a deduction for a charitable donation is permitted, it may be subject to other limitations including § 67's 2-percent floor, which limits total miscellaneous itemized deductions that exceed 2 percent of adjusted gross income.

IRC § 1091(d) - Unadjusted basis in case of wash sale of stock

This wash sale rule attempts to prevent loss harvesting if an investor is not actually disposing of the security but is rather continuing the investment. A taxpayer who is a dealer in stock or securities and the loss is sustained in a transaction made in the ordinary course of such business is not subject to this rule. In the [Build Back Better Act, H.R.5376, 117th Cong. § 138153 \(as passed by House, Nov. 19, 2021\)](#), which, at the time of writing, appears unlikely to get enacted, § 1091(d)'s application was expanded to include cryptocurrency assets which would give rise to substantial administrative challenges to taxpayers.

IRC § 1031 (Repealed for Personal Property) - Like-Kind Exchanges

Before the enactment of the Tax Cuts and Jobs Act (TCJA) of 2017, IRC § 1031 may have applied when one cryptocurrency was exchanged for another. The TCJA eliminated the availability of section 1031 to like-kind exchanges of personal property. Guidance is required as to when one cryptocurrency was like-kind to another for purposes of properly reporting income from cryptocurrency exchanges prior to January 1, 2018.

IRC § 6050I - Returns relating to cash received in trade or business, etc.

On November 15, 2021, President Biden signed the Infrastructure Investment and Jobs Act, which modified § 6050I to require reporting for transactions undertaken with digital assets in excess of \$10,000 to the IRS on Form 8300. The change will come into effect after December 31, 2023.

Relevant Guidance

- **Crypto-Specific Guidance**

- [I.R.S. - FAQs on Virtual Currency Transactions](#) (Note that these FAQs are not binding)
- [C.C.A. 2021-14-020 \(Apr. 4, 2021\)](#) (Advice regarding the tax consequences for an individual who received Bitcoin Cash as a result of the Bitcoin hard fork on August 1, 2017)
- [Rev. Rul. 2019-24, 2019-44 I.R.B. 1004](#) (IRS guidance on income from hard forks and airdrops)
- [Notice 2014-21, 2014-16 I.R.B. 938](#) (This notice describes how existing general tax principles apply to transactions using virtual currency in the form of answers to FAQs)
- [Department of Justice News Release - "Court Authorizes Service of John Doe Summons Seeking Identities of U.S. Taxpayers Who Have Used Cryptocurrency." \(May 5, 2021\)](#) (The IRS was successful getting permission to serve a John Doe summons on Payward Ventures Inc., and Subsidiaries d/b/a Kraken (Kraken) seeking information about U.S. taxpayers who conducted at least the equivalent of \$20,000 in transactions in cryptocurrency during the years 2016 to 2020)
- [Department of the Treasury - Letter 6173, \(6-2019\), Letter 6174 \(6-2019\), Letter 6174-A \(6-2019\)](#) (In instances where the IRS has information regarding the taxpayer's unreported cryptocurrency accounts, the taxpayer may receive a letter underlining the seriousness of omitting this information)

- [Jarrett v. United States, No. 3:21-cv-00419 \(M.D. Tenn. May 26, 2021\)](#) (Plaintiffs argue that they should be taxed on the cryptocurrency they received in the course of their staking enterprise to validate transactions on the Tezos public blockchain only once the tokens are sold; IRS [offered refund](#), plaintiff is still [pursuing](#) the case)
- **Generally Applicable IRS Guidance**
 - [I.R.S. News Release FS-2007-18, "Business or Hobby? Answer Has Implications for Deductions" \(Apr. 2007\)](#)
 - [I.R.S. Pub. No. 551, Cat. No. 15094C \(Dec. 10, 2018\)](#) (Basis of Assets)
 - [I.R.S. Pub. No. 526, Cat. No. 15050A \(Mar. 3, 2021\)](#) (Charitable Contributions)
 - [I.R.S. Pub. No. 544, Cat. No. 15074K \(Mar. 16, 2021\)](#) (Sales and Other Dispositions of Assets - guidance on how to distinguish capital assets and non-capital assets)
- **Forms**
 - [IRS - Form 8949](#) (This form is used to report sales and other dispositions of capital assets).
 - [IRS Form 1040 \(Schedule D, Capital Gains and Losses\)](#) (On this form, the taxpayer has to provide a summary of capital gains and losses)
 - [IRS Form 1099-MISC \(Miscellaneous Income\)](#) (Cryptocurrency exchanges have begun to use this form to report rewards and fees income from staking, Earn and other such programs if a taxpayer has earned \$600 or more in the relevant tax year)
- **Commentary**
 - [Cryptocurrency: What's Next for Regulation and Compliance? \(Transcript\)](#), March 9, 2022
 - [American Bar Association - Comments on Notice 2014-21](#)
 - [AICPA - Comments on IRS Virtual Currency Guidance](#)
 - [Matthew B. Kulkin, Lisa M. Zarlenga, Micah S. Green, Alan Cohn, "Build Back Better 'Wash Sales' Legislation Would Impact Currency, Commodity, Options, and Digital Asset Markets," \(Steptoe, Nov. 2, 2021\)](#)
 - [NYSBA Tax Section Gives Feedback on Proposed Wash Sale Provision, Jan. 14, 2022](#)
- **Blue J's Crypto Tax Blog Posts**
 - [Crypto Tax: Tax treatment and reporting of cryptocurrency transactions](#) (Jan. 19, 2022)
 - [Crypto Tax: How to calculate gains and losses on cryptocurrency transactions](#) (Feb. 4, 2022)
 - [Crypto Tax: Tax treatment of cryptocurrency gained from mining and staking](#) (Feb. 22, 2022)
 - [Crypto Tax: Tax treatment of cryptocurrency received from hard forks and airdrops](#) (Mar. 16, 2022)

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