Crypto-Investors Get Long-Awaited Guidance on Transactions

For the first time in five years, the Internal Revenue Service issued guidance on the tax treatment of cryptocurrency transactions.

This guidance sheds light on how cryptocurrency holders should address “hard forks” in an existing blockchain. Hard forks occur when there has been a change to the rules governing the underlying blockchain.

While the mechanics of a hard fork are confusing enough to explain, their tax treatment posed yet another set of questions for cryptocurrency investors, which is why the IRS’ guidance was so eagerly awaited.

Per the IRS: “If your cryptocurrency went through a hard fork, but you did not take possession and control of a new cryptocurrency, whether through an airdrop (a distribution of cryptocurrency to multiple taxpayers’ distributed ledger addresses) or some other kind of transfer, you don’t have taxable income.”

However, in instances where an investor receives new cryptocurrency, and takes possession and control, the IRS notes that holder will have to record ordinary income equal to the fair market value of the cryptocurrency when it was received.

For many cryptocurrency investors, the new guidance will raise as many questions as it answers. The IRS acknowledged that there may be cryptocurrency investors who may have failed to record their transactions properly, potentially putting them on the hook for tax liabilities, interest and penalties.

Cryptocurrency investors should consult with tax advisors to make sure their current and past cryptocurrency transactions were recorded properly in light of the latest IRS guidance.

The recent changes to the IRS guidance provide a fresh reason for cryptocurrency investors to map out -- or update -- their estate plans to make sure that their cryptocurrency holdings are enabled to be transferred to heirs.

The nature of cryptocurrencies can make it difficult to ensure that proper transfers happen. Since assets are held in a digital “wallet,” which is accessed by a “private key,” cryptocurrency investors will want to be careful not to share their key for fear that their account could be accessed and depleted. However, without the key, heirs will not be able to access their assets when needed, making the holdings practically worthless to heirs.

As always, cryptocurrency investors will want to consult with tax and estate planning professionals to ensure the proper treatment of their assets. For more information, contact your Anchin relationship partner or Jeffrey Palley, a Tax Partner in Anchin Private Client, at 212.840.3456 or info@anchin.com.

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