



February 28, 2020

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on [Revenue Ruling 2019-24](#), the New Question on Schedule 1 (Form 1040), and the Internal Revenue Service’s [Frequently Asked Questions](#) on Virtual Currency Transactions

Dear Messrs. Rettig and Desmond:

The American Institute of CPAs (AICPA) appreciates the opportunity to submit recommendations on the taxation of virtual currency transactions¹ and guidance regarding hard forks and airdrops. The Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS or “agency”) recently issued Revenue Ruling 2019-24 (“Revenue Ruling”), along with new frequently asked questions (FAQs). We have identified specific areas that warrant additional or updated guidance.

Virtual currency transactions, in which taxpayers increasingly engage, add a new layer of complexity to the analysis of a client’s reporting requirements. The issuance of additional guidance will provide certainty and clarity to tax preparers and taxpayers on the application of the tax law to virtual currency transactions.

Our recommendations address the following areas:

- I. Revenue Ruling 2019-24
- II. New Question on the 2019 Form 1040, Schedule 1
- III. Frequently Asked Questions
- IV. Form of Guidance
- V. Prior AICPA Recommendations Not Included in New IRS Guidance

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¹ See prior AICPA letter: “[Updated Comments on Notice 2014-21: Virtual Currency Guidance](#),” submitted May 30, 2018.

prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Donald Zidik, Chair, AICPA Virtual Currency Task Force, at (781) 801-1468 or Donaldz@waldronrand.com; Amy Wang, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9264 or Amy.Wang@aicpa-cima.com; or me at (612) 397-3071 or Chris.Hesse@CLAconnect.com.

Sincerely,

A handwritten signature in blue ink that reads "Christopher W. Hesse". The signature is fluid and cursive, with a prominent flourish at the end.

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: Mr. John Moriarty, Associate Chief Counsel, Income Tax & Accounting, IRS
Ms. Suzanne R. Sinno, Attorney, Income Tax & Accounting, IRS
Mr. Christopher Wrobel, Special Counsel to the Associate Chief Counsel, Income Tax & Accounting, IRS
Mr. Krishna Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Ms. Natasha Goldvug, Attorney-Advisor, Department of the Treasury
Mr. Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation
Mr. Kenneth A. Blanco, Director, Financial Crimes Enforcement Network

AMERICAN INSTITUTE OF CPAs

Comments on [Revenue Ruling 2019-24](#), the New Question on Schedule 1 (Form 1040), and IRS [Frequently Asked Questions](#) on Virtual Currency Transactions

I. Revenue Ruling 2019-24

BACKGROUND

Revenue Ruling 2019-24, released in October 2019, considers two cryptocurrency events identified in, and defined by, the ruling as a “hard fork” and an “airdrop.” However, the ruling does not address certain significant events – notably, the Ethereum chain split in 2016, the Bitcoin chain splits in 2017, as well as other chain splits and hard forks.

While we commend the IRS for its efforts to address the tax consequences of events unique to virtual currency, the Revenue Ruling describes two hypothetical situations that do not have economic consequences.² Many taxpayers interpreted the ruling as not applying to either the Ethereum or the Bitcoin chain splits since neither was a hard fork followed by an airdrop (further explained below). The AICPA concurs with Coin Center, members of Congress, and other commenters that hard forks and airdrops are terms that describe distinct and unrelated events, rather than the sequentially related events illustrated in the Revenue Ruling.³

Chain Splits

A chain split is an economic outcome of some (but not all) hard forks. It is the shared pre-split transaction history that is the source of economic gain – that being, chain split coins – which taxpayers may realize. A chain split coin is an amount⁴ of a new cryptocurrency controlled by the same credentials that control identical amounts recorded on the pre-split blockchain. Thus, for example, a taxpayer who has 10 Bitcoins prior to the Bitcoin Cash chain-split will have 10 Bitcoin Cash, along with their 10 original Bitcoins, after the chain-split.

In the case of either a chain split or an airdrop, no payment of money or exchange of property occurs, nor does the taxpayer give up any rights.⁵ Moreover, users are not required to take action upon the occurrence of a chain split. Generally, a chain split can create significant risks for legacy owners as well as wallet developers, exchanges, and other businesses supporting (or not

² See also Congressional letter to Commissioner Rettig, <https://coincenter.org/files/2019-12/letter-to-irs-dec-20.pdf> (December 20, 2019) (“The hypothetical fact patterns concerning forks and airdrops offered in this guidance do not appear to bear a close resemblance to actual forks or airdrops as they have occurred in the cryptocurrency ecosystem.”), and Peter Van Valkenburgh, *What are cryptocurrency forks, airdrops, and what’s the difference?*, <https://coincenter.org/entry/what-are-cryptocurrency-forks-airdrops-and-what-s-the-difference>.

³ *Id.*

⁴ In the case of Bitcoin and similar cryptocurrencies, a spendable amount is referred to as an unspent transaction output (UTXO).

⁵ New coins (e.g., Bitcoin Cash) corresponding to pre-split bitcoins are referred to as “chain split coins” unless otherwise specifically noted.

supporting) the new coin. Many legacy owners take no action until the risks associated with a chain split are sufficiently evaluated and mitigated, and some owners may never take action to claim the chain split coins.

The most often cited risks involved with chain splits are security and replay attacks.⁶ A replay attack occurs if a transaction is valid on both chains. In those cases, transferring a chain split coin results in transferring the corresponding pre-split coin, or vice versa. In other words, both coins are unintentionally transferred in a single transaction that is meant to only send the chain split coins. Transactions are irreversible, and where no or uncertain replay protection is provided, a taxpayer would need to carefully evaluate and activate precautions to prevent replay attacks. Even if replay protection is provided or a replay attack mitigated, chain split coins cannot transfer unless the corresponding credentials are held in a wallet supporting the chain split, or the user is willing and able to import the necessary credentials into such a wallet. Therefore, in many cases, chain split coins are regarded as unwanted property, unclaimed by taxpayers, and not taxable at the time of the chain split.⁷

Examples of Chain Splits

a. Bitcoin Chain Splits

Temporary chain splits in the Bitcoin blockchain are not unusual. However, the number of intentionally persistent chain splits increased dramatically beginning in 2017, a type of event that is fairly simple to execute.⁸ In fact, any user can copy the Bitcoin Core software, make modifications to it, and create their own version of Bitcoin.

Modifications to a copy of Bitcoin do not cause a *persistent* split in the Bitcoin blockchain unless the new version is actually adopted, supported, and activated by miners, intermediary nodes, and wallets. If all those levels of acceptance occur, the result is a persistent branching of the blockchain on which transactions are recorded. We refer to this event as a “chain split,” and generally, it is described as follows:

⁶ See, e.g., Jimmy Song, *Replay Attacks Explained*, Bitcoin Tech Talk (August 21, 2017), <https://bitcointechtalk.com/replay-attacks-explained-e3d6d2ea0ab2> (last checked December 4, 2018).

⁷ See Adrian Zmudzinski, *Two Alleged Ethereum ‘Scam Forks’ Appropriating Users’ Private Keys, Report Finds*, CoinTelegraph (January 11, 2019), <https://cointelegraph.com/news/two-alleged-ethereum-scam-forks-appropriating-users-private-keys-report-finds>.

⁸ See BitMEX, *List of 44 Bitcoin fork tokens since Bitcoin Cash*, <https://blog.bitmex.com/44-bitcoin-fork-coins/> (listing 44 chain split coins planned for or occurring later in 2017 and early in 2018).

- A chain split is caused by a “hard fork.” Bitcoin Improvement Proposal (BIP) 99⁹ uses this terminology, and BIP123¹⁰ restated the terms for purposes of classifying BIPs.
- A “soft fork” is best understood as an upgrade to the Bitcoin Core software that is not a “hard fork.” Soft fork upgrades make the consensus rules more restrictive. In other words, new transactions and blocks must be valid under both the old and new consensus rules.
- In a “hard fork,” structures that were invalid under the old rules become valid under the new rules. In this case, the consensus rules of a forked version are not compatible with Bitcoin Core.

However, the definitions above are irrelevant for federal income tax purposes because income tax is only applicable when an actual, economic outcome (intended or not) of a software change is realized. Some software changes create chain splits that create tax consequences, while others do not.¹¹

The following list identifies hard forks (and a soft fork) occurring prior to 2017 which, to our knowledge, caused (or may have caused) unintentional Bitcoin chain splits. These incidents, and the related debates, illustrate the complexity of applying technical terms that do not correspond to coins that are persistent, valuable, and likely for taxpayers to claim:

1. July 31, 2010: Temporary 51 block chain split.¹²
 - Addition of OP_NOP script operations on July 31, 2010¹³ (hard fork).
2. March 11, 2013: Temporary 24 block chain split at 22543.¹⁴
 - Berkeley DB (BDB) change to levelDB in 2013 created a bug that was fixed by reverting to an earlier version. While the bug was not directly related to the consensus rules, the added levelDB limits implemented the consensus rules and did cause a consensus fork.

⁹ See BIP99 abstract at: https://github.com/bitcoin/bips/blob/master/bip-0002.mediawiki#BIP_workflow. “Bitcoin Improvement Proposals (BIP) are design documents providing information to the Bitcoin community, or describing a new feature for Bitcoin or its processes or environment. The BIP should provide a concise technical specification of the feature and a rationale for the feature. BIPs are intended as the primary mechanisms for proposing new features, for collecting community input on an issue, and for documenting the design decisions that have gone into Bitcoin. The BIP author is responsible for building consensus within the community and documenting dissenting opinions. Because the BIPs are maintained as text files in a versioned repository, their revision history is the historical record of the feature proposal.”

¹⁰ See BIP 123 at: <https://github.com/bitcoin/bips/blob/master/bip-0123.mediawiki>.

¹¹ See, e.g., *List of Bitcoin forks*, https://en.wikipedia.org/wiki/List_of_bitcoin_forks (listing forks of the client software, intentional hard forks splitting the cryptocurrency, and unintended hard forks).

¹² Prior to the BIP16 soft fork (April 1, 2012), a fork that occurred without a chain split was not identified with a specific block height or date, other than the addition of the 1MB block size limit (September 12, 2010).

¹³ See <https://archive.is/L7amG> (“We fixed an implementation bug where it was possible that bogus transactions could be displayed as accepted. Do not accept Bitcoin transactions as payment until you upgrade to version 0.3.6!”).

¹⁴ See e.g., Temporary chain split on March 11, 2013 at block 225,430, (an unintended hard fork occurred due to the migration from Berkeley DB to LevelDB).

3. May 15, 2013 (or August 16, 2013): No chain split.¹⁵
 - The BDB lock limit, related to the levelDB change, could have been considered a hard fork.
4. July 4, 2015: Six block chain split at 363731.
 - Soft fork implementing a new opcode for the Bitcoin scripting system allowing a transaction output to become not spendable until some point in the future.¹⁶

While a hard fork always precedes a persistent chain split,¹⁷ a persistent chain split is not always the result of a hard fork. Regardless of labels, an event is only taxable when a software change creates a chain split coin that is likely to persist, likely to have value, and, as a consequence, chosen to be claimed by taxpayers.

b. Bitcoin Cash and Bitcoin Gold, 2017

Bitcoin Cash (August 1, 2017, block height 478558),¹⁸ and Bitcoin Gold (October 24, 2017),¹⁹ are well known chain splits that occurred in 2017. The two events demonstrate the complexity of valuation, as well as the uncertain time at which income is treated as realized or realizable. Bitcoin Cash may (or may not) have had value at the time of the chain split on August 1, 2017. There was trading in futures and forward contracts on Bitcoin Cash prior to that time. However, we understand that those contracts were only available outside of the U.S., and specifically not available to U.S. persons. Thus, a U.S. person could not actually sell forward Bitcoin Cash chain split coins at the price indicated by these non-U.S. exchanges.

A notable illustration of uncertain timing was the Bitcoin Gold chain split. While Bitcoin Gold forked at block height 491406 (October 24, 2017), mining did not commence until November 12, 2017 (at 491407). This timing means that without miner support, a pre-split Bitcoin owner could not actually claim the corresponding Bitcoin Gold chain split coins until November 12, 2017.²⁰

¹⁵ See BIP50, *March 2013 Chain Fork Post-Mortem*, <https://github.com/bitcoin/bips/blob/master/bip-0050.mediawiki>.

¹⁶ See BIP65, *OP_CHECKLOCKTIMEVERIFY*, <https://github.com/bitcoin/bips/blob/master/bip-0065.mediawiki>.

¹⁷ Persistent chain splits are often referred to as contentious or schism hard forks. While the developers and/or sponsors intentionally cause a chain split, holders of the legacy coins may lack interest, are unaware, and/or are unsupportive of an intentional chain split. See BIP99, *Motivation and deployment of consensus rule changes*, <https://github.com/bitcoin/bips/blob/master/bip-0099.mediawiki> (defining Schism hard forks as those in which users consciously validate two different sets of consensus rules).

¹⁸ A subsequent hard fork of Bitcoin Cash on November 15, 2018, created the Bitcoin SV chain split.

¹⁹ See Peter Van Valkenburgh, *What are cryptocurrency forks, airdrops, and what's the difference?*, <https://coincenter.org/entry/what-are-cryptocurrency-forks-airdrops-and-what-s-the-difference>.

²⁰ See BTCGPU/BTCGPU repository, *Bitcoin Gold Readme.md*, (“Bitcoin Gold (codename BTCGPU) began as a fork of Bitcoin after block height 491406 on Tue, 24 October 2017 01:17:35 GMT and began being mined as a separate chain at block height 491407 on Sun, 12 November 2017 13:34:01 GMT.”), <https://github.com/BTCGPU/BTCGPU> (Last checked December 10, 2019). See also Jimmy Song, *Bitcoin Gold: What you need to know*, <https://bitointechtalk.com/bitcoin-gold-what-you-need-to-know-8b3e645be409>.

c. Ethereum, 2016

The Ethereum chain split (often referred to as the DAO Hard Fork) occurred on July 20, 2016.²¹ It was not until July 24, 2016, that the Poloniex exchange listed both the original and the chain split coin for trading (we understand that Poloniex was the first U.S. exchange to do so). Between those dates, pre-split Ethereum holders could theoretically have claimed their new Ethereum coins (referred to as ETH, while pre-split ETH is ETC, or Ethereum Classic). However, transactions were replayed on both chains – meaning, if a taxpayer had sent ETH, the taxpayer was also at risk of sending ETC, and vice versa. While the making of a market by Poloniex may not be a prerequisite to selling Ethereum chain split coins – a taxpayer might have sold a paper wallet for USD in person before July 24, 2016. The valuation of the chain split coin would have been highly uncertain without the Poloniex exchange.

d. Bitcoin Private, 2018

Despite its high profile, Bitcoin Private has been criticized as a shadowy project, with strong evidence supporting that criticism.²² Taxpayers would have been well-advised to not claim Bitcoin Private. Bitcoin Private was a merged fork of ZClassic (generally regarded as a failed fork of ZCash) and Bitcoin. Holders of Bitcoin or ZClassic on February 28, 2018 (block snapshots 511346 for Bitcoin, and 272991 for ZClassic) were eligible to claim a corresponding number of Bitcoin Private coins. Bitcoin Private is an example of unsolicited, and likely unwanted, property which should not have tax consequences until taxpayers have manifested acceptance by actually exercising dominion and control (See Appendix A).

Situations Described in the Revenue Ruling

We assume that significant cryptocurrency events – the Ethereum chain split in 2016, and the Bitcoin chain splits in 2017 – are the intended subject matters of the Revenue Ruling. However, the current ruling, as written, does not technically apply to those cryptocurrency events.

Situation 1 describes a cryptocurrency event resulting from a hard fork. The Ethereum and Bitcoin chain splits almost fit the facts of Situation 1. However, the ruling states that the taxpayer did not receive any units of the new cryptocurrency. Specifically, taxpayers holding pre-split Bitcoin would have held an equal number of Bitcoin Cash, but Bitcoin Cash chain split coins were not airdropped (according to the definition in the ruling or even as colloquially or technologically understood) or transferred to an account or address on a distributed ledger. Bitcoin Cash chain split

²¹ See Vitalik Buterin, *Hard Fork Completed*, <https://blog.ethereum.org/2016/07/20/hard-fork-completed/>.

²² See Coinmetrics, *Don't trust, verify: A Bitcoin Private case study*, <https://coinmetrics.io/bitcoin-private/> (December 23, 2018).

coins reference the pre-split transaction history of Bitcoin (See Appendix B).²³ As a result, a taxpayer could reasonably conclude that, because there was no distribution or transfer of Bitcoin Cash chain split coins to the taxpayer, the holding of Situation 1 does not apply.

Situation 2 describes a fact pattern that also fails to describe either the Ethereum or Bitcoin chain splits. In the case of a chain split, cryptocurrency is not distributed or transferred to legacy addresses.²⁴ However, the ruling describes an airdrop, which is a distribution of cryptocurrency, but it does not describe a chain split. A chain split caused by a hard fork results in the new protocol referencing the transaction history of the legacy distributed ledger up to the chain split. The difference is not trivial. Situation 2, as currently provided in the ruling, does not apply to chain splits, generally, or to the Ethereum or Bitcoin chain splits, specifically.

Valuation at the Time of a Chain Split

For purposes of this discussion, we are relying on statements made by government representatives that the Revenue Ruling was intended to address chain split coins. Arguably, chain split coins have a zero or near-zero realizable value at the time of a split. However, the value of any particular chain split coin at the time of a chain split is fact specific. In addition, even if a chain split coin was considered to have a non-zero value at the time of a chain split, taxpayers often cannot claim the coins at that time because those coins are not supported by wallets or coin splitting services. While, in theory, taxpayers can exercise dominion and control by selling a paper wallet entitling the buyer to the chain split coins, in reality, taxpayers would not actually transact in that matter because that type of market would be illiquid, unregulated, and inefficient.

Characterization of Chain Split and Airdropped Coins

Chain split coins and airdropped coins are not gifts. While a Bitcoin owner may claim chain split and airdropped coins at no cost, these coins were never intended as gifts (in the case of a chain split, there is not even a donor), and cannot receive exclusion from income on that basis.²⁵

Chain split and airdropped coins are not windfall found property. Cryptocurrency owners know, should know, and may even anticipate that by investing in and holding cryptocurrency, they may receive chain split coins and airdropped coins.²⁶ Therefore, neither would constitute windfall found

²³ For example, the Bitcoin Cash chain split does not create a “new distributed ledger” as described in the ruling; instead, a Bitcoin Cash transaction sending Bitcoin cash from a pre-split address references the pre-split Bitcoin blockchain (“legacy distributed ledger”).

²⁴ Rev. Rul. 2019-24, “a hard fork followed by an airdrop results in the distribution of units of the new cryptocurrency to addresses containing the legacy cryptocurrency.”

²⁵ *Comm’r v. Duberstein*, 363 U.S. 278, 285 (1960) (a gift, in the statutory sense, proceeds from a detached or disinterested generosity out of affection, respect, admiration, charity, or like impulses; donor intent is relevant for this determination).

²⁶ Chain split coins would still have characterization as unsolicited property despite cryptocurrency owners knowing or anticipating receipt. See, e.g., *Haverly v. United States*, 513 F.2d 224 (7th Cir. 1975) (unsolicited books received by a school principal); Rev. Rul. 70-498 (unsolicited books received by a taxpayer employed by a newspaper as its book reviewer); Technical Advice Memorandums (TAMs) 8109004 and 8109003 (unsolicited sports tickets received

property – “something received for nothing” – as generally understood for federal income tax purposes.²⁷

With few exceptions, **taxpayers should characterize airdropped and chain split coins as unsolicited property.** Specifically, an evaluation of a limited set of Bitcoin and Ethereum chain splits (detailed above) highlights the practicality of properly treating chain split and airdropped coins as unsolicited property. It is highly burdensome for the IRS to administer, and taxpayers to apply, a realization rule that requires a case-by-case basis to determine the time at which a particular taxpayer can, or should, exercise dominion and control over unsolicited, and possibly unwanted, property.²⁸ The IRS’s long-standing policy – an actual manifestation of acceptance of unsolicited property – has addressed the tax issues regarding unwanted property for many decades.²⁹ Our analysis indicates that treating Bitcoin Cash chain split coins as unsolicited property maximizes the realized gross income when compared to treating the realization as occurring at the time of a chain split (See Appendix C).

Further, there is no authority or analogy that would reasonably treat a chain split as a property division for federal income tax purposes.³⁰ Treating chain split coins as a type of non-windfall in-kind receipt, which is often not taxable prior to disposition, seems to mischaracterize the coins as property obtained as a result of the taxpayer’s active efforts to obtain it (*e.g.*, mining, farming, manufacturing).³¹ While cryptocurrency owners might reasonably expect to receive chain split coins, Treasury and the IRS should not characterize taxpayers who merely hold cryptocurrency as engaged in a venture to obtain chain split coins. The agency should view the developers or sponsors of a chain split as actively engaged in a venture.

Undoubtedly, some taxpayers acquire cryptocurrency immediately prior to a chain split *solely* for purposes of claiming, and then disposing of, the chain split coins. In these cases, assuming the taxpayer acquired the cryptocurrency to receive the chain split coins, they likely intend to exercise dominion and control over the chain split coins (if and when the chain split occurs, which is not

by a taxpayer on the Board of Supervisors supervising the operation of the stadium); GCM 36639 (unsolicited congressional record received by a member of Congress).

²⁷ See Joseph M. Dodge, *Accessions to Wealth, Realization of Gross Income, and Dominion and Control: Applying the ‘Claim of Right Doctrine’ to Found Objects, Including Record-Setting Baseballs*, 5 Fla. Tax Rev. 685, (2000) (discussing in-depth the taxation of windfall found property - “something for nothing” - which are distinctly different than non-windfall gains resulting from an investment of capital and services). Also see Treas. Reg. § 1.61-14.

²⁸ See Adrian Zmudzinski, *Two Alleged Ethereum ‘Scam Forks’ Appropriating Users’ Private Keys, Report Finds*, CoinTelegraph (January 11, 2019), <https://cointelegraph.com/news/two-alleged-ethereum-scam-forks-appropriating-users-private-keys-report-finds>.

²⁹ Alternative characterizations of chain splits seem either (or both) unpersuasive in law (*e.g.*, property division), or too attenuated in fact (*e.g.*, mining or farming).

³⁰ See *e.g.* Rev. Rul. 56-437, 1956-2. C.B. 507 (partition of property); PLR 201419001 (division of trust); PLR 201349002 (modification and division of a trust); PLR 200736002 (pro-rata trust decanting); PLR 97300007 (notional principal contract is a single, indivisible financial instrument); FSAs 1998-124 and 1999-1041 (interest rate swap is treated as a single indivisible financial product).

³¹ See Joseph M. Dodge, *Accessions to Wealth, Realization of Gross Income, and Dominion and Control: Applying the ‘Claim of Right Doctrine’ to Found Objects, Including Record-Setting Baseballs*, 5 Fla. Tax Rev. 685, 696 (2000) (see discussion of sought-after property).

certain).³² On the other hand, taxpayers holding Bitcoin often object to (even actively oppose) any software change that may cause a Bitcoin chain split. While an acquisition prior to a possible chain split may have occurred for purposes of acquiring the resulting chain split coins, the taxpayer's intention to do so is not known until it is manifested.

Furthermore, persistent chain split coins and airdropped coins are best characterized, for purposes of income realization under section 61,³³ as unsolicited property. The IRS and courts have, for many years, determined that unsolicited property is includible as income under section 61 only when the taxpayer manifests acceptance of the property by exercising dominion and control over it. This treatment is appropriate for purposes of determining the tax consequences of chain splits and airdrops for most taxpayers. Though certain airdrops, where the taxpayer took a specific action to obtain the airdrop coin, should not have treatment as unsolicited property.

While we refer to *persistent*³⁴ chain splits as the relevant economic outcome of a hard fork, we want to highlight the fact that there are *temporary* chain splits that are unlikely (and typically impossible) for almost all taxpayers to claim and/or accept. It is unnecessary to define "persistent" for purposes of taxing chain split coins because chain split coins are unsolicited property that are taxable only if, and when, a taxpayer exercises dominion and control over the coins (See Appendix B).

As temporary chain splits caused by hard forks will continue to occur,³⁵ chain splits that taxpayers believe will persist are more likely to have value, and more likely for taxpayers to accept and claim. The IRS does not need to determine whether chain split coins are likely to persist, likely to have value, and likely for taxpayers to accept and claim. Instead, as with any other forms of unsolicited property, income is realized if, and when, dominion and control is exercised by the taxpayer. Sometimes, despite being recorded on the distributed ledger, a taxpayer may choose to not exercise dominion and control due to the risk of fraud or scam associated with certain coins.³⁶

³² See e.g. Bitcoin SegWit2x (a well-known hard fork of Bitcoin which failed despite 80% of miners signaling their intention to support it), <https://en.bitcoin.it/wiki/SegWit2x>.

³³ Unless otherwise indicated, references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

³⁴ We recommend using the term "persistent" as opposed to a "permanent" chain split. While persistent suggests a chain split may have indefiniteness, taxpayers should read this term to exclude temporary chain splits that eventually reconverge on the best, valid blockchain. In any event, cryptocurrencies forked from Bitcoin Core come and go with few (perhaps none) likely to remain permanent.

³⁵ See examples below.

³⁶ See Adrian Zmudzinski, *Two Alleged Ethereum 'Scam Forks' Appropriating Users' Private Keys, Report Finds*, CoinTelegraph (January 11, 2019) (describing Ethereum Nowa and Ethereum Classic Vision as scam forks used to appropriate the private keys of users trying to redeem their chain split coins), <https://cointelegraph.com/news/two-alleged-ethereum-scam-forks-appropriating-users-private-keys-report-finds>, and *Ethereum Nowa*, Bitcointalk, <https://bitcointalk.org/index.php?topic=5079183.0>.

RECOMMENDATIONS

Treasury and the IRS should modify and supersede Rev. Rul. 2019-24 to explicitly provide that chain split coins and airdropped coins (and other similar results of virtual currency events) are unsolicited property included in gross income under section 61 only when dominion and control is exercised.

Specifically, the AICPA recommends that Treasury and the IRS:

1. Restate the background, facts, and examples in the ruling to address chain splits and other virtual currency events that have economic consequences (including the Ethereum chain split in 2016 and the Bitcoin chain splits in 2017);
2. Characterize chain split coins as unsolicited property for federal income tax purposes that are taxable if and when the recipient-taxpayer manifests acceptance by exercising dominion and control;
3. Provide guidance to address any unsolicited property arising from virtual currency events, whether they are airdrops, chain splits, or similar events; and
4. Permit taxpayers to evidence their acceptance of unsolicited property resulting from virtual currency events (including chain splits, airdrops, giveaways, or other similar events) by filing a notification with the IRS similar to what is allowed under section 83(b).

ANALYSIS

1. *Restate the background, facts, and example in the ruling to address chain splits and other virtual currency events that have economic consequences.*

As we have learned since Notice 2014-21 (“Notice”) was published on March 25, 2014, technological changes and the rate at which they occur, are impossible to predict. However, the economic outcomes from these changes are more likely to remain subject to IRS’s regulations if the language is modified and superseded. Therefore, Treasury and the IRS should restate the “Background and Facts” in Rev. Rul. 2019-24 to address events that have occurred and, specifically, events that have affected the greatest number of taxpayers.

The Revenue Ruling also provides an example that incorrectly permits a third-party agent to defer realization of airdrop coins on behalf of beneficial owners if the agent delays crediting the coins to the accounts of beneficial owners. A taxpayer should not have the ability to defer income realization through the use of agents or nominees.³⁷ Instead, taxpayers should realize income at the time the taxpayer’s agent exercises dominion and control over the airdrop (or chain split) coins on behalf of the taxpayer.

Our recommendations are intended to broaden the application of the ruling and the ability for taxpayers to properly report the tax consequences of virtual currency events.

³⁷ *Lucas v. Earl*, 281 U.S. 111 (1930); *Helvering v. Horst*, 311 U.S. 112 (1940); *Hicks v. U.S.*, 314 F.2d 180 (4th Cir. 1963). See also *Fidelity-Philadelphia Trust Company*, 23 T.C. 527 (1954).

2. *Characterize chain split coins as unsolicited property for federal income tax purposes that are taxable if and when the recipient-taxpayer manifests acceptance by exercising dominion and control.*

Unsolicited property is property received, but not paid for, by a taxpayer. For example, this type of property includes free samples as well as unsolicited security purchase rights.³⁸ The receipt of a chain split or airdropped coin is best characterized as unsolicited property for taxpayers. Ordinary income is realized from unsolicited property if and when the taxpayer manifests acceptance by exercising dominion and control over it.³⁹ The long-standing, and consistently applied position of the IRS is that unsolicited property is realized as income only if and when a taxpayer exercises dominion and control.⁴⁰ Treasury and the IRS should clarify that the mere recording of unsolicited virtual currency on a distributed ledger is not a manifestation of acceptance. Furthermore, when the courts have considered the issue of unsolicited property, the decisions have been consistent with the IRS's position.⁴¹

While airdropped coins are distributed by developers and/or sponsors of the coin to taxpayers, chain split coins are neither distributed nor transferred to taxpayers. In either case, there is an actual receipt of property. However, actual receipt has no practical significance as both the airdropped and chain split coins are unsolicited property for federal income tax purposes and do not constitute income until the taxpayer exercises both dominion and control over the asset (*e.g.*, a book reviewer receiving books, an elected official receiving sports tickets, or a school principal receiving textbooks)⁴² (See Appendix A).

3. *Provide guidance to address any unsolicited property arising from virtual currency events, whether they are airdrops, chain splits, or similar events.*

We recommend that Treasury and the IRS clarify the terms “hard fork,” “chain split,” and “airdrop.” The current use of these terms in the ruling creates confusion for taxpayers.⁴³ Specifically, an “airdrop” is a colloquial term which, most often, is interpreted to mean a distribution of a cryptocurrency for marketing purposes by its developers and/or sponsors (*e.g.*, the promotional giveaway of a coin). We recommend that guidance redefine airdrop to include any

³⁸ See Calvin, 190 T.M., *Taxation of Cryptocurrencies* (discussing characterization of chain split coins as unsolicited property) (Bloomberg Tax).

³⁹ *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

⁴⁰ Rev. Rul. 63-225; Rev. Rul. 70-498. See also GCM 36639 (“[I]t is clearly the position of the Service that the mere receipt of [free samples] does not constitute income. Rather, the inclusion of the value of the [free samples] in income is dependent on the taxpayer accepting them as his own.”).

⁴¹ *Haverly v. United States*, 513 F.2d 224, 226 (7th Cir. 1975) (“[I]ntent to exercise complete dominion over unsolicited samples is demonstrated by donating those samples to a charitable institution ...”); *Holcombe v. Commissioner*, 73 T.C. 104, 117–18 (1979) (court indicated it might have decided based upon Rev. Rul. 70-498 had the taxpayer not failed to show that the IRS erred in its determination of the year of inclusion with respect to donated non-gift items received without cost).

⁴² See Rev. Rul. 70-498, TAM 8109004 and *Haverly*, 513 F.2d 224 (7th Cir. 1975), respectively. See further discussion on the dominion and control doctrine at Appendix A.

⁴³ As published, Rev. Rul. 2019-24 does not appear to apply to airdrops that are not the result of a hard fork.

unsolicited distribution of virtual currency. This category of unsolicited virtual currency is intended to include all unsolicited distributions or transfers of virtual currency to taxpayers other than chain split coins, which are not distributed or transferred to taxpayers. This category is recommended because the creation of new methods of distributing or transferring unsolicited virtual currency may occur in the future. Additionally, guidance should state that receipt of a coin as a reward for certain behavior should have treatment as income immediately upon receipt.

4. *Permit taxpayers to evidence their acceptance of unsolicited property resulting from virtual currency events (including chain splits, airdrops, giveaways, or other similar events) by filing a notification with the IRS similar to what is allowed under section 83(b).*

Attempting to create a mechanism or a set of rules for price discovery or price allocation, which can only take place at a moment in time after the transaction occurs, would create an undue burden for taxpayers and result in an unlimited number of approaches, inconsistently applied. Taxpayers could apply a range of reasonable approaches to determine a United States dollar (“USD”) fair value for chain splits, airdrops, and giveaways. However, taxpayers should have consistent application from one virtual currency to the next as these practices can give rise to possible manipulation or difficulty in proving when dominion and control was exercised. An election similar to what is allowed under section 83(b)⁴⁴ (see Appendix D for sample draft notification) would offer taxpayers some flexibility while providing a method for consistent application with new virtual currency events. In addition, a notification would clearly identify a point in time when income (and the amount of income) is realized under section 61.

If no notification is made, the holder reports ordinary income based on the disposition proceeds. If a notification is made, the taxpayer reports ordinary income based on value at the time the notification is made and capital gain or loss on subsequent disposition (assuming the asset is held for investment). This approach would help limit disputes between taxpayers and the IRS as to whether and how dominion and control was exercised (or not exercised) and when, and additional guidance would add clarity to the challenging situation of how to tax these virtual currency events.

II. New Question on the 2019 Form 1040, Schedule 1

BACKGROUND

Concurrent with the release of Rev. Rul. 2019-24 and new FAQs in early October 2019, the IRS updated the 2019 [Schedule 1](#), *Additional Income and Adjustments to Income*, that some individuals must include with their Form 1040 or 1040-SR. The update included a new question at the start of

⁴⁴ The notification is evidence of acceptance by the taxpayer. The notification allows taxpayers to realize gain without undergoing the risks required to claim coins at an inopportune time (*e.g.*, prior to a coin splitting service or wallet support). We understand that section 83(b) is a statutory construct that applies in a compensatory context. Therefore, our comments are not interpreted to mean that we believe the statute dictates that the section 83(b) rules apply to virtual currency chain splits outside that context. Rather, we recommend that the government exercise its authority to create a rule that is similar to section 83(b) as a way to tax chain splits that is administrable for both taxpayers and the IRS.

the form: “At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?”

RECOMMENDATIONS

The IRS should provide clarity on the new Schedule 1 question. Currently, the [Form 1040 and 1040-SR instructions](#) include a brief explanation (page 81), but do not address all the questions that taxpayers and tax practitioners have regarding this new addition. While individuals who are required to complete line items in Schedule 1 will see the new question, individuals without other income or deductions for adjusted gross income (AGI) will not know to look for the new virtual currency question on Schedule 1. Thus, some individuals who are now required to answer “yes” must attach the new Schedule 1, but may not be aware of the Schedule 1 filing requirement. They will be out of compliance. We recommend that the IRS take additional steps to prevent this situation and offer taxpayers filing relief.

We encourage Treasury and the IRS to provide clarity on the following questions:

1. If an individual moves virtual currency from one wallet to another and has no other transactions with virtual currency, what answer should they select (is this situation considered an exchange)?
2. How should taxpayers report a virtual currency gift?
3. How can taxpayers disclose transactions if they own an interest in a partnership but do not know if the partnership received, sold, sent, exchanged, or otherwise acquired any virtual currency? Or is the question specific to the individual Form 1040 taxpayer’s ownership (without considering any pass-through entity activity)?
4. Should taxpayers who claim a child or dependent credit for someone involved in or possibly involved in gaming answer “yes”?
5. When might certain gift cards or company online accounts constitute virtual currency for purposes of the new question?
6. What does the term “financial interest” mean?
7. Should an individual who holds a virtual currency but who did not use it during the year answer “yes”?

ANALYSIS

1. *If an individual moves virtual currency from one wallet to another and has no other transactions with virtual currency, what answer should they select (is this situation considered an exchange)?*

Taxpayers need clarity that moving virtual currency from one wallet to another, while having no other transactions with virtual currencies, does not create an exchange and would not warrant a “yes” answer to the question on Schedule 1.

2. *How should taxpayers report a virtual currency gift?*

If an individual received virtual currency (e.g. via gift or wages) and holds the gift without any disposition or use during 2019, they should check "yes." However, this situation results in no entry for virtual currency anywhere else on the tax return, such as on Form 8949, *Sales and Other Dispositions of Capital Assets*, or Schedule D, *Capital Gains and Losses*. Therefore, taxpayers must determine whether they should attach a statement to the return explaining why there is no transaction on the return labeled as involving virtual currency.

3. *How can taxpayers disclose transactions if they own an interest in a partnership but do not know if the partnership received, sold, sent, exchanged, or otherwise acquired any virtual currency? Or is the question specific to the individual Form 1040 taxpayer's ownership (without considering any pass-through entity activity)?*

If the question relates to the individual taxpayer's virtual currency activity including activity of pass-through entities, taxpayers need guidance as to how to properly make disclosures if they do not have access to partnerships' transactions involving virtual currency. Currently, only individual taxpayers are required to comply with answering the question on Schedule 1. However, the businesses in which they invest may have activities involving virtual currency transactions.

4. *Should taxpayers who claim a child or dependent credit for someone involved in or possibly involved in gaming answer "yes"?*

The IRS defines convertible virtual currency broadly to include cryptocurrency and non-crypto digital currencies. For example, the IRS website on virtual currency (on February 10, 2020) stated that "Bitcoin, Ether, Roblox, and V-bucks are a few examples of a convertible virtual currency."⁴⁵ Roblox and V-bucks are not cryptocurrencies. They are forms of currency used in computer and video games (such as in the popular game, Fortnite) and may or may not have the ability to convert back to cash.⁴⁶ The reference to Ether, Roblox, and V-bucks was added to the IRS website in early October 2019⁴⁷ (when Rev. Rul. 2019-24 and FAQs were released) and on February 12, 2020, the reference was removed from the website. Formal binding guidance is needed to more clearly define "virtual currency."

⁴⁵ IRS, "Virtual Currencies;" <https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies>.

⁴⁶ A website of Epic Games (at Feb. 10, 2010) states that V-Bucks are not transferable between accounts and cannot be redeemed or returned for cash; <https://www.epicgames.com/fortnite/en-US/vbuckscard>. In contrast, a website for Roblox (at Feb. 10, 2020) states that a user of Roblox who is at least 13 years old may exchange a minimum amount of Roblox in his or her account for USD; <https://www.roblox.com/developer-exchange/help>.

⁴⁷ Changes in the IRS website can be tracked using the Wayback Machine website (<https://web.archive.org/>) and the IRS URL (<https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies>).

5. *When might certain gift cards or company online accounts constitute virtual currency for purposes of the new question?*

The gaming currencies previously listed on the IRS website also share similarities with many gift cards or online accounts, such as Starbucks Stars and Amazon Coins. Taxpayers need clarification of when these digital funds are considered virtual currencies for purposes of the Schedule 1 question.

6. *What does the term “financial interest” mean?*

The mere fact that a taxpayer purchases virtual currency and holds it is not a taxable event, and therefore, the IRS has no authority to require reporting it. As a result, the IRS should provide clarity that taxpayers are not required to answer the question unless they have a taxable event. Instructions or guidance can provide that “financial interest” does not include the mere buying or holding of virtual currency. However, this answer changes if it is determined that virtual currency is reportable under the Foreign Account Tax Compliance Act (FATCA). If virtual currency is reportable, the Internal Revenue Code (“Code” or IRC) provides authority to require taxpayers to report the mere buying or holding of virtual currency.

7. *Should an individual who holds a virtual currency but who did not use it during the year answer “yes”?*

Given that certain events might occur for a virtual currency, such as a chain split or an airdrop, Treasury and the IRS should clarify whether an individual who holds a virtual currency but who did not use it during the year should answer “yes” on Schedule 1. The taxpayer may have possible receipt of a “coin” via an air drop or a chain split, even though the owner did not exercise dominion and control over the new coin (and likely did not know about the receipt).⁴⁸

For any of the above situations that require a “yes” to the Schedule 1 question, while no tax consequences occur and additional reporting is not required on the remainder of the return, taxpayers need guidance as to how (and where) they can provide the appropriate explanations regarding their Schedule 1 answer to prevent any future IRS notices.

III. Frequently Asked Questions

a. Binding Authority

BACKGROUND

The IRS issued guidance in the form of online FAQs. Unlike regulatory guidance, the FAQs did not include a notice of proposed rulemaking before the rules became operative. Meanwhile, many

⁴⁸ As discussed in our comments, we do not agree with the Service position that recording a new coin on the distributed ledger is sufficient to satisfy dominion and control thresholds, but realize that Rev. Rul. 2019-24 as currently written takes that approach.

of the topics addressed in the FAQs are economically and technologically complex, and have not been previously addressed by the IRS.

While providing information in the form of FAQs on an IRS webpage helps to answer certain questions, it is not a reliable form of guidance for taxpayers, tax preparers, or the IRS. The online FAQs are not binding and sometimes offer interpretations of law not found in binding guidance, unlike the authority that is offered by statutes, regulations, and judicial decisions. In addition, the IRS can change FAQs and it has no responsibility to track those changes. Since the initial publication of virtual currency FAQs on the webpage, the IRS has added and renumbered the FAQs. Unfortunately, this approach creates a complex and unreliable form of guidance that can have changes at any time and without notice.

RECOMMENDATIONS

Treasury and the IRS should issue guidance in the form of proposed regulations and allow a period for public comment. This process is consistent with the March 2019 Treasury policy statement⁴⁹ expressing Treasury's preference for notice and rulemaking. Specifically, the IRS should communicate FAQs in a notice published in the Internal Revenue Bulletin. The notice should modify and supersede existing Notice 2014-21, making the new webpage FAQs authoritative guidance on the treatment of virtual currency.

If the IRS does not adopt the recommendation above, and instead, maintains the FAQs on its webpage, it should add new FAQs to the end of the list, rather than inserting new items and renumbering FAQs. Treasury and the IRS should also inform taxpayers of any changes, and clearly identify where changes are made to the online list. Alternatively, the IRS could redline and add to each FAQ the date it was posted or last modified. As FAQs on the IRS's webpage are not binding authority for purposes of the penalty regulations,⁵⁰ we would also recommend a disclaimer at the bottom of the IRS FAQ webpage to clearly note the non-binding nature of the information.

ANALYSIS

A formal guidance issuance process is needed to allow the helpful information in the FAQs to become binding on both taxpayers and the IRS.⁵¹ For example, FAQ 40 allows the use of first-in, first-out (FIFO) basis to track virtual currency transactions. However, the Code requires the use of

⁴⁹ See Department of the Treasury release: "Policy Statement on the Tax Regulatory Process," issued March 5, 2019.

⁵⁰ See IRM 4.10.7.2.4 (01-10-2018) which states: "Caution: Internal Revenue Service employees must follow items published in the Bulletin and taxpayers may rely on them. Some items, such as frequently asked questions (FAQs), are found on IRS.gov but have not been published in the Bulletin. FAQs that appear on IRS.gov but that have not been published in the Bulletin are not legal authority and should not be used to sustain a position unless the items (*e.g.*, FAQs) explicitly indicate otherwise or the IRS indicates otherwise by press release or by notice or announcement published in the Bulletin."

⁵¹ As noted in the preamble to REG-107431-19 (December 17, 2019), regulations are often preferred over subregulatory guidance such as revenue procedures and notices. In the case of FAQs, this information is below subregulatory guidance and not binding on the IRS..

specific identification. Therefore, FAQ 40 suggests a method that is not allowed under the Code.⁵² In this particular example, Treasury and the IRS should provide binding guidance (in the form of regulation, revenue ruling, or notice) that permits the use of alternative options such as FIFO, last-in, first-out (LIFO), average cost basis, or other acceptable methods.

b. Tax Accounting for Virtual Currency Dispositions

BACKGROUND

Notice 2014-21 describes the application of general tax principles on transactions involving virtual currencies. The Notice answers the fundamental question for federal income tax purposes: convertible virtual currency is treated as property, but it “is not treated as currency that could generate foreign currency gain or loss.” However, this general classification does not address whether a particular convertible virtual currency could have treatment as a commodity, security, financial contract, or something else. Many of the tax consequences related to transactions involving virtual currencies are questions that taxpayers can answer without requiring special new cryptocurrency guidance if virtual currencies were specifically, rather than specially, classified for federal income tax purposes.

For example, despite the absence of explicit definitions, the general meaning of the term “commodity” for federal income tax purposes is likely to include Bitcoin.⁵³ As a result, the use of existing precedent related to adequately identifying dispositions of commodities would eliminate the need for special guidance such as that provided by the FAQs (originally, numbered as Q&A-36, -37, and -38, but later renumbered Q&A-38, 39, and 40). The special guidance provided by current FAQs Q&A-38, 39, and 40 highlights the hazards of creating special guidance specifically for cryptocurrencies. For example:

- FAQ 38 grammatically implies that a pre-trade identification of units deemed sold is a requirement (*i.e.*, a taxpayer may choose which units “are deemed to be sold, exchanged, or otherwise disposed of.”) If a pre-trade identification is (or is not) a necessary requirement, the IRS FAQs should explicitly state this guidance.
- FAQ 39 describes the information required by the IRS to constitute an effective identification. According to this FAQ, a taxpayer 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
 - Records showing the transaction information for all units of a specific virtual currency (such as, Bitcoin), held in a single account, wallet, or address.

⁵² In certain instances, specific identification is not possible for determining gain or loss where the technology for recording virtual currency occurs in wallets or similar tools. In those situations, taxpayers need other alternative methods such as FIFO or other acceptable methods.

⁵³ See Calvin, 190 T.M., Taxation of Cryptocurrencies (discussing federal income tax classification of bitcoin) (Bloomberg Tax).

RECOMMENDATIONS

Treasury and the IRS should modify the FAQs to allow taxpayers to identify a specific unit of virtual currency by documenting records that show the transaction information for units held in the taxpayer's holdings. Guidance should not limit specific identification of units to those units held in a single account, wallet, or address. Furthermore, the terms "wallet," "address," and "account" are imprecise. These terms are better suited to "specified securities" than to an undefined class of property.

We also recommend modifying the FAQs to provide that taxpayers may apply, in a reasonable manner (recognizing that brokers may not provide confirmations) the safe harbor rules applicable to stocks and securities. Guidance should also allow taxpayers to identify cryptocurrency dispositions based upon unspent transaction output (UTXO) or outpoint, and not suggest using a private key even if it might offer a reasonable identifier for federal income tax purposes.

ANALYSIS

Creating new special rules for cryptocurrencies would complicate, confuse, and likely result in unintended non-compliance by taxpayers. Cryptocurrencies fall into existing classifications for federal income tax purposes, and the tax consequences that follow from those classifications are significantly more certain.

Generally, the use of transaction records for documentation is the most practical method for the many taxpayers who trade, hold, and transfer virtual currencies on and between exchanges, wallets, custodians, and other agents. However, the FAQs greatly minimize this practicality by limiting specific identification of units to those held in a single account, wallet, or address, rather than the taxpayer's holdings.

c. Nature of Virtual Currency Held by Merchant

BACKGROUND

Many merchants who accept virtual currency, such as Bitcoin, use a third party to immediately convert the virtual currency to USD. Other merchants hold the virtual currency and likely use it to pay bills (including wages to employees) and collect virtual currency from customers. It is not clear how this virtual currency is appropriately categorized for tax purposes.

RECOMMENDATION

Treasury and IRS should provide guidance on how a merchant treats virtual currency that it holds for purposes of making payments and accepting receipts from customers.

ANALYSIS

While Notice 2014-21 confirms Treasury and the IRS's position that virtual currency is treated as property, guidance is unclear as to whether virtual currency is similar to an asset used in a trade or business (such as depreciable property), inventory (although not held for sale to customers), or other types of property. IRS's guidance on this issue is relevant for a few tax purposes, including whether the currency is a capital asset and whether there are any simplifying conventions allowed in tracking gain or loss each time the virtual currency is used or received.

IV. Form of Guidance

BACKGROUND

Five years lapsed between the original IRS issuance of Notice 2014-21 and the recent Rev. Rul. 2019-24. The new Revenue Ruling and FAQs do not have an applicability date, and government speakers have repeatedly confirmed that the IRS's positions reflected in the guidance applies retroactively.

RECOMMENDATIONS

Treasury and the IRS should issue proposed regulations before publishing guidance that is retroactively effective. Specifically, we recommend prospective application of a revised Rev. Rul. 2019-24.⁵⁴ In the absence of guidance on virtual currency events, taxpayers and tax practitioners are forced to exercise judgment and use reasonable efforts to characterize and report airdrops and chain splits for federal income tax purposes. While Notice 2014-21 stated that convertible virtual currency was treated as property, it did not answer questions involving unique characteristics of virtual currencies that do not directly correlate with other types of property.

To encourage voluntary compliance, we recommend that Treasury and the IRS provide transition relief for tax years prior to the 2019 guidance. This relief should include penalty relief for taxpayers who, by a certain date, amend their prior year tax returns for open years to take positions consistent with the IRS's guidance as modified and updated.

In the case of chain splits and air drops occurring prior to the publication of the Revenue Ruling, guidance should provide a safe harbor that would allow taxpayers to treat chain split coins claimed as having zero basis if the taxpayer recognizes ordinary gain on the date they dispose of the chain split coins. This safe harbor should allow taxpayers to amend returns for open years, if necessary.

⁵⁴ See Congressional letter to Commissioner Rettig, <https://coincenter.org/files/2019-12/letter-to-irs-dec-20.pdf> (December 20, 2019), and Monte Jackel, Letter to Michael Desmond (Chief Counsel): Recent Guidance on Cryptocurrency, 2019 TNTF 200-19 (October 15, 2019).

ANALYSIS

Many taxpayers and their tax preparers have taken reasonable, well-considered positions since 2014 (when IRS guidance was first released) to document that certain virtual currency events such as chain splits were not realization events. Other taxpayers, for various reasons that may include confusion, unawareness, or a belief that IRS was not enforcing the rules, did not report their virtual currency transactions.

Taxpayers who did not treat their virtual currency transactions consistent with Rev. Rul. 2019-24 and the FAQs for tax years prior to the guidance was issued may believe that they have no choice now but to risk an audit or amend their returns for open years and pay penalties. Individuals who wish to conform their tax treatment of virtual currency transactions, occurring in tax years prior to the new guidance, should receive transition relief to help them fully comply with the new rules.

V. Prior AICPA Recommendations Not Included in New IRS Guidance

The AICPA submitted prior recommendations on the taxation of virtual currency transactions⁵⁵ and guidance. We continue to encourage Treasury and the IRS to address the following areas:

1. Expenses of Obtaining Virtual Currency
2. Need for a De Minimis Election
3. Acceptable Valuation and Documentation
4. Valuation for Charitable Contribution
5. Holding Currency in a Retirement Account
6. Foreign Reporting Requirements
7. Treatment Under Section 1031
8. Treatment Under Section 453
9. Nature of Virtual Currency Held by Merchant

1. Expenses of Obtaining Virtual Currency

Generally, the costs of acquiring property are treated as part of the basis of that property. Notice 2014-21, Section 4, Q&A-8 explains that when virtual currency is mined, gross income is realized upon receipt at fair market value. This treatment implies that mining is akin to a service activity, rather than a production activity where income is not realized until disposition of the property. Therefore, it is appropriate that the costs of mining virtual currency are treated similarly to expenses incurred in providing other services (*i.e.*, expensed as paid or incurred).

2. Need for a De Minimis Election

Treasury and the IRS should offer administrative relief by allowing a *de minimis* exclusion for virtual currency, similar to the exclusion allowed for foreign currency transactions. Tracking small

⁵⁵ See prior AICPA letter: "[Updated Comments on Notice 2014-21: Virtual Currency Guidance](#)," submitted May 30, 2018.

amounts of gain or loss on transactions of low value creates a situation where the administrative costs outweigh any possible tax on the immaterial transactions. While section 988 only applies to currency, the IRS should exercise its administrative discretion to enforce the tax laws to create a *de minimis* safe harbor that is not subject to enforcement.

3. *Acceptable Valuation and Documentation*

Treasury and the IRS should provide additional guidance to allow taxpayers to:

- Use an average of different exchanges;
- Use the average rate for the day to calculate the exchange rate;
- Rely on virtual currency tax software as a reasonable and consistent method for determining FMV;
- Use a combination of transaction time stamps and dates (without a time stamp) in a reasonable and consistent manner and have this method considered as consistently applied;
- Apply the same reasonable and consistent method to all the transactions on a per virtual currency wallet or exchange basis; and
- Use a virtual currency price index that aggregates the prices from major exchanges, such as the CoinDesk Bitcoin Index (XBP).

4. *Valuation for Charitable Contribution*

Treasury and the IRS should provide guidance that treats charitable contributions of virtual currency valued in excess of \$5,000 the same as contributions of publicly traded stock which do not require a qualified appraisal. Alternatively, the IRS should offer an acceptable means of providing a qualified appraisal that permits reasonable methods of valuing virtual currency based on one of the methods recommended in item 3 above.

5. *Holding Currency in a Retirement Account*

Guidance should permit taxpayers to hold virtual currencies in an individual retirement account (IRA) or similar retirement savings account.⁵⁶ Taxpayers need clarity on whether other types of retirement accounts, if any, can hold virtual currencies. Guidance is also needed on what special documentation rules or requirements apply given the decentralized nature of virtual currencies and the various ways these currencies are held and transferred.

6. *Foreign Reporting Requirements*

Taxpayers need specific guidance on foreign reporting requirements for virtual currency. An IRS analyst for the Small Business/Self-Employed Division (SBSE) stated, in June of 2014, that virtual currency accounts were not reportable on the Form 114, *Report of Foreign Bank and Financial*

⁵⁶ Virtual currency is considered property and taxpayers may hold it in an IRA if all other IRA requirements under section 408(m) are satisfied.

Accounts (FBAR), for tax years ended 2014. However, this guidance was not formally written by the agency and no guidance was provided in regard to future tax years.

The AICPA Virtual Currency Tax Force recently contacted Treasury's Financial Crimes Enforcement Network (FinCEN) in regard to whether FBAR reporting was required. FinCEN responded that the regulations under 31 Code of Federal Regulations (CFR) § 1010.350(c) do not define virtual currency held in an offshore account as an account that is required for reporting. While AICPA members have been relying on this informal statement, the FinCEN has not issued formal written guidance to the general public.

The AICPA recommends that Treasury and the IRS should:

- Issue formal written guidance to make an affirmative statement regarding the application of FATCA⁵⁷ to virtual currency;
- Provide guidance to require taxpayers who hold virtual currencies and/or fiat currencies on centralized virtual currency exchanges, operating in a jurisdiction other than the U.S., to report the value of the virtual currencies; and
- Clarify that virtual currency wallets, where taxpayers own, control, and are in possession of private keys for the wallets, are not considered a Foreign Financial Institution (FFI) for purposes of both FBAR and FATCA compliance.

We recommend that FinCEN make an affirmative statement in authoritative published guidance regarding whether virtual currency is subject to FBAR reporting. Guidance should explain whether there are circumstances that may alter virtual currency accounts into foreign financial assets under section 6038D, and therefore require reporting on Form 8938, *Statement of Specified Foreign Financial Assets*. Additionally, guidance should provide whether additional reporting obligations exist under FATCA or whether there are other requirements for money services businesses (MSB) that exchange virtual currency. For example, guidance should clarify whether the IRS considers this exchange a financial institution activity. Guidance should also clarify whether virtual currency accounts may become reportable on Form 114.

Virtual currency wallets are owned and controlled by the taxpayer when in possession of the private key for that particular wallet. In this case, the virtual currency is considered cash that resides wherever the taxpayer resides and is, therefore, not considered a Foreign Financial Institution or subject to either FBAR or FATCA compliance.

Conversely, when a taxpayer owns, controls and is in possession of a private key for a virtual currency wallet, it has 100% custody and control over all of the virtual currencies held in that wallet. If the taxpayer loses the private key, it lose all of its funds. This concept is akin to the taxpayer holding cash, gold, or any other asset in its personal possession. When the taxpayer owns, controls, and is in possession of the private key, the virtual currency resides in the country of the taxpayer's residence. In the case of a U.S. resident, the virtual currency, by definition, resides in

⁵⁷ Under both section 6038D and Chapter 4 of the Internal Revenue Code.

the U.S. There is no FFI of any kind because the taxpayer maintains possession similar to cash or gold. The same principles apply to both the FBAR and FATCA.

7. *Treatment Under Section 1031*

Treasury and the IRS should provide that section 1031 applies to an exchange before 2018 of virtual currency held for investment or business (other than dealer property) and note the key factors relevant in determining when one virtual currency is like-kind to another.⁵⁸

Notice 2014-21 provides that virtual currency is treated as property. Thus, if the property is held for investment or business (not dealer property), and all requirements of section 1031 are satisfied, like-kind exchange treatment applies if the exchange occurs before 2018. Taxpayers need guidance in order to properly interpret and apply the rules and regulations in this area. Guidance on the relevant factors to determine if two virtual currencies are like-kind is necessary, along with guidance on whether any of the existing section 1031 rules apply differently given the various types of virtual currencies, how they are held, and how taxpayers can transfer them.

8. *Treatment Under Section 453*

Treasury and the IRS should provide that the installment method in section 453 applies to virtual currencies. The installment method applies to virtual currencies that are not dealer property or inventory and requires reporting on Form 6252, *Installment Sale Income*. If the taxpayer elects out of the installment method treatment, this method would not apply.

⁵⁸ If the requirements of that section are otherwise satisfied.

APPENDIX

A) The Dominion and Control Doctrine as it Applies to Unsolicited Property

The IRS and courts have applied the dominion and control doctrine to free samples and capital market transactions. In both published and private rulings, valuable rights received by a taxpayer without payment to purchase shares in an unrelated corporation were not treated as taxable upon receipt, but, instead, taxable at the time the taxpayer exercised dominion and control.⁵⁹

Ordinarily, a taxpayer who uses the cash receipts and disbursements method of accounting must include items of gross income in the taxable year when actually or constructively received.⁶⁰ However, "... where a taxpayer receives 'unsolicited' property that is otherwise includible in gross income, the IRS has determined that the property is includible in income only when the taxpayer manifests acceptance of the property by exercising dominion and control over such property."⁶¹ The dominion and control doctrine is focused on whether something is income while the constructive receipt rule addresses when a cash method taxpayer reports income.

Notably, the IRS held in Rev. Rul. 70-498, 1970-2 C.B. 6, that a newspaper's book reviewer did not have gross income per section 61 for the value of unsolicited books received from publishers until he donated to a charitable organization and claimed a charitable deduction. This ruling was issued to supersede an earlier ruling, Rev. Rul. 70-330, 1970-1 C.B. 14, which held that mere retention of unsolicited books was sufficient to cause them to have gross income.

GCM 36639 considered these rulings and concluded:

... it is clearly the position of the Service that the mere receipt of books does not constitute income. Rather, the inclusion of the value of the books in income is dependent on the taxpayer accepting them as his own. The taxpayer manifests this acceptance if he contributes the books to charity and claims a deduction therefor, sells them, or places the books in his own library. The taxpayer does not receive income if he returns the books or discards them. In addition, the Service in *** and

⁵⁹ Rev. Rul. 63-225; GCM 32441 (November 19, 1962). Compare PLR 8821082, PLR 8811034, PLR 8801053 (citing Rev. Rul. 63-225, certain account holders did not recognize income upon receipt of subscription rights distributed without payment as part of a conversion of mutual savings banks or associations), and GCM 7246 (same rationale for purposes of realization; however, the character of income was ordinary based on the then current law)) with Rev. Rul. 70-521 (distribution of share purchase rights by a corporation to its shareholders was taxable under § 301), and GCM 32441 (November 19, 1962)). See also GCM 37452 (March 9, 1978) (dominion and control was presumed to occur when unilaterally extended warrants were exercised after the expiration of the original warrants, sold, exchanged or otherwise disposed of (e.g., by gift or charitable contribution)).

⁶⁰ Treas. Reg. §1.451-1(a).

⁶¹ TAM 8109004, TAM 8109003. See also Rev. Rul. 70-498 (book reviewer must include in his gross income the value of unsolicited books received from publishers at the time he donated the books to a charitable organization and for which a charitable deduction was taken.), *superseding* Rev. Rul. 70-330 (mere retention of unsolicited books was sufficient to cause them to have gross income); Rev. Rul. 63-225 (GCM 36639 ("[I]t is clearly the position of the Service that the mere receipt of [free, unsolicited samples] does not constitute income under section 61. Rather, the inclusion of the value of the [free samples] in income is dependent on the taxpayer accepting them as his own.")).

Haverly did not claim that the taxpayers derived income when they examined or stored the books.

Revenue Ruling 63-225 considered unsolicited security purchase rights received by a taxpayer.⁶² In Rev. Rul. 63-225, a taxpayer, by virtue of being a shareholder of M corporation, received from an unrelated corporation, N, at no cost to himself, rights to purchase debentures and common stock of N corporation. The taxpayer in the ruling sold the rights immediately. The taxpayer was treated as not realizing any taxable income upon their actual receipt of the rights from N corporation; instead, the taxpayer was taxable at the time he manifested acceptance by selling the rights.⁶³

Exercising Dominion and Control

A sale of unsolicited property, as in Rev. Rul. 63-225, is not the only method of exercising dominion and control. A transfer of some, but not all, of the unsolicited property received by a taxpayer may demonstrate the taxpayer's intent to exercise dominion and control over it all. For example, in two private letter rulings, the IRS held that the fair market value of all complimentary tickets received by a taxpayer were includible in income in the year in which he demonstrated intent to exercise dominion and control. In Private Letter Ruling (PLR) 8109003, involving the receipt by the taxpayer of most of one of two separate sets of season sports tickets, and all of the second, the fact that the taxpayer had given away most, but not all, of the complimentary tickets demonstrated their intent to exercise dominion over all of the tickets.⁶⁴ In IRS Technical Advice Memorandum (TAM) 8109004, the IRS treated the transfer of any one of a series to a third party and the personal use of any of the other series as demonstrating an intent to exercise dominion over all of the tickets.

Revenue Ruling 2019-24 treats the time at which a taxpayer can dispose of airdropped coins as equivalent to the taxpayer actually exercising dominion and control over those coins.⁶⁵ The IRS's

⁶² Rev. Rul. 63-225, 1963-2 C.B. 339; GCM 32441 (November 19, 1962) (concurring with Rev. Rul. 63-225); see, also, PLR 8821082, PLR 8811034, and PLR 8801053 (citing Rev. Rul. 63-225, certain account holders did not recognize income upon receipt of subscription rights distributed without payment as part of a conversion of mutual savings banks or associations); GCM 7246: C.B. VIII-2-4461 (1929) (same rationale for purposes of realization; however, character of income was ordinary based on the then current law); compare, *e.g.*, with Rev. Rul. 70-521, 1970-2 C.B. 72 (distribution of share purchase rights by a corporation to its shareholders was realized under §301). GCM 37452 (March 9, 1978) (dominion and control was presumed to occur when unilaterally extended warrants were exercised after the expiration of the original warrants, sold, exchanged, or otherwise disposed of (*e.g.*, by gift or charitable contribution)).

⁶³ See, also, GCM 32441 (November 19, 1962) (compare Rev. Rul. 63-225 as issued stating that the rights were sold immediately to the original draft stating that the rights were held for less than the long-term holding period prior to sale), and GCM 37452 (March 9, 1978) (recommending that the holding of Rev. Rul. 63-225 be modified to indicate that ordinary income is recognized when dominion and control is exercised over such rights); however, while Rev. Rul. 63-225 was not modified as recommended, the AICPA agrees with that recommendation.

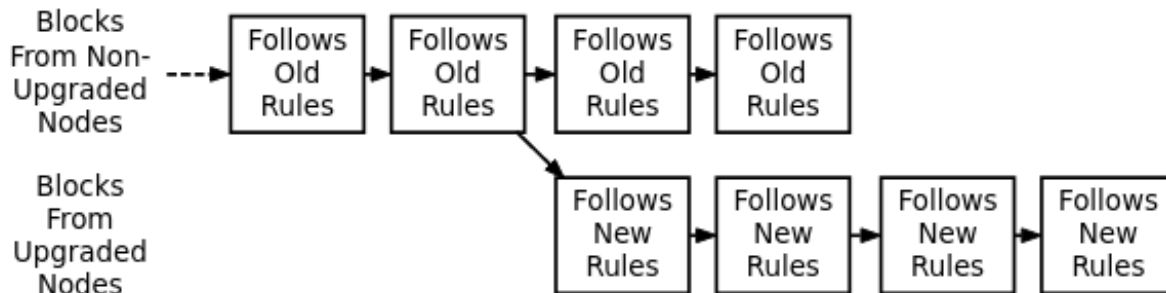
⁶⁴ PLR 8109003 (gift by the taxpayer of most of one of two separate sets of season tickets, and all of the second).

⁶⁵ See II.A.5. The dominion and control standard in the ruling (which is different than the standard the IRS applies to unsolicited property) is invoked when the ruling incorrectly permits a third-party agent (an exchange is used as an example in the ruling) to defer realization of airdrop coins on behalf of beneficial owners if the agent delays crediting the coins to the accounts of beneficial owners.

long-standing administrative policy, which has been considered and approved by the courts, conditions taxability of unsolicited property on an actual exercise of dominion and control. This standard has been consistently applied by the IRS to rights and property received, but not paid for, by a taxpayer. The standard applies to free samples as well as to valuable property and security purchase rights. It is applied to the receipt of unsolicited property by taxpayers even if they know they will receive, or reasonably should anticipate receiving, unsolicited property.⁶⁶

B) Persistent Chain Split

A persistent chain split is caused by a software upgrade that changes consensus rules activated and supported by miners, developers, and others. The graphic⁶⁷ below illustrates a permanent blockchain divergence (*i.e.*, a persistent chain split). One chain follows the old rules while the other chain follows the new rules, which, for example, would depict the Bitcoin Cash (new rules) chain split from Bitcoin (old rules).⁶⁸



A Hard Fork: Non-Upgraded Nodes Reject The New Rules, Diverging The Chain

A block that adheres to the new consensus rules is accepted by upgraded nodes but rejected by non-upgraded nodes. Mining software receives block chain data from non-upgraded nodes that does not build on the same chain as mining software receiving data from upgraded nodes. This change creates a persistent chain split – one built on by non-upgraded nodes and one built on by upgraded nodes. The observable economic outcome of a persistent chain split, which have tax consequences if realized, are the resulting chain split coins that reference the pre-split transaction history of the legacy blockchain.

Note: Not all chain splits persist. Temporary chain splits can occur without a software change. These splits eventually reconverge with the best, valid blockchain.

⁶⁶ See, e.g., *Haverly v. United States*, 513 F.2d 224 (7th Cir. 1975) (unsolicited books received by a school principal); Rev. Rul. 70-498 (unsolicited books received by a taxpayer employed by a newspaper as its book reviewer); TAMs 8109004 and 8109003 (unsolicited sports tickets received by a taxpayer on the Board of Supervisors supervising the operation of a stadium); GCM 36639 (unsolicited congressional record received by a member of Congress).

⁶⁷ Source: Bitcoin Developer’s Guide, Consensus Rule Changes, <https://bitcoin.org/en/blockchain-guide#consensus-rule-changes>.

⁶⁸ See also Jimmy Song, Replay Attacks Explained, <https://bitcointechtalk.com/replay-attacks-explained-e3d6d2ea0ab2>.

C) Bitcoin Cash Value Realized

As an example, we evaluated data related to Bitcoin Cash.⁶⁹ The data suggests that (a) gross income realized at the time chain split coins are claimed (*i.e.*, actual exercise of dominion and control by taxpayers) substantially exceeds (b) gross income theoretically realizable at the time of the chain split). Generally, we would anticipate this result as taxpayers seek to maximize realizable value. In addition, a higher price justifies the effort required to claim coins and accept or mitigate related risks. The example is not intended to suggest a tax policy which maximizes revenue. Instead, it highlights the fact that taxpayers claim chain split coins when those coins are perceived to have value.

Tables

Table 1 is an estimate of the value of Bitcoin Cash at the time of the chain split. We have assumed that legacy holders could have claimed Bitcoin Cash chain split coins at the time of the chain split and have applied the opening price in the futures market on the date of the chain split, August 1, 2017. Table 2 compares the estimated value of Bitcoin Cash chain split coins on the date these coins were claimed by taxpayers (based on a volume-weighted average price for the date claimed) to the estimated value of Bitcoin Cash at the date of the chain split (Table 1). Table 3 provides an estimate of value realized by calendar year, and an estimate of unrealized value as of November 28, 2019 (based on a closing price for that date).

Note: The realized value of Bitcoin Cash chain split coins claimed in calendar year 2017 (\$5.2B) exceeded the realizable value of all Bitcoin Cash chain split coins at the time of the chain split in 2017 (\$4.9B).

Table 1 - Estimated Value if Realized at Chain Split

16,482,748.59	Bitcoin Cash at chain split (equal to Bitcoin supply)
\$294.60	Bitcoin Cash opening price (August 1, 2017)
<u>\$4,855,817,734.61</u>	Value of Bitcoin Cash at chain split

Table 2 - Estimated Difference in Value Realized as of November 28, 2019

\$7,329,451,745.33	Value of Bitcoin Cash when claimed (November 28, 2019)
\$4,855,817,734.61	Value of Bitcoin Cash at chain split
<u>(\$2,473,634,010.72)</u>	Estimated difference (November 28, 2019)

⁶⁹ Coin Metrics, *Network Data*, <https://coinmetrics.io/> (November 28, 2019).

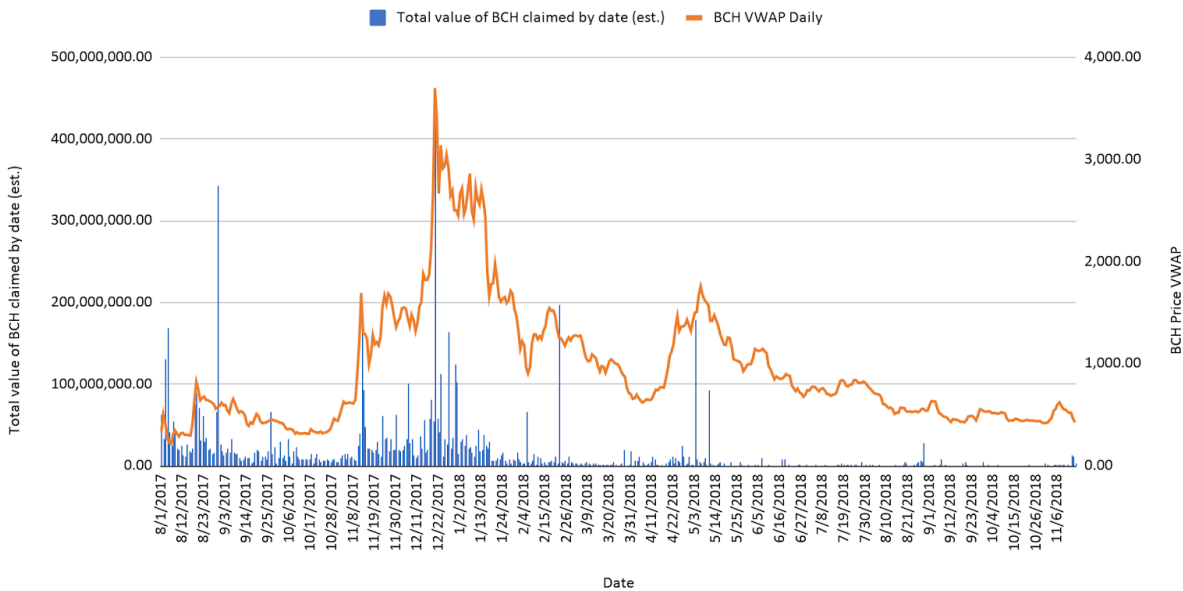
Table 3 - Years Value Realized (Estimated)

\$5,191,282,971.37 Value of Bitcoin Cash chain split coins claimed in 2017
 \$1,952,721,948.52 Value of Bitcoin Cash chain split coins claimed in 2018
 \$185,446,825.44 Value of Bitcoin Cash chain split coins claimed 2019 (November 28, 2019)
 \$1,427,645,349.51 Value of unclaimed Bitcoin Cash chain split coins (November 28, 2019)

Chart

The following chart, derived from the same data, graphically illustrates the value realized from Bitcoin Cash chain split coins (Total value of BCH claimed by date (est.)) and the Bitcoin Cash price (BCH VWAP Daily) from the date of the Bitcoin Cash chain split (August 1, 2017) to the date of the Bitcoin SV chain split from Bitcoin Cash (November 15, 2018).

BCH Coin Split Value Realized (est)



D) Taxpayer Irrevocable Notice of Acceptance and Inclusion in Ordinary Income of Unsolicited Virtual Currency

The sample notification below is based on the requirements provided in Treas. Reg. § 1.83-2(e). See [Rev. Proc. 2012-29](#), page 9 for a sample election under section 83(b): <https://www.irs.gov/pub/irs-drop/rp-12-29.pdf>. The notification would constitute a taxpayer's irrevocable and unequivocal acceptance of all unsolicited chain split coins received from a chain split event, or other unsolicited virtual currency event.

Notice to Include a Virtual Currency Event as Ordinary Income in Year Received

The undersigned taxpayer hereby accepts and shall, pursuant to [IRS Guidance on Virtual Currency], include in ordinary income the fair market value of the virtual currency described below.

1. The name, taxpayer identification number, address of the undersigned, and the taxable year for which this notification is being made are:

TAXPAYER'S NAME: _____
TAXPAYER IDENTIFICATION NUMBER: _____
ADDRESS: _____
TAXABLE YEAR: Calendar Year 20__

2. The property which is the subject of this notification is [specify virtual currency or currencies, event type, and event date].

3. The property was received by the undersigned on [date received by taxpayer].

4. The fair market value of the property at the time notification is made: \$_____.

The undersigned taxpayer will file this notification with the Internal Revenue Service office with which taxpayer files his, her or its annual income tax return not later than 30 days after the date the virtual currency was received. The undersigned is the person with potential economic benefit in connection with the virtual currency event.

Dated: _____ Taxpayer: _____