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IRS Officials Discuss Promotional Airdrops, Pre-2018 Crypto-for-Crypto Exchanges, and Other Issues Not Addressed in Recent Tax Guidance

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In October of 2019, the U.S. Internal Revenue Service issued the first new guidance on the taxation of cryptocurrency transactions in over five years (the "Guidance"). The Guidance comprising a revenue ruling (Rev. Rul. 2019-24) and answers to frequently asked questions on the taxation of cryptocurrency transactions published on the IRS's website.

This post discusses recent news reports of statements by officials with the IRS and the Treasury Department's Financial Crimes Enforcement Network (FinCEN) concerning issues not explicitly addressed in the Guidance.

Please refer to our earlier post for complete coverage of the Guidance.

1. ***Tax treatment of promotional airdrops remains uncertain***

Revenue Ruling 2019-24 indicated that cryptocurrency received in a hard fork would be taxable to the owner at the moment the new units of cryptocurrency issued in connection with the hard fork are "received" by the holder of the legacy cryptocurrency, which is generally the moment the units of the new cryptocurrency are "airdropped" to the legacy holder's wallet, provided the holder is able to exercise "dominion and control" over the units at that time.

Because the facts of the ruling involved a hard fork (i.e., a change in the protocol of a cryptocurrency's blockchain causing the creation of a new blockchain and, therefore, a new cryptocurrency), it was not clear whether the same rule would apply to airdrops of cryptocurrency received in other contexts. Airdrops may occur for promotional or marketing purposes by blockchain-focused startups in order to generate interest in the startup in connection with an upcoming ICO or to encourage mass adoption of the cryptocurrency. The coins may be distributed for free to holders of existing cryptocurrencies (such as Bitcoin or Ethereum), or may be "earned" by posting to social media or referring the cryptocurrency to other users.

An attorney in the IRS Office of the Associate Chief Counsel clarified in recent comments that promotional airdrops are not within the scope of Revenue Ruling 2019-24, but also noted that the IRS had not yet reached a decision on the tax treatment of these airdrops

2. ***Valuation and receipt issues for airdropped coins***

If coins of a new cryptocurrency are "received" for tax purposes, the owner of the cryptocurrency is required to include in its taxable income the fair market value—generally, the trading price—of the cryptocurrency at the moment of its receipt. An attorney for the IRS speaking before a recent conference of the American Institute of CPAs (AICPA) in Washington, D.C., suggested that a limited market for new coins may affect their valuation and that a zero valuation may be appropriate for a cryptocurrency that cannot be disposed of at all.

The same attorney also noted that, depending on the specific facts, a taxpayer may be treated as actually or constructively receiving coins of the new cryptocurrency distributed in a hard fork even if it is necessary for the taxpayer to download new software or undertake some other ministerial-type action to accept (or later to transfer) the cryptocurrency. Taxpayers cannot avoid or delay a taxable event simply by declining to accept the airdropped coins.

3. ***"Like-kind" exchange treatment for pre-2018 crypto-for-crypto exchanges remains uncertain and may depend on the facts of the transaction***

Prior to the changes in the tax law brought about by Public Law 115-97 (commonly known as the Tax Cuts and Jobs Act, or TCJA), gain realized on certain exchanges of property for like-kind property used in a taxpayer's trade or business or otherwise held for investment was not immediately subject to U.S. federal income tax by reason of section 1031 of the U.S. Internal Revenue Code. Such transactions are commonly referred to as "like-kind exchanges." For tax years beginning after December 31, 2017, like-kind exchange treatment is limited to exchanges of real property.

Some taxpayers (and some tax advisors) have taken the position with respect to pre-2018 tax years that certain cryptocurrency-for-cryptocurrency exchanges qualified as like-kind exchanges. While this question was not addressed in the Guidance, an IRS attorney speaking before the same AICPA conference indicated that like-kind exchange treatment would depend on the specific facts of the transaction, suggesting there may be circumstances in which cryptocurrency-for-cryptocurrency exchanges would qualify as like-kind exchanges under pre-TCJA law.

4. ***Offshore cryptocurrency accounts may be reportable on IRS Form 8938***

No official guidance has been issued confirming whether cryptocurrency assets held through a foreign exchange are required to be reported either on a foreign bank account report (FBAR) or an IRS Form 8938 (*Statement of Specified Foreign Financial Assets*).

A FinCEN official confirmed in comments before the same AICPA conference that cryptocurrency is not required to be reported on an FBAR. (This is consistent with previous statements made by FinCEN to the AICPA Virtual Currency Tax Force.)

However, taxpayers may be required to report cryptocurrency held through a foreign exchange on a Form 8938 attached to their annual tax return. Whether an asset is reportable on Form 8938 will depend on whether a cryptocurrency wallet hosted on a foreign exchange is treated as a "financial account" maintained by a "foreign financial institution." While these terms are defined in the instructions to Form 8938, their application in the cryptocurrency context is less than straightforward.

An IRS official speaking to the publication *Tax Notes* indicated that the IRS likely would not penalize taxpayers for failing to report foreign-held cryptocurrency assets in previous tax years—provided these taxpayers have properly reported their taxable cryptocurrency transactions on their federal income tax returns in prior years and properly report such assets and transactions on their tax returns (including on a Form 8938, if applicable) from the current year forward.

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