The IRS Issues Guidance on Cryptocurrency Hard Forks and Airdrops

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Last month, the Internal Revenue Service issued its first guidance on the taxation of cryptocurrency in five years. Revenue Ruling 2019-24 addresses the taxation of “hard forks” and the IRS’s version of “air drops.”

Technically, hard forks are software changes that split a network into two — the network running the original software and the network running the new software. The coin that trades on the network with the new software is considered a hard fork of the coin from the original network. Bitcoin cash and ethereum classic are results of a hard fork.

An airdrop is a distribution of a token or coin to numerous holders' wallets and results in a holder receiving new coins with no action on the holder’s part. Airdrops are used to increase the size of a network, resulting in a larger user-base and a wider distribution of tokens or coins.

The taxation of hard forks has been uncertain. The new forked coins might seem like stock dividends or calves from cows (nontaxable), or more like awards and prizes (taxable). Under the new IRS ruling, a hard fork will be a taxable event if a taxpayer receives units of a new cryptocurrency. The taxpayer will have income equal to the fair market value of the coins created in the hard fork, which will be recognized when the taxpayer has “dominion and control over the cryptocurrency so that [he/she] can transfer, sell, exchange, or otherwise dispose of the cryptocurrency.” Thus, a fork in a blockchain may result in tax obligations for every holder of coins on the chain. Similarly, an airdrop of new tokens or coins will result in income to the recipients when received.

The IRS also issued a set of FAQs on the same day addressing other issues relating to cryptocurrencies. The FAQs provide that a taxpayer’s basis in crypto will be the amount spent to acquire the cryptocurrency, the quoted price on the exchange, or the fair market value as reported on an index, depending on how the crypto was acquired. Taxpayers are expressly permitted to use specific identification or first-in-first-out (FIFO) accounting to calculate gains or losses. These rules are generally viewed as taxpayer favorable as prior to the FAQ it was not clear that taxpayers could use FIFO.