CUMMINGS & LOCKWOOD LLC

IRS AND U.S. TREASURY RELEASE GUIDANCE ON CRYPTOCURRENCY REPORTING

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IRS Guidance: Tax Consequences of Staking

Crypto staking rewards are a kind of digital “dividend” or “interest” paid to cryptocurrency owners who help regulate and validate cryptocurrency transactions in the underlying blockchain network. Staking pays out cryptocurrency as compensation for using the owner’s existing holdings to vouch for the accuracy of the transactions. On July 13, 2023, the IRS issued Rev. Rul. 2023-14 which addresses the U.S. federal income tax consequences to a cash-method taxpayer who receives additional cryptocurrency units as a reward for validating transactions on a proof-of-stake blockchain. Citing case law which provides that an accession to wealth over which the taxpayer has dominion and control constitutes income, the ruling clarified that the taxpayer is required to include the fair market value of the validation reward in gross income in the taxable year that the taxpayer has sufficient “dominion and control” of the reward through his/her ability to “sell, exchange or otherwise dispose of” the reward.

Some taxpayers had previously argued that crypto staking rewards received directly from the blockchain should be analogized to self-created property, which is not taxed until disposition. Rev. Rul. 2023-14 clearly takes the position that staking rewards are income to the recipient when received. Taxpayers who receive staking rewards should maintain thorough records of the fair market value of these rewards and the date dominion and control is acquired for tax compliance purposes.

U.S. Treasury and IRS Guidance: Proposed Cryptocurrency Regulations

The Infrastructure Investment and Jobs Act of 2021 expanded the scope of information reporting obligations for brokers to cover digital assets, including cryptocurrency. On August 25, 2023, the U.S. Treasury Department issued proposed regulations which would require cryptocurrency brokers to report information on sales and exchanges of digital assets to the IRS in a manner similar to brokers of other financial instruments such as stocks and bonds. Under the proposed regulations, brokers will be required to report the gross proceeds from the sale of digital assets occurring on or after January 1, 2025. Brokers will also be required to report the adjusted basis and character of the gain or loss for sales effected on or after January 1, 2026. Brokers will use a newly developed IRS Form 1099-DA to report the required information, including:

- When the taxpayer obtained the digital asset (acquisition date)
- How much the taxpayer paid for the digital asset (cost basis)
- When the taxpayer sold the digital asset (sale or disposition date)
- How much money the taxpayer received from selling the digital asset (sales proceeds)
- Gross proceeds (total proceeds from the exchange or broker, not taking cost basis into account)

In addition, the proposed regulations would require real estate reporting persons (e.g., title companies, closing attorneys, mortgage lenders) who are treated as brokers for dispositions of digital assets to report the disposition of digital assets paid as consideration by real estate purchasers to acquire real estate in transactions that close on or after January 1, 2025. These real estate reporting persons would also be required to include on IRS Form 1099-S the fair market value of the digital assets paid to sellers in real estate transactions that close on or after January 1, 2025.

Finally, the proposed regulations set forth gain (or loss) computation, basis determination and backup withholding rules applicable to digital asset sale and exchange transactions.

Under the proposed regulations, brokers would start reporting information on digital asset sales and exchanges from 2025, with the reporting requirement commencing in 2026. Until the regulations are final, however, the proposed regulations provide a basic framework for anticipating the coming regulatory and reporting scheme that will be applicable to digital assets and related transactions.

If you have any questions regarding this alert, please contact your Cummings & Lockwood attorney.