Current Federal Tax Developments

Week of October 14, 2019

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ACCOUNTING
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CURRENT FEDERAL TAX DEVELOPMENTS
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Current Federal Tax Developments

Kaplan Financial Education

Table of Contents

SECTION: SECURITY
IRS EXPANDS VOLUNTARY IP PIN PROGRAM TO ADDITIONAL 10 STATES

Citation: "IRS Makes Identity Protection PINs Available to More Taxpayers," e-News for Tax Professionals, Issue 2019-36, 10/4/19

The IRS has expanded the number of states by 10 for which residents can voluntarily apply for an Identity Protection Personal Identification Number (IP PIN). This expansion was announced by the IRS in its *e-News to Tax Professionals* email subscription sent out on October 4, 2019.[1]

The IP PIN program was created to combat tax-related identity theft. Originally the PINs were issued only at the IRS's discretion to actual or suspected victims of tax-related theft. As Kay Bell notes on her website, in 2010 the IRS created a pilot program in 2010 to allow for taxpayers to voluntarily request IP PINs, limited to only the three areas that had the highest level of tax related identity theft.[2]

Last year the IRS had their first expansion of the program, offering the program to residents of 9 states and the District of Columbia.[3] During 2019 Congress mandated in the Taxpayer First Act that the program be expanded so that by July 1, 2024 all taxpayers could opt to participate in the program.[4]

For 2020 the program will be offered to those who filed a 2019 income tax return in the following states:

- Arizona,
- California, *
- Colorado,
- Connecticut,

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[1] "IRS Makes Identity Protection PINs Available to More Taxpayers," *e-News for Tax Professionals*, Issue 2019-36, October 4, 2019

[2] Kay Bell, "Taxpayers in 19 states & D.C. now can get special IRS IP PIN to fight tax identity theft," *Don't Mess With Taxes,* October 6, 2019 (retrieved October 7, 2019)

[3] Kay Bell, "Taxpayers in 19 states & D.C. now can get special IRS IP PIN to fight tax identity theft," *Don't Mess With Taxes,* October 6, 2019 (retrieved October 7, 2019)

[4] Taxpayer First Act of 2019, Act Section 2005

- Delaware, *
- District of Columbia, *
- Florida, *
- Georgia, *
- Illinois, *
- Maryland, *
- Michigan, *
- Nevada, *
- New Jersey,
- New Mexico,
- New York,
- North Carolina,
- Pennsylvania,
- Rhode Island, *
- Texas and
- Washington.[5]

* States where residents were eligible to participate in the program in 2019.[6]

The IRS has been using the states with the largest number of ID thefts reported by the FTC to add to the list in the past.[7] Although the email does not indicate how the new states were selected, given the population sizes of the states being added it is likely the

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[5] "IRS Makes Identity Protection PINs Available to More Taxpayers," *e-News for Tax Professionals*, Issue 2019-36, October 4, 2019

[6] "Get An Identity Protection PIN (IP PIN)," IRS Website, September 20, 2019 version, https://www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin, retrieved October 7, 2019

[7] Kay Bell, "Taxpayers in 19 states & D.C. now can get special IRS IP PIN to fight tax identity theft," *Don't Mess With Taxes,* October 6, 2019 (retrieved October 7, 2019)

IRS is continuing to use the FTC list of absolute numbers of ID thefts reported to expand the program—so Wyoming residents may have a while to wait to get added to the list if for no other reason than are just far fewer people in Wyoming than most other states.

Note—as the IRS writes in its description of the program on IP PIN page, once a taxpayer opts into the program there's no way to get out of the program. The program is described as follows:

> An IP PIN is a six-digit number assigned to eligible taxpayers that helps prevent the misuse of their Social Security number on fraudulent federal income tax returns.
>
> Requesting an IP PIN is strictly voluntary. If you choose not to participate in the program by not requesting an IP PIN, you can file your return as you would normally. If you are assigned or if you request an IP PIN, you must use it to confirm your identity on any tax returns filed electronically during the calendar year. A new IP PIN is generated for each filing season and can be retrieved starting in mid-January of each year by logging into the account you create. **At this time, if you choose to receive an IP PIN, you must use your IP PIN for all future filings.**[8]

The IRS web page for requesting an IP PIN had not been updated as of the morning of October 7, 2019 to provide for the new states for which an IP PIN can be requested and it's not clear if taxpayers in the newly added states would be able to request an IP PIN right away.[9]

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[8] "Get An Identity Protection PIN (IP PIN)," IRS Website, September 20, 2019 version, https://www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin, retrieved October 7, 2019

[9] "Get An Identity Protection PIN (IP PIN)," IRS Website, September 20, 2019 version, https://www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin, retrieved October 7, 2019

Taxpayers requesting an IP PIN will need to complete the IRS's secure access identity verification process[10] in order to be admitted to the program.[11]

Should clients enter this program? There are advantages and disadvantages to the program that a taxpayer should understand before entering the program—but entering the program is something clients likely should consider.

The key advantage of entering the program is the taxpayer makes it much more difficult for a third party to use the taxpayer's information to commit tax-related identity theft. As Kay notes in her post, acting before a problem occurs is much more effective than only taking such an action following a tax-related ID theft incident.[12] Taxpayers who have been through tax-related identity theft are aware of all of the problems triggered in such an incident, including delayed refunds and inability to get confirmation of tax numbers for lenders.

With the large number of data breaches that have been reported recently, getting an IP PIN may be the only effective way to protect the taxpayer from tax-related identity theft. Virtually all U.S. taxpayers have likely had most of their key information leaked by some organization by now.

But there are also issues with the program. First, remember that once a taxpayer enters this program there's no way out. That makes sense—if there was a simple way out, fraudsters would simply attack that program to "free up" returns. Security concerns dictate that it should be very difficult, if not nearly impossible, to get out of the program. But since it will reduce convenience, a number of clients will likely find the program too much of a bother (after all, they haven't had a problem yet, so…)

And that brings us to the second problem—the taxpayer must assure that they retrieve and secure the IP PIN each year. The taxpayer will be responsible for getting his/her IP PIN each year. As the IRS notes:

> **Getting Your IP PIN**
>
> To get your IP PIN, you must be eligible as determined in Step 1 below. Your IP PIN will be displayed to you online once we verify

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[10] "Secure Access: How to Register for Certain Online Self-Help Tools," IRS website, https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools, retrieved October 7, 2019

[11] "Get An Identity Protection PIN (IP PIN)," IRS Website, September 20, 2019 version, https://www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin, retrieved October 7, 2019

[12] Kay Bell, "Taxpayers in 19 states & D.C. now can get special IRS IP PIN to fight tax identity theft," *Don't Mess With Taxes,* October 6, 2019 (retrieved October 7, 2019)

> your identity. A new IP PIN is generated for each filing season and can be retrieved starting in mid-January of each year by logging into the account you create.[13]

If the taxpayer loses his/her IP PIN for the year and loses his/her credentials to log into the IRS website to obtain the current year IP PIN, the taxpayer must go through the process to get the IP PIN reissued.

The IRS describes that process as follows:

> **How to get your IP PIN reissued**
>
> If you're unable to retrieve your IP PIN online, you may call us at 800-908-4490 for specialized assistance, Monday - Friday, 7 a.m. - 7 p.m. your local time (Alaska & Hawaii follow Pacific Time), to have your IP PIN reissued. An assistor will verify your identity and mail your IP PIN to your address of record within 21 days.
>
> Exceptions:
>
> - If you've moved since January 1 of this year, or
> - It's after October 14 and you haven't filed your current or prior year Forms 1040 or 1040 PR/SS,
>
> you'll need to complete and mail a paper tax return without your IP PIN. We'll review your return to confirm it's yours but this may delay any refund you're due.[14]

As was noted, if the taxpayer can't get the new IP PIN issued, the only option is to paper the tax return as any electronically filed return submitted without the proper IP PIN will be rejected. As well, the paper return is going to be subjected to additional

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[13] "Get An Identity Protection PIN (IP PIN)," IRS Website, September 20, 2019 version, https://www.irs.gov/identity-theft-fraud-scams/get-an-identity-protection-pin, retrieved October 7, 2019

[14] "Retrieve Your Identity Protection PIN (IP PIN)," IRS website, https://www.irs.gov/identity-theft-fraud-scams/retrieve-your-ip-pin, retrieved October 7, 2019

verification, delaying any refund that might be due as well as likely delaying any access by a lender to verification information for the return.[15]

Advisers with clients in the 20 states that now have the option (which cover most of the U.S. population) should consider providing information on the program to clients once it is clear that the program will now accept applicants from all affected states. Advisers should emphasize that the program is the best option to stop tax related ID theft ***but*** it will require the taxpayer to obtain and secure that IP PIN each year and if the taxpayer is not able to manage dealing with the program there's no easy way out of the program.

Based on this adviser's experience, taxpayers who find many online systems challenging in generally will almost certainly run into issues with this program—it can't be "easy" in the sense of not requiring the taxpayer to be responsible for doing things like retaining passwords and keeping two factor authentication information up to date. That cautions against giving the blanket advice that all clients should enroll in the system.

SECTION: 1001
2019 FORM 1040 SCHEDULE 1 WILL ASK TAXPAYERS IF THEY HAVE HAD VIRTUAL CURRENCY TRANSACTIONS

Citation: Draft Form 1040 and 1040-SR Instructions, Form 8995-A Instructions, Deduction for Qualified Business Income, and Draft Schedule 1, Form 1040 or 1040-SR, Additional Income and Adjustments to Income, 10/10/19

Just before the extended individual filing deadline for 2018 returns, the IRS released new instructions and a second revision to a Form 1040 Schedule 1 that adds a question related to IRS's increased interest in virtual currencies.

The IRS has released the complete draft instructions for Form 1040 and Form 1040-SR for 2019[16] and the instructions for Form 8995-A, the form for computing the qualified

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[15] "Retrieve Your Identity Protection PIN (IP PIN)," IRS website, https://www.irs.gov/identity-theft-fraud-scams/retrieve-your-ip-pin, retrieved October 7, 2019

[16] Draft Form 1040 and 1040-SR Instructions, https://www.irs.gov/pub/irs-dft/i1040gi--dft.pdf, October 10, 2019, retrieved October 11, 2019.

business income deduction for taxpayers with taxable income in excess of the threshold amount.[17]

The Form 8995-A instructions are much like the previously released Form 8995 instructions, including containing the comment about reducing QBI by charitable contributions related to the business, a position that many found surprising in the "simple" form instructions.

[17] Form 8995-A Instructions, *Deduction for Qualified Business Income*, https://www.irs.gov/pub/irs-dft/i8995a--dft.pdf, October 10, 2019, retrieved October 11, 2019

However, the big news was found in the IRS's release of a second draft of Schedule 1 for Form 1040 and Form 1040-SR.[18] The new revision looks like this:

SCHEDULE 1 (Form 1040 or 1040-SR)
Department of the Treasury Internal Revenue Service

Additional Income and Adjustments to Income

▶ Attach to Form 1040 or 1040-SR.
▶ Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2019
Attachment Sequence No. 01

Name(s) shown on Form 1040 or 1040-SR | **Your social security number**

DRAFT AS OF October 10, 2019 DO NOT FILE

At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ **Yes** ☐ **No**

Part I Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes	1	
2a	Alimony received	2a	
b	Date of original divorce or separation agreement (see instructions) ▶		
3	Business income or (loss). Attach Schedule C	3	
4	Other gains or (losses). Attach Form 4797	4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	5	
6	Farm income or (loss). Attach Schedule F	6	
7	Unemployment compensation	7	
8	Other income. List type and amount ▶	8	
9	Combine lines 1 through 8. Enter here and on Form 1040 or 1040-SR, line 7a	9	

Part II Adjustments to Income

10	Educator expenses	10	
11	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	11	
12	Health savings account deduction. Attach Form 8889	12	
13	Moving expenses for members of the Armed Forces. Attach Form 3903	13	
14	Deductible part of self-employment tax. Attach Schedule SE	14	
15	Self-employed SEP, SIMPLE, and qualified plans	15	
16	Self-employed health insurance deduction	16	
17	Penalty on early withdrawal of savings	17	
18a	Alimony paid	18a	
b	Recipient's SSN ▶		
c	Date of original divorce or separation agreement (see instructions) ▶		
19	IRA deduction	19	
20	Student loan interest deduction	20	
21	Reserved for future use	21	
22	Add lines 10 through 21. These are your **adjustments to income.** Enter here and on Form 1040 or 1040-SR, line 8a	22	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040 or 1040-SR) 2019**

The key addition is the question at the top of the form. It reads:

> At any time during 2019, did you receive, sell, send, exchange or otherwise acquire any financial interest in any virtual currency?

The taxpayer must answer that question either "yes" or "no" if Schedule 1 is required to be attached to the return.

[18] Draft Schedule 1, Form 1040 or 1040-SR, *Additional Income and Adjustments to Income*, https://www.irs.gov/pub/irs-dft/f1040s1--dft.pdf, October 10, 2019, retrieved October 11, 2019

In the October 11, 2019 *e-News for Tax Professionals*,[19] the IRS explained why this question was added to the Schedule.

> Earlier this week, as part of a wider effort to assist taxpayers and to enforce the tax laws in a rapidly changing area, the Internal Revenue Service issued two new pieces of guidance for taxpayers who engage in transactions involving virtual currency. The new guidance includes Revenue Ruling 2019-24 and frequently asked questions (FAQs). It supplements the guidance the IRS issued on virtual currency in Notice 2014-21 that describes how virtual currency is treated for federal tax purposes.[20]

The IRS has been successful in recent years having penalties for willful failure to file the FBAR form sustained based on the taxpayer having signed a Form 1040 that had Schedule B attached, with the questions regarding foreign bank accounts answered to indicate there were no such accounts. The question on virtual currencies may be used by the IRS in a similar fashion—if the taxpayer fails to report income from virtual currency transactions, if that question is answered "no" that would be evidence the taxpayer had willfully omitted the income.

Any taxpayer that files Schedule 1 must answer that question. But the IRS does clarify in the *e-News* that a taxpayer will not be forced to file Schedule 1 merely to answer "no" to that question:

> Taxpayers who file Schedule 1 to report income or adjustments to income that can't be entered directly on Form 1040 should check the appropriate box to answer the virtual currency question. Taxpayers do not need to file Schedule 1 if their answer to this question is NO and they do not have to file Schedule 1 for any other purpose.[21]

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[19] *IRS e-News for Tax Professionals*, Issue Number: 2019-37, October 11, 2019

[20] *IRS e-News for Tax Professionals*, Issue Number: 2019-37, October 11, 2019

[21] *IRS e-News for Tax Professionals*, Issue Number: 2019-37, October 11, 2019

The IRS has more information on the virtual currency question in the draft Form 1040 and 1040-SR instructions that were released at the same time:

> **Virtual Currency**
>
> If, in 2019, you engaged in any transaction involving virtual currency, check the "Yes" box next to the question on virtual currency at the top of Schedule 1. A transaction involving virtual currency includes:
>
> - The receipt or transfer of virtual currency for free (without providing any consideration), including from an airdrop or following a hard fork;
> - An exchange of virtual currency for goods or services;
> - A sale of virtual currency; and
> - An exchange of virtual currency for other property, including for another virtual currency.
>
> If you disposed of any virtual currency that was held as a capital asset, use Form 8949 to figure your capital gain or loss and report it on Schedule D (Form 1040 or 1040-SR).
>
> If you received any virtual currency as compensation for services or disposed of any virtual currency that you held for sale to customers in a trade or business, you must report the income as you would report other income of the same type (for example, W-2 wages on Form 1040 or 1040-SR, line 1, or inventory or services from Schedule C on Schedule 1).
>
> If, in 2019, you have not engaged in any transaction involving virtual currency, and you don't otherwise have to file Schedule 1, you don't have to do anything further. If you otherwise have to file Schedule 1, check the "No" box.

Advisers will need to obtain the answer to this question when preparing 2019 tax returns for clients. Presumably the question will be added to the organizer questionnaires by the major tax products.

SECTION: 1001
IRS RELEASES LONG-AWAITED CRYPTOCURRENCY GUIDANCE

Citation: Revenue Procedure 2019-24, Frequently Asked Questions on Virtual Currency Transactions, IRS website, 10/9/19

The IRS finally released its promised guidance on tax issues related to cryptocurrencies in the form of Revenue Procedure 2019-24[22] and a set of frequently asked questions on the IRS website.[23]

The Revenue Procedure looks to answer a question many have had about how to treat the hard fork of a cryptocurrency. The best-known hard fork of a cryptocurrency was the fork that created Bitcoin Cash in August 2017.[24] Investopedia's article on Bitcoin Cash describes the fork and related issues as follows:

> Amidst a war of words and staking out of positions by miners and other stakeholders within the cryptocurrency community, Bitcoin Cash was launched in July 2017. Each Bitcoin holder received an equivalent amount of Bitcoin Cash, thereby multiplying the number of coins in existence. Bitcoin Cash debuted on cryptocurrency exchanges at an impressive price of $900. Major cryptocurrency exchanges, such as Coinbase and Itbit, boycotted Bitcoin Cash and did not list it on their exchanges.[25]

In Notice 2014-21 the IRS had defined cryptocurrencies as assets rather than currencies, defining tax treatments for sales and exchanges of such assets (normally generating capital gains and losses), as well as for mining the coin (generally giving rise

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[22] Revenue Procedure 2019-24, October 9, 2019, https://www.irs.gov/pub/irs-drop/rr-19-24.pdf (retrieved October 9, 2019)

[23] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

[24] Jake Frankenfield, "A History of Bitcoin Hard Forks," Investopedia website, June 25, 2019, https://www.investopedia.com/tech/history-bitcoin-hard-forks/ (retrieved October 9, 2019)

[25] Jake Frankenfield, "Bitcoin Cash Definition," Investopedia website, July 30, 2018, https://www.investopedia.com/terms/b/bitcoin-cash.asp (retrieved October 9, 2019)

to ordinary income). But the concept of a "hard fork" wasn't covered in the guidance and isn't much like any other transaction that tax advisers often encounter.

Some advisers had speculated it should be treated as a form of like-kind exchange (where original Bitcoin is "exchanged" for Bitcoin and Bitcoin Cash), but many had issues with that treatment and Congress effectively mooted the discussion for future forks when the Tax Cuts and Jobs Act modified IRC §1031 to limit like-kind exchanges to those exchanges involving real property. Some felt that the taxpayers receiving Bitcoin Cash had income as they had an accession to wealth by receiving the new currency (note the $900 debut price)—but, as the Investopedia article noted, major exchanges were boycotting the currency—so some individuals with Bitcoin on deposit with certain exchanges might not get access to the related Bitcoin Cash.

The IRS has attempted to give some guidance looking at whether the taxpayer has a true accession to wealth when a fork takes place.

The ruling describes the issues of a hard fork of cryptocurrency as follows:

> A hard fork is unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. Following a hard fork, transactions involving the new cryptocurrency are recorded on the new distributed ledger and transactions involving the legacy cryptocurrency continue to be recorded on the legacy distributed ledger.
>
> An airdrop is a means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple taxpayers. A hard fork followed by an airdrop results in the distribution of units of the new cryptocurrency to addresses containing the legacy cryptocurrency. However, a hard fork is not always followed by an airdrop.
>
> Cryptocurrency from an airdrop generally is received on the date and at the time it is recorded on the distributed ledger. However, a taxpayer may constructively receive cryptocurrency prior to the airdrop being recorded on the distributed ledger. A taxpayer does not have receipt of cryptocurrency when the airdrop is recorded on the distributed ledger if the taxpayer is not able to exercise dominion and control over the cryptocurrency. For example, a taxpayer does not have dominion and control if the address to which the cryptocurrency is airdropped is contained in a wallet managed through a cryptocurrency exchange and the cryptocurrency exchange does not support the newly-created cryptocurrency such that the airdropped cryptocurrency is not immediately credited to the taxpayer's account at the cryptocurrency exchange. If the taxpayer later acquires the ability to

> transfer, sell, exchange, or otherwise dispose of the cryptocurrency, the taxpayer is treated as receiving the cryptocurrency at that time.[26]

Based on these concepts, the ruling comes to two holdings:

> (1) A taxpayer does not have gross income under § 61 as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency.
>
> (2) A taxpayer has gross income, ordinary in character, under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency.[27]

The ruling offers two different examples to illustrate these holdings.

EXAMPLE 1 (BASED REVENUE PROCEDURE 2019-24)

A holds 50 units of Crypto M, a cryptocurrency. On Date 1, the distributed ledger for Crypto M experiences a hard fork, resulting in the creation of Crypto N. Crypto N is not airdropped or otherwise transferred to an account owned or controlled by A.

A did not receive units of the new cryptocurrency, Crypto N, from the hard fork; therefore, A does not have an accession to wealth and does not have gross income under § 61 as a result of the hard fork.[28]

EXAMPLE 2 (BASED ON REVENUE PROCEDURE 2019-24)

B holds 50 units of Crypto R, a cryptocurrency. On Date 2, the distributed ledger for Crypto R experiences a hard fork, resulting in the creation of Crypto S. On that date, 25 units of Crypto S are airdropped to B's distributed ledger address and B has the ability to dispose of Crypto S immediately following the airdrop. B now holds 50 units of Crypto R and 25 units of Crypto S. The airdrop of Crypto S is recorded on the distributed ledger on Date 2 at Time 1 and, at that date and time, the fair market value of B's 25 units of Crypto S is $50. B receives the Crypto S solely because B owns Crypto R at the time of the hard fork. After the airdrop, transactions involving Crypto S are recorded on the new distributed ledger and transactions involving Crypto R continue to be recorded on the legacy distributed ledger.

B received a new asset, Crypto S, in the airdrop following the hard fork; therefore, B has an accession to wealth and has ordinary income in the taxable year in which the Crypto S is received. See §§ 61 and 451. B has dominion and control of Crypto S at the time of the airdrop, when it is recorded on the distributed ledger, because B immediately has the ability to dispose of Crypto S. The amount included in gross income is $50, the fair market value of

[26] Revenue Ruling 2019-24, pp. 2-3

[27] Revenue Ruling 2019-24, p. 5

[28] Revenue Ruling 2019-24, pp. 3, 5

B's 25 units of Crypto S when the airdrop is recorded on the distributed ledger. B's basis in Crypto S is $50, the amount of income recognized. See §§ 61, 1011, and 1.61-2(d)(2)(i). [29]

The frequently asked questions indicate that they are issued primarily to expand upon the concepts found in the five year old Notice 2014-21. The FAQ also cautions that it only applies to cryptocurrency treated as a capital asset. [30]

The FAQ consisted of 43 questions and answers when originally published. The IRS is known to revise such FAQs from time to time, and it is possible more information will eventually be published here so advisers should keep an eye on the web page for changes.

The final question provides taxpayers and their advisers with guidance on the type of records the IRS believes should be maintained by those who have cryptocurrency transactions.

> **Q43. What records do I need to maintain regarding my transactions in virtual currency?**
>
> A43. The Internal Revenue Code and regulations require taxpayers to maintain records that are sufficient to establish the positions taken on tax returns. You should therefore maintain, for example, records documenting receipts, sales, exchanges, or other dispositions of virtual currency and the fair market value of the virtual currency. [31]

The IRS also deals with the methods a taxpayer may use to determine which specific cryptocurrency blocks have been sold to properly determine the basis, defaulting to FIFO but allowing specific identification:

> **Q36. I own multiple units of one kind of virtual currency, some of which were acquired at different times and have different basis amounts. If I sell, exchange, or otherwise dispose of some units of that virtual currency, can I choose which units are deemed sold, exchanged, or otherwise disposed of?**
>
> A36. Yes. You may choose which units of virtual currency are deemed to be sold, exchanged, or otherwise disposed of if you can specifically

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[29] Revenue Ruling 2019-24, pp. 3, 5

[30] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

[31] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

identify which unit or units of virtual currency are involved in the transaction and substantiate your basis in those units.

Q37. How do I identify a specific unit of virtual currency?

A37. You 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 by records showing the transaction information for all units of a specific virtual currency, such as Bitcoin, held in a single account, wallet, or address. This information must show (1) the date and time each unit was acquired, (2) your basis and the fair market value of each unit at the time it was acquired, (3) the date and time each unit was sold, exchanged, or otherwise disposed of, and (4) the fair market value of each unit when sold, exchanged, or disposed of, and the amount of money or the value of property received for each unit.

Q38. How do I account for a sale, exchange, or other disposition of units of virtual currency if I do not specifically identify the units?

A38. If you do not identify specific units of virtual currency, the units are deemed to have been sold, exchanged, or otherwise disposed of in chronological order beginning with the earliest unit of the virtual currency you purchased or acquired; that is, on a first in, first out (FIFO) basis. [32]

While Revenue Ruling 2019-24 provides for potential taxation for a hard fork, the FAQ indicates that a soft fork will not be a taxable event:

Q29. Do I have income when a soft fork of cryptocurrency I own occurs?

A29. No. A soft fork occurs when a distributed ledger undergoes a protocol change that does not result in a diversion of the ledger and thus does not result in the creation of a new cryptocurrency. Because soft forks do not result in you receiving new cryptocurrency, you will

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[32] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

> be in the same position you were in prior to the soft fork, meaning that the soft fork will not result in any income to you. [33]

The IRS points out that spending the cryptocurrency will result in taxable exchange of the currency—that is, the fact a holder does not receive legal tender for his/his cryptocurrency does not eliminate the tax impact:

> **Q13. Will I recognize a gain or loss if I pay someone with virtual currency for providing me with a service?**
>
> A13. Yes. If you pay for a service using virtual currency that you hold as a capital asset, then you have exchanged a capital asset for that service and will have a capital gain or loss. For more information on capital gains and capital losses, see Publication 544, Sales and Other Dispositions of Assets.
>
> …
>
> **Q15. Will I recognize a gain or loss if I exchange my virtual currency for other property?**
>
> A15. Yes. If you exchange virtual currency held as a capital asset for other property, including for goods or for another virtual currency, you will recognize a capital gain or loss. For more information on capital gains and capital losses, see Publication 544, Sales and Other Dispositions of Assets. [34]

Similarly, an individual receiving cryptocurrency in exchange for services or a product will recognize income equal to the fair market value of the currency.[35]

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[33] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

[34] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

[35] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, Q&As 8, 9, 10 and 11, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

However, transferring cryptocurrency from one digital wallet to another, or from one account to another will not result in a taxable transaction:

> **Q35. Will I have to recognize income, gain, or loss if I own multiple digital wallets, accounts, or addresses capable of holding virtual currency and transfer my virtual currency from one to another?**
>
> A35. No. If you transfer virtual currency from a wallet, address, or account belonging to you, to another wallet, address, or account that also belongs to you, then the transfer is a non-taxable event, even if you receive an information return from an exchange or platform as a result of the transfer. [36]

Conspicuously absent from the ruling or FAQ is any indication that the IRS will only apply this guidance prospectively—presumably the agency believes this information represents the state of the law as it has existed at least since Notice 2014-21 was issued.

The IRS also emphasized in the news releasew issued along with this guidance that the agency is taking steps to address prior noncompliance, noting:

> The IRS is aware that some taxpayers with virtual currency transactions may have failed to report income and pay the resulting tax or did not report their transactions properly. The IRS is actively addressing potential non-compliance in this area through a variety of efforts, ranging from taxpayer education to audits to criminal investigations.
>
> For example, in July of this year the IRS announced that it began mailing educational letters to more than 10,000 taxpayers who may have reported transactions involving virtual currency incorrectly or not at all. Taxpayers who did not report transactions involving virtual currency or who reported them incorrectly may, when appropriate, be liable for tax, penalties and interest. In some cases, taxpayers could be subject to criminal prosecution. [37]

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[36] Frequently Asked Questions on Virtual Currency Transactions, October 9, 2019, https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions (retrieved October 9, 2019)

[37] "Virtual currency: IRS issues additional guidance on tax treatment and reminds taxpayers of reporting obligations," IRS News Release IR-2019-167, October 9, 2019, https://www.irs.gov/newsroom/virtual-currency-irs-issues-additional-guidance-on-tax-treatment-and-reminds-taxpayers-of-reporting-obligations (retrieved October 9, 2019)