



By Email Submission to Notice.Comments@irs counsel.treas.gov
“FAQs on Virtual Currency”

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Comments and Responses from the Wall Street Blockchain Alliance, Accounting Working Group - Re: IRS FAQs and Revenue Ruling Issued Q4 2019

Introduction

When the IRS first issued guidance for virtual currencies in 2014 the accounting profession was still trying, for the most part, to get a handle on just what the blockchain and cryptoasset spaces represented. As awareness increased, punctuated by the parabolic rise and subsequent collapse of crypto prices during 2017, it quickly became apparent that the initial 2014 guidance was insufficient in the face of a rapidly evolving blockchain environment. Despite numerous requests from industry associations, accounting firms, financial services institutions, and prominent individuals, the IRS remained close lipped on further clarification until October of 2019. This silence began to thaw in the summer of 2019, when the IRS announced a rollout of enforcement letters related to unpaid taxes connected to cryptocurrencies, which would vary in severity depending on the available information. Building on this and following five years of extremely limited commentary and feedback, the IRS released responses to 43 Frequently Asked Questions (FAQ's) and a Revenue Ruling addressing some of the income recognition issues connected to hard forks and airdrops - two issues that had moved to the forefront. Although these releases and associated speaking engagements did clarify some outstanding questions and issues, they also raised new ones.

The Wall Street Blockchain Alliance (“WSBA”), a 501(c)6 non-profit trade association based in New York City, would like to take this opportunity to respectfully submit our collective thoughts and potential considerations regarding the 2019 Revenue Ruling and FAQ's. Compiled by the WSBA Accounting Working Group, the following are some of the most prominent outstanding questions or items for which members are seeking further clarification. Not meant to be presented as all-inclusive nor authoritative, we believe that the questions and commentary included within this document do represent a productive and objective place from which to continue the crypto-taxation dialogue:

Comment #1 - Revisiting the Taxonomy of Cryptoassets

Given that the underlying purpose of many cryptoassets, ranging from traditionally decentralized options such as bitcoin to more centrally organized stablecoins, is to serve as an alternative currency option, the current accounting taxonomy, classification and tax treatment seems inappropriate. Classifying cryptoassets as property creates additional compliance and reporting requirements that seems to neither add value to the taxpayer nor merchants accepting cryptoassets as payment for goods or services. Realizing that there is no



definitive cryptoasset guidance as yet issued by the Financial Accounting Standards Board (FASB), the IRS could consider establishing a de minimis exemption for both individuals and merchants. Doing so would reduce the burden on smaller taxpayers and allow practitioners to instead focus efforts on larger clients requiring more comprehensive advice. The AICPA had previously required such an exemption in [Request for Guidance Regarding Virtual Currency](#) submitted to the Service in May of 2018.

Note that recent [draft legislation](#) proposing exemptions based on amount of potential capital gains due as a result of a given disposal does not fairly address this need and may only serve to further complicate the already complex accounting and reporting issues around cryptoassets.

Comment #2 - Differentiation in Tax Treatment Dependent on use Case

Expanding on Comment #1 it also seems that differentiating tax treatment and reporting requirements for cryptoassets should be in some way connected to the use of said cryptoassets. For example, if an exchange holds various cryptoassets as an integral component of its core business operations, such as crypto ATM firms or crypto exchanges might, these cryptoassets serve a different purpose than those held by other market actors. Additionally, cryptoassets that are traded on a continuous basis versus those held as part of a longer-term portfolio diversification strategy serve different purposes, and seemingly should be treated differently from a tax and reporting perspective. Building on the differentiation inherent to how various cryptoassets are used by taxpayers there seems to be a need for increased clarification connected to what criteria should be used to determine tax treatment, i.e. ordinary income versus capital gains. General guidance related to the income treatment of cryptocurrencies exist but given that wide range of use cases these existing criteria might need to be revisited.

Comment #3 - Stablecoin Tax Treatment

With stablecoins becoming a larger part of the mainstream cryptoasset conversation in 2019, it makes sense that the tax treatment for stablecoins and other cryptoassets should be differentiated from each other. Lacking authoritative guidance from the FASB on either stablecoins or decentralized cryptoassets from a financial accounting point of view, the IRS does have the option to distinguish (even in the interim) these two items from one another. Inherent in the nature of asset, stablecoins have lower levels of volatility and are often developed with the explicit purpose of being tethered, backed, linked, or otherwise supported by an underlying asset.

This underlying support structure, in addition to reducing volatility if operated correctly, also raises questions as to the taxation of that underlying basket of assets. For example if there are foreign currency gains or losses generated by the underlying basket of fiat currencies, but the taxpayer does not exchange or redeem the stablecoin during the reporting period, is there a tax obligation - since those underlying assets backstop the value of stablecoin, or merely a disclosure and reporting requirements? The same question can be put forward for stablecoins that are stabilized by a commodity such as oil or spot gold prices.

If there is a reporting and/or tax implication of these underlying asset gains/losses, which entity is obliged to fulfill these requirements? For example, stablecoins may be held by individuals or used by merchants as a component of how a business is operated, could be held by a financial intermediary (exchange of other financial institution) as part of a custodial services offering, or be in a restricted fund such as those at charitable



organizations. It may be simpler to issue consistent standards for price changes linked to assets underlying stablecoins, regardless of use case.

Comment #4 - Determination of FMV and Basis

The [IRS FAQs](#) did attempt to answer some of the open items and questions related to how practitioners should determine the basis and fair market value of various cryptoassets. Summarizing the feedback and responses included can be distilled to 1) use the FMV of the assets or services exchanged for the cryptoassets received, or 2) consult the value reported on exchanges that list the cryptoasset in question. These responses, while helpful and seeming to confirm industry practice that had sprung up in the interim do, however, present several other questions that require addressing.

The IRS states that taxpayers should consult prices listed on exchanges to assist in establishing either basis or FMV of cryptoassets, but this may not always be a practical course of action. Many cryptocurrency exchanges exist, and the proliferation of new exchanges continues to accelerate, including the increasing number of decentralized exchanges. This growth can result in conflicting prices, with no one exchange seeming to have a dominant or leadership position in a certain area. Additionally, many crypto exchanges are domiciled outside of the United States, may not have to comply with full IRS and other reporting requirements, and may in fact be illegal for U.S. citizens to use.

Given the sheer size of the cryptoasset marketplace, with well over 2,000 cryptoassets trading daily, there is also the possibility that some thinly traded, or newly created tokens may not have a true fair market value. Being thinly traded, either as a result of being newly created or being held by a relatively concentrated number of investors, this may lead to an inaccurate or distorted valuation on exchanges. Also, if a native token is developed by an organization as a core component of how its business will operate, what is the appropriate basis for these native tokens? Should all costs be expensed, similar to internal R&D expenses, or is it appropriate for some of the costs allocated to the development of these tokens to be capitalized if they are indeed core to the business?

Comment #5 - Crypto Reporting & Disclosure Requirements

With the growth and continued maturation of the cryptoasset ecosystem especially given the continued development of stablecoins and central bank backed cryptoassets it seems time to revisit the conversation as to what information should be reported and disclosed in a standardized manner. Specifics will vary depending on the organization and use case connected to the cryptoassets themselves, but commonalities do appear to exist. Basis determination, methodologies used to determine fair market value, and subsequent events that could impact the organization moving forward look like areas where standardization and clarification would be helpful.

Especially as institutional adoption of blockchain and cryptoassets continue to increase across industry verticals, the importance of consistent reporting and disclosure is difficult to overstate. Financial information is useful to market participants, in large part, due to the fact that it is reported and disclosed consistently no matter what the organization. Implementing similar standards and guidance for blockchain and cryptoasset reporting will assist with the maturation and transparency of the market.



Comment #6 - Clarification of Tax Treatment for Airdrops

Airdrops represent a relatively recent development in the blockchain and cryptoasset ecosystem, but it is a development that continues to raise questions related to basis determination, reporting, and tax implications. Although the IRS did address some of the issues connected to airdrops in both FAQs, several open items remain that need to be addressed. First, however, it is recommended that the IRS distinguish between hard forks and airdrops; they seem to have been conflated in the public facing guidance issued during late 2019. Follow up [comments](#) notwithstanding, it seems that some additional and authoritative clarification is necessary moving forward specifically as it connects to differentiating forks and increasing the granularity of the airdrop conversation. Although airdrops may occur as a result of hard forks these two items are distinct events that should be treated, reported, and disclosed distinct from each other. Building on this, there are also several different questions that are worthy of additional analysis and clarification.

1. How are different classes of airdrops going to be treated from a recipient perspective? If a taxpayer has taken action prior to receiving these airdropped cryptoassets that may require different tax treatment than a taxpayer that has received airdropped cryptoassets without taking action. In essence, if a taxpayer has actively solicited the delivery of cryptoassets, should this be treated differently than a taxpayer who may or may not even realize they have been airdropped cryptoassets due to the lack of active participation or solicitation.
2. The basis of airdropped cryptoassets need to also be taken into account; do these tokens even have a basis? Linking back to an earlier point should the cost of producing these cryptoassets be used as a starting point for basis conversations, should the basis be zero? These questions and subsequent conversations also serve to illustrate just how interconnected these tax, reporting, and valuation questions are for the broader cryptoasset space moving forward. Since airdropped cryptoassets will most likely also be thinly traded, it seems logical that any guidance connected to thinly traded assets will also apply to airdropped tokens.
3. Much of the conversation and debate connected to cryptoassets has concentrated on the recipient of these cryptoassets, but there is also a question as to how the issuing organization should treat this issuance for tax purposes. Given the ambiguity and open items related to the basis determination for recipients, similar questions exist for the issuing organization. How exactly should the issuing organization account for the basis, revenues, and even potential income implications of token issuance is simply a few of the open items that seem worthy of additional consideration.

Comment #7 - Stablecoin Issuance and Exchange Tax Treatment

With stablecoins and other asset backed coins, be they privately issued or managed by a central bank or other governmental entity, becoming an increasingly large part of the cryptoasset space there are several tax issues that remain unresolved. Building on earlier comments related to the tax implications of changes in value of the underlying stabilizing assets, two other considerations seem worthy of inclusion.

1. Should the issuance of stablecoins generate a taxable event? Whereas traditionally decentralized cryptocurrencies such as bitcoin are mined, with requisite costs required to do so, the issuance process for stablecoins can vary wildly depending on the specifics of the cryptoasset. Additionally, and assuming that stabilization mechanism operates as advertised and generates a low volatility asset, it could be argued that such a cryptoasset should be treated as a legitimate currency equivalent. Since the cryptoasset derives a core value proposition (reduced volatility) from its connection to the underlying asset, a tax regime similar to that of the underlying seems to make sense.



2. Building on this, and acknowledging that based on recent Service commentary that traditional cryptocurrencies are not eligible for like-kind exchange treatment, should stablecoins be exempted from this restriction? Since the core functionality of such a cryptoasset is to, in essence, replicate the functionality of the underlying asset (commonly a fiat currency), the exchange of one stablecoin for another could reasonably be seen as an alternative for fiat to fiat exchanges. Extrapolating this, exclusion of traditional cryptocurrencies from like-kind exchange treatment may not be appropriate for stablecoins being transitioned for one another.

Comment #8 - Implications of Intangible Treatment for Cryptoassets

With no authoritative guidance for the accounting of cryptoassets from either the FASB or IASB, practitioners seem to be settling into a broad consensus that cryptocurrencies should be treated and reported as intangible assets. Although there are clear functional and operational differences between stablecoins and traditional decentralized cryptocurrencies the available practitioner literature seems to be categorizing all cryptoassets under the same umbrella. Setting aside the appropriateness of classifying cryptoassets as intangible assets for a moment, the classification raises several integral questions that point to the need for increased clarification related to how these cryptoassets should be treated.

1. What is the change in the business environment that would otherwise initiate the impairment test? Other assets classified as intangible assets, and therefore eligible for impairment testing, seem to have rather clear events or changes that would lead to additional review of asset valuation. Cryptoassets, however, can swing wildly in value based on headline news stories, new competitors entering into the marketplace, or any other number of external forces. Establishing a threshold or listing of events that would qualify as changes in the business environment seems to represent an important first step.
2. Should the impairment losses be deductible for tax purposes, considering that although for tax purposes these cryptoassets are classified as property the financial accounting seems to be coalesced around classifying these items as intangible assets. Given the [previous guidance](#) from the FASB related to the testing for and reporting of impairment, revisiting this issue for cryptoassets seems a logical next step. A corollary to this question, but equally as important, is whether or not the basis of cryptoassets can be restored if an impairment had previously been taken and, given the volatility of some cryptoassets, if these should not just be marked to market.

Comment #9 - Tax Implications of Crypto Staking Operations

As the blockchain and cryptoasset ecosystem continues to develop and mature it is inevitable that new and innovative ways of using these technologies will continue to come to the forefront. Staking appears to represent such an extension and further development of cryptoassets; in essence staking allows participants to earn interest on existing cryptoasset holdings. Specifics will vary depending on the specific staking function in question, the following questions will need to be answered to facilitate further development and expansion of this application.

1. How will income derived from staking operations be treated; ordinary income or capital gain? Building on this question it also seems reasonable to ask whether or not income will be treated differently depending on 1) whether or not staking income is core to the operating of business, and 2) if the taxpayer in question is an individual or commercial taxpayer.
2. When are the gains taxable; when the taxpayer has constructive receipt, or does it wait until the taxpayer has actual receipts? Especially if staking is used as a source of passive or complementary income, actual receipt of funds may take place at a date subsequent to when it was generated.



Additionally, given that staking income can take the form of earning additional cryptoassets on existing cryptocurrencies does price volatility related to these cryptoassets require additional tax reporting and disclosure.

3. If losses occur as a result of staking, either through a decline in value of the underlying cryptoassets or through other means, are these losses deductible for tax purposes? If yes, are these losses limited to staking gains, or if they are treated as ordinary income could they be used to offset other sources of ordinary income?

Comment #10 - Tax Implications of Crypto De-Fi / Loans / Rehypothecation

Cryptocurrency finance products involving smart contracts, loans, and rehypothecation are expanding greatly and approaching over a billion dollars USD in value of collateral alone. Clarification around the treatment of the transfer of ownership for loan and rehypothecation of assets is needed in this rapidly growing set of financial products. Ensuring that the transfer of ownership for purposes of collateral is not viewed as a disposal event for purposes of capital gains is crucial and seems clear within the intent and purpose of the nature of the transaction.

Comment #11 - Request for Interdisciplinary Approach

Not a technical comment or question, this is a request that the IRS continue to engage in a proactive and iterative process toward working on new standards, revenue rulings, and additional clarification of existing guidance. Recognizing the fact that such close inter-agency communication and collaboration might be difficult, this still seems to represent a logical path forward. Given that blockchain and cryptoassets 1) continue to develop and change so quickly, 2) are increasingly becoming integrated into an array of economic sectors, and 3) have generated open items and questions in every aspect of accounting and reporting, a collaborative approach might be the only way to keep pace with this fast changing marketplace. The Wall Street Blockchain Alliance stands willing to assist in any way felt to be constructive by either the IRS or any associated regulator or standard setting body.

Concluding Thoughts

Blockchain and cryptoassets continue to drive change, innovation, disruption, and the development of new products and services in the accounting space as well as in other areas of the economy. Accompanying this rapid development and maturation, however, is also the increasing amounts of uncertainty and ambiguity that continues to exist. Although the IRS did address some of the open items and questions raised by the profession since the issuance of prior guidance in 2014, several other questions and areas for consideration have arisen that require further clarification. The comments and questions contained in the document above are merely some of the items pressing and relevant to fostering continued blockchain development and maturation. The Wall Street Blockchain Alliance looks forward to your responses and comments and stands ready to assist in a constructive and objective manner with these and other issues.

Respectfully Submitted,



A handwritten signature in black ink, appearing to read "Ron Quaranta".

Ron Quaranta

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