



NEW GUIDANCE ON VIRTUAL CURRENCY COVERS “HARD FORKS”; NEW VIRTUAL CURRENCY CHECKBOX ON THE 2019 SCHEDULE 1

The IRS is continuing to provide guidance on taxpayers’ use of cryptocurrency and other virtual currencies. Virtual currency is considered property for federal income tax purposes. Transactions involving virtual currency are often similar to transactions involving stock investments, although virtual currency is *not* a stock. In 2014, the IRS published initial guidance on virtual currency in Notice 2014-21 (covered in TAX in the News April 1 and April 8, 2014).

Hard forks and airdrops

News release [IR-2019-167](#) and [Rev. Rul. 2019-24](#) explain the tax consequences of new cryptocurrency received following a hard fork. Cryptocurrency, such as Bitcoin, is a type of virtual currency that utilizes cryptography to digitally record transactions on a distributed ledger, such as blockchain.

A “hard fork” occurs when a distributed ledger undergoes a “protocol change” that results in a permanent diversion from an existing or “legacy” ledger. The result is that a new cryptocurrency may be created on a new distributed ledger that is separate from the legacy cryptocurrency and the legacy distributed ledger. After the hard fork, transactions involving the new and legacy cryptocurrencies are recorded on their respective distributed ledgers.

A hard fork may or may not result in an “airdrop” of the new cryptocurrency to the addresses existing in the legacy distributed ledger. A taxpayer is considered to be in receipt of the new cryptocurrency if the taxpayer is able to exercise dominion and control over the new cryptocurrency. That is, the newly-created cryptocurrency is credited to the taxpayer’s account or “wallet” at the cryptocurrency exchange and the taxpayer is able to transfer, sell, exchange, or otherwise dispose of the new cryptocurrency.

A taxpayer who receives and has dominion and control over units of a new cryptocurrency as the result of a hard fork recognizes ordinary income based on the fair market value of the units received.

Example: Bella holds 50 units of “Crypto R.” On December 4, 2019, Crypto R experiences a hard fork and creates “Crypto S.” On that date, 25 units of Crypto S are airdropped to Bella’s distributed ledger address. Crypto S is valued at \$50 per unit at the time of the airdrop. Bella immediately has the ability to dispose of the new cryptocurrency. Transactions involving the existing and new cryptocurrencies are recorded on their respective distributive ledgers. On her 2019 tax return, Bella must recognize ordinary income of \$1,250 (25 units of Crypto S × \$50). Had she not received units of the new cryptocurrency, or if she did not have dominion and control over them, she would not be required to recognize income. Bella’s basis in Crypto S is also \$1,250, the amount of income recognized.

New Schedule 1 checkbox

The 2019 Form 1040 [Schedule 1 draft](#) includes the following question: “At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?” The draft instructions require the taxpayer to check “yes” if any of the following transactions occurred:

- The receipt or transfer of virtual currency for free (including from a hard fork airdrop).
- An exchange of virtual currency for goods or services.
- A sale of virtual currency.
- An exchange of virtual currency for other property, including another type of virtual currency.

Taxpayers are advised to report virtual currency transactions as they would record other activity of the same type. For example, the sale of virtual currency held as a capital asset is reported on Form 8949 and Schedule D. The payment of virtual currency to acquire inventory used in a trade or business is recorded on Schedule C for a sole proprietorship.



Taxpayers who have not engaged in any virtual currency transactions check “No” if they’re filing Schedule 1 for some other reason. In other words, taxpayers do not have to file Schedule 1 solely to check the box “No” if they did not have any transactions.

Other virtual currency information

The IRS has also provided an extensive [Frequently Asked Questions on Virtual Currency Transactions](#). The FAQ covers most aspects of acquiring, holding, exchanging, and selling virtual currencies. See the August 7, 2019 edition of TAX in the News for coverage of IRS’s virtual currency compliance campaigns. Also see TTI’s series on [virtual currency](#) in the Tax Research Center.

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