GT GreenbergTraurig

Alert | Tax/Blockchain & Digital Assets

August 2023

IRS Clarifies Taxation of Staking Crypto Rewards

To address the tax implications for taxpayers who stake cryptocurrency on a proof-of-stake blockchain and receive validation rewards, on July 21 the Internal Revenue Service (IRS) issued Revenue Ruling 2023-14.

The ruling clarifies that when taxpayers stake cryptocurrency and receive validation rewards, the fair market value of the rewards must be included in the taxpayers' gross income for the taxable year when the taxpayer gains control over the rewards. A taxpayer has control over rewards once the taxpayer gains the ability to sell, exchange, or dispose of the received units.

The ruling explains how the proof-of-stake consensus mechanism allows taxpayers to receive validation rewards. Taxpayers may participate in the validation process by staking their holdings in a cryptocurrency. Taxpayers who successfully validate transactions on the blockchain receive rewards in the form of additional units of the cryptocurrency. Upon gaining control of the additional units of the cryptocurrency, taxpayers have an accession to wealth.

The ruling emphasizes that a taxpayer should include the fair market value of the additional units of the cryptocurrency received in the taxpayer's gross income. This inclusion should be made based on the date and time at which control over the units is effectively established. Importantly, the tax treatment applies similarly if a taxpayer stakes cryptocurrency through a cryptocurrency exchange and receives rewards for validation.

It is essential to note that this ruling only applies to taxpayers who use the cash method of accounting and does not address the tax consequences for taxpayers who use the accrual method of accounting. In addition, the ruling explicitly excludes the consideration of any transaction fees beyond validation rewards, including "gas" fees.

This ruling is the IRS's first clear guidance on the tax treatment of validation rewards. Notice 2014-21, issued in 2014, provided that cryptocurrency is considered property for tax purposes but did not address validation rewards. In 2019, the IRS issued Rev. Rul. 2019-24 to address questions related to the tax treatment of only hard forks and air drops. The lack of clear guidance led to the filing of *Jarrett v. U.S.*, a lawsuit in district court that asserted that validation rewards are only taxable upon the disposition of the reward.

This may not be the final chapter in the debate on the taxation of validation rewards. Revenue rulings are not binding on courts. There has also been a renewed attempt in the Senate to pass legislation that would address the taxation of validation rewards.

Stakeholders and individuals involved in cryptocurrency transactions should closely monitor these developments, as the landscape continues to evolve. Taxpayers should maintain thorough records of the fair market value of validation rewards and the date they acquire control over the cryptocurrency. Accurate documentation would be essential for compliance.

Authors

This GT Alert was prepared by:

- Shira Peleg | +1 212.801.6754 | pelegs@gtlaw.com
- Pallav Raghuvanshi | +1 212.801.2151 | raghuvanship@gtlaw.com