26 CFR 1.61-1: Gross income.
(Also § 61)

Rev. Rul. 2023-14

ISSUE

If a taxpayer that uses a cash method of accounting (cash-method taxpayer) stakes cryptocurrency native to a proof-of-stake blockchain and receives additional units of cryptocurrency as rewards when validation occurs (validation rewards or rewards), must the taxpayer include the value of the rewards in the taxpayer's gross income and, if so, in which taxable year?

BACKGROUND

Section 6045(g)(3)(D) of the Internal Revenue Code[1] generally defines a digital asset, for purposes of information reporting by brokers, as any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.

Digital assets do not exist in physical form and include, but are not limited to, property the Department of the Treasury and the Internal Revenue Service have previously referred to as convertible virtual currency and cryptocurrency. See Notice

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[1] Unless otherwise specified, all "section" or "§" references are to sections of the Internal Revenue Code (Code) or the Income Tax Regulations (26 CFR part 1).

2014-21, 2014-16 I.R.B. 938, as modified by Notice 2023-34, 2023-19 I.R.B. 837; Rev. Rul. 2019-24, 2019-44 I.R.B. 1004. Notice 2014-21 defines convertible virtual currency as virtual currency that has an equivalent value in real currency or acts as a substitute for real currency. Notice 2014-21 provides that convertible virtual currency is treated as property and that general tax principles applicable to property transactions apply to convertible virtual currency.

Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger. See Rev. Rul. 2019-24. References to cryptocurrency in this revenue ruling are to cryptocurrency that is convertible virtual currency. Units of cryptocurrency are generally referred to as coins or tokens.

Many cryptocurrencies utilize blockchain technology, a specific type of distributed ledger technology. Distributed ledger technology uses independent digital systems to record, share, and synchronize transactions, the details of which are recorded simultaneously on multiple nodes on a network. In this context, a node generally refers to a device that maintains a copy of the distributed ledger and runs copies of the software associated with the protocol for the distributed ledger at issue.

In general, it is these nodes that maintain the integrity of a blockchain by validating transactions and ensuring that new entries in the ledger, in the form of blocks of transactions, are legitimate and not duplicative so that a new block can be recorded on the blockchain. This can be done, for example, by rejecting transactions that attempt to move the same units to two different wallet addresses at the same time. The creation of new blocks on a blockchain generally requires the participation of multiple validators

who are selected and rewarded pursuant to the blockchain protocol. These validation

rewards typically consist of one or more newly created units of the cryptocurrency native

to that blockchain.

A consensus mechanism is a set of protocols by which nodes reach agreement

on updates to the blockchain. One consensus mechanism is commonly referred to as

proof-of-stake. In a proof-of-stake consensus mechanism, persons who hold

cryptocurrency may participate in the validation process by staking their holdings, if they

hold the requisite number of units of a particular cryptocurrency. Persons may also

participate in the validation process by staking their holdings through a cryptocurrency

exchange. In a proof-of-stake consensus mechanism, validators may be selected by

the protocol for the blockchain associated with the specific cryptocurrency based on a

variety of factors including the number of coins or tokens staked. These validators

confirm transactions and add blocks to the blockchain in accordance with the protocol.

If a validator is chosen by the protocol and validation is successful, the validator will

receive a reward. If a validator is chosen by the protocol and validation is unsuccessful,

the staked units may be subject to penalty in the form of "slashing," a process by which

the staked units, or a portion thereof, are forfeited.

FACTS

Transactions in M, a cryptocurrency, are validated by a proof-of-stake consensus

mechanism. On Date 1, Taxpayer A, a cash-method taxpayer, owns 300 units of M. A

stakes 200 of the units of M and validates a new block of transactions on the M

blockchain, receiving 2 units of M as validation rewards. Pursuant to the M protocol,

during a brief period ending on Date 2, A lacks the ability to sell, exchange, or otherwise

dispose of any interest in the 2 units of M in any manner. The following day, on Date 3, A has the ability to sell, exchange, or otherwise dispose of the 2 units of M.[2]

LAW

Section 61(a) provides the general rule that, except as otherwise provided by subtitle A of the Code, gross income means all income from whatever source derived. Specifically, gross income includes, but is not limited to, compensation for services, gross income derived from business, and gains from dealings in property. Under section 61, "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion," require inclusion in gross income. See Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). "Gross income includes income realized in any form, whether in money, property, or services. Income may be realized, therefore, in the form of services, meals, accommodations, stock, or other property, as well as in cash." § 1.61-1(a). Unless otherwise provided by a Code or regulatory provision, any receipt of property constitutes gross income in the amount of its fair market value at the date and time at which it is reduced to undisputed possession. See, e.g., section 61(a); Koons v. United States, 315 F.2d 542 (9th Cir. 1963); Rooney v. Commissioner, 88 T.C. 523, 526-527 (1987); § 1.61-2(d)(1).

Cryptocurrency that is convertible virtual currency is treated as property for Federal income tax purposes and general tax principles applicable to property transactions apply to transactions involving cryptocurrency. See Notice 2014-21. For example, a taxpayer who receives cryptocurrency as a payment for goods or services or who mines cryptocurrency must include the fair market value of the cryptocurrency in

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[2] The facts in this revenue ruling do not address any type of "gas" or transaction fees other than the validation rewards described herein.

the taxpayer's gross income in the taxable year the taxpayer obtains dominion and control of the cryptocurrency. See id., Q&A 3 and Q&A 8. Amounts received as gains derived from dealings in property, or as rents or royalties, also generally must be included in a cash-method taxpayer's gross income in the taxable year the taxpayer obtains dominion and control of those amounts through actual or constructive receipt. See also § 1.451-1(a).

ANALYSIS

The 2 units of M represent A's reward for staking units and validating transactions on the M blockchain. On Date 3, A has an accession to wealth as A gains dominion and control through A's ability, as of this date, to sell, exchange, or otherwise dispose of the 2 units of M received as validation rewards. Accordingly, the fair market value of the 2 units of M, as of the date and time A gains dominion and control over the 2 units of M, is included in A's gross income for the taxable year that includes Date 3.

HOLDING

If a cash-method taxpayer stakes cryptocurrency native to a proof-of-stake blockchain and receives additional units of cryptocurrency as rewards when validation occurs, the fair market value of the validation rewards received is included in the taxpayer's gross income in the taxable year in which the taxpayer gains dominion and control over the validation rewards. The fair market value is determined as of the date and time the taxpayer gains dominion and control over the validation rewards.[3] The same is true if a taxpayer stakes cryptocurrency native to a proof-of-stake blockchain

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[3] This revenue ruling does not address issues that may arise under any rules not specifically cited, such as section 83.

through a cryptocurrency exchange and the taxpayer receives additional units of

cryptocurrency as rewards as a result of the validation.

DRAFTING INFORMATION

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