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IRS Concludes That Staking Rewards Are Included in Gross Income

The Internal Revenue Service (IRS) issued Revenue Ruling 2023-14 on July 31, 2023, providing clarity on its position regarding the tax treatment of crypto staking rewards for cash-method taxpayers.

According to the Revenue Ruling, crypto staking rewards are included in a taxpayer's gross income at the time the taxpayer gains "dominion and control" over the tokens.

The Revenue Ruling

The Revenue Ruling presented a scenario involving Taxpayer A, a cash-method taxpayer who owns 300 units of cryptocurrency M. Transactions in M are validated by a proof-of-stake consensus mechanism. Taxpayer A stakes 200 units of M to validate a new block of transactions on the M blockchain. As a reward of validation, Taxpayer A receives two additional units of M, which become accessible for sale, exchange, or disposal on Date 3, based on the M protocol.

The IRS determined that when a cash-method taxpayer stakes cryptocurrency native to a proof-of-stake blockchain and receives additional units as rewards at validation, the fair market value of these validation rewards must be included in the taxpayer's gross income for the tax year in which they gain "dominion and control" over the rewards. The fair market value is determined as of the date and time the taxpayer gains dominion and control over the rewards.

To support its conclusion, the IRS referenced Section 61(a) of the Internal Revenue Code and *Commissioner v. Glenshaw Glass Co.*, which dictate that any undeniable accession to wealth, clearly realized, and over which taxpayers have complete control, should be included in gross income. The IRS also cited IRS Notice 2014-21, which treats convertible virtual currency, including cryptocurrency, as property for federal income tax purposes. Consequently, general tax principles applicable to property transactions apply to cryptocurrency dealings.

Thus, any gains derived from property transactions, such as rents or royalties, should be included in the gross income of a cash-method taxpayer in the taxable year when the taxpayer obtains dominion and control of those gains, either through actual or constructive receipt. When Taxpayer A gains the ability to sell, exchange, or otherwise dispose the two units of M received as rewards for staking and validation transactions, Taxpayer A gains dominion and control, resulting in an "accession to wealth." Accordingly, the fair market value of the two units of M at the time Taxpayer A gains dominion and control (Date 3) is included in Taxpayer A's gross income for the taxable year that includes Date 3.

The IRS also clarified in the Revenue Ruling that the same tax treatment applies if a taxpayer stakes cryptocurrency native to a proof-of-stake blockchain through a cryptocurrency exchange and receives additional units of cryptocurrency as rewards for the validation.

Takeaway

The Revenue Ruling is somewhat controversial, as many taxpayers and advisors believe that staking rewards should be treated similarly to other situations where a taxpayer's dominion and control over property does not result in gross income until the property is disposed. Some potential analogies include property that is created, harvested, or extracted, or the receipt of shares of stock pursuant to a stock split or dividend (under the principles of *Eisner v. Macomber*). The IRS did not address any of these alternative theories.

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