

Token Taxation—Proof of Work and Proof of Stake

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Notice 2014-21

- Treats virtual currency as property and not as currency
 - Virtual currency is “a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value *other than a representation of the U.S. dollar or a foreign currency.*” (italicized portion added by Rev. Rul. 2019-24).
- Taxpayer has gain or loss determined by reference to its basis in virtual currency and the FMV of property received in exchange for such virtual currency.
- The character of gain or loss generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer.
- A taxpayer who receives cryptocurrency as payment for goods or services must include in gross income the FMV of the virtual currency measured in USD as of the date the virtual currency was received.
- A taxpayer who successfully “mines” virtual currency includes in gross income the FMV of the virtual currency on the date of receipt.

General Tax Concepts

- Supreme Court's *Glenshaw Glass* test for income, cited in Rev. Ruls. 2019-24 and 2023-14:
 - Undeniable accession to wealth
 - Clearly realized
 - Over which the taxpayer has complete dominion.
- Treas. Reg. 1.451-2(a)—income is constructively received by a taxpayer in the year when “it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time.”
- Rev. Rul. 59-60 provides guidelines for valuing an asset (in that case, privately-held stock), using a willing-buyer/willing-seller standard.
 - The Rev. Rul. states, “the prices of stocks which are traded in volume in a free and active market by informed persons best reflect the consensus of the investing public. . . . When a stock is closely held, is traded infrequently, or is traded in an erratic market, some other measure of value must be used” and no one-size-fits-all approach is appropriate.

Rev. Rul. 2023-14

- Facts: a cash-method taxpayer who “stakes 200 units of [token] M and validates a new block of transactions on the M blockchain, receiving 2 units of M as validation rewards.” The ruling posits that upon receiving the tokens [Date 2] the taxpayer lacks the ability to sell exchange or otherwise dispose of them, and that on the following day [Date 3] the taxpayer has the ability to sell, exchange, or otherwise dispose of the tokens.
- Conclusion: the taxpayer must include the “fair market value of the validation rewards received” in gross income in “the taxable year in which the taxpayer gains dominion and control.”
 - As to precise timing, the ruling states, “The fair market value is determined as of the date and time the taxpayer gains dominion and control over the validation rewards.”
- Ruling cites

The Universe & Taxonomy of Staking

Main Categories of Staking

Solo Staking

Running a node, creating new tokens.

Delegated Staking

Delegating tokens to a node operator, joint staking with node operator and creation of new tokens.

Pooled Staking

Tokens are part of a staking pool. Possible issuance of receipt tokens

Staking as a Service

Depositing tokens with a service provider who runs nodes and is paid a fee.

Liquidity Pools

Depositing token/token pairs to AMM Protocols (DeFi Exchanges), earning a share of trading fees paid by other users.

Farming

Depositing an LP Token (from providing assets to a Liquidity Pool) and earning an additional third token.

Staking Variants and Other Issues

- Locked Tokens
 - Dominion and control (inability to dispose)
 - Valuation
- Basis and Timing Tracking
- Proof of stake vs. proof of work
- Character and source issues
- Liquid Staking Pools
- Joint Staking Arrangements
- Accession to Wealth prong of *Glenshaw Glass*—Situation 1 in Rev. Rul. 2019-24 (hard fork).