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Tax Insights

A Publication of the Stradley Ronon
Tax Practice Group

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APRIL 22, 2021

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IRS Issues Additional Guidance on Crypto Hard Fork

The IRS, in ILM 202114020, held that a taxpayer who received Bitcoin Cash as a result of a hard fork has gross income because the taxpayer had an accession to wealth. Under Section 61 of the Internal Revenue Code of 1986, as amended (Code), all gains or undeniable accessions to wealth, clearly realized, over which a taxpayer has complete dominion, are included in gross income. Revenue Ruling 2019-24 applies the general principles of Section 61 to conclude that the receipt of a new cryptocurrency following a hard fork results in income. Specifically, the ruling includes in the facts an airdrop following a hard fork as an example of how a taxpayer could receive new cryptocurrency from a hard fork. The specific means by which the new cryptocurrency is distributed or otherwise made available to a taxpayer following a hard fork does not affect the Revenue Ruling's holding. (See our prior coverage here.)

A "hard fork" occurs when a cryptocurrency on a distributed ledger (such as blockchain) undergoes a protocol change resulting in a permanent diversion from the existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. Following a hard fork, transactions involving the new cryptocurrency are recorded on the new distributed ledger, and transactions involving the legacy cryptocurrency continue to be recorded on the legacy distributed ledger.

In ILM 202114020, Bitcoin underwent a hard fork on Aug. 1, 2017, at 9:16 am, EDT, which resulted in the creation of a new cryptocurrency, Bitcoin Cash. The developers of Bitcoin Cash designed the Bitcoin Cash protocol in such a way that holders of Bitcoin received Bitcoin Cash in a 1:1 ratio based on the transaction history recorded in the shared portion of the Bitcoin/Bitcoin Cash distributed ledger. The ILM 202114020, address two factual situations as a result of the Aug. 1, 2017 hard fork.

In Situation 1, A had sole control over the private key to a distributed ledger address that, as of Aug. 1, 2017, at 9:16 a.m., EDT, held 1 unit of Bitcoin. Following the hard fork, A's distributed ledger address continued to hold 1 unit of Bitcoin while also holding 1 unit of Bitcoin Cash. At that time, A had the ability to initiate a transaction to dispose of some or all of A's Bitcoin Cash holdings. A has ordinary income in the 2017 taxable year equal to the fair market value of the Bitcoin Cash as of Aug. 1, 2017, at 9:16 a.m., EDT. A can determine the Bitcoin Cash's fair market value using any reasonable method, such as adopting the publicly published price value at a cryptocurrency exchange or cryptocurrency data aggregator.

In Situation 2, B is a customer of CEX, a cryptocurrency exchange that provides hosted wallet services. As of Aug. 1, 2017, at 9:16 a.m., EDT, B owned 1 unit of Bitcoin, which was held by CEX in a hosted wallet. CEX had sole control over the private key to a distributed ledger address that, as of Aug. 1, 2017, at 9:16 a.m., EDT, held 100 units of Bitcoin. According to CEX's off-chain, internal ledger, one unit of the 100 units of Bitcoin was owned by B. B did not have dominion and control over any Bitcoin Cash at the time of the hard fork, and therefore did not receive any income from the hard fork at that time. On January 1, 2018, at 1:00 p.m., EDT, CEX initiated support of Bitcoin Cash, allowing B—for the first time—to sell, transfer, or exchange B's 1 unit of Bitcoin Cash. B has ordinary

income in the 2018 taxable year equal to the fair market value of the Bitcoin Cash as of January 1, 2018, at 1:00 p.m., EDT. B can determine the fair market value by consulting CEX's pricing data. If CEX lacks such information, B can use any other reasonable method.

IRS Releases Opportunity Zone Regulations for Foreign Investors

The IRS has released proposed regulations (REG-121095-19) that provide requirements for certain foreign persons and certain foreign-owned partnerships investing in qualified opportunity funds (QOFs) under the Opportunity Zone program and flexibility for working capital safe harbor plans. Generally, qualified opportunity zones, Sections 1400Z-1 and 1400Z-2 added as part of the 2017 Tax Cuts and Jobs Act, are designated tracts in low-income communities in which eligible taxpayers may invest through a QOF and elect to defer certain gain.

Under Section 1400Z-2 regulations, a taxpayer qualifies for deferral under section 1400Z-2(a) only if the taxpayer is an eligible taxpayer. An eligible taxpayer is defined as a person that is required to report the recognition of gains during the taxable year under Federal income tax accounting principles. If an eligible taxpayer that is a partnership does not elect to defer gain, a partner of such partnership may elect to defer its distributive share of the gain. In general, an eligible gain is gain that (i) is treated as a capital gain or is a qualified 1231 gain, (ii) would be recognized for Federal income tax purposes and subject to tax under subtitle A of the Code before Jan. 1, 2027, if section 1400Z-2(a)(1) did not apply to defer the gain, and (iii) does not arise from a sale or exchange of property with certain related persons. Thus, for example, a nonresident alien individual or foreign corporation generally may make a deferral election with respect to an item of capital gain that is effectively connected with a U.S. trade or business because this gain otherwise is subject to Federal income tax.

Foreign persons are generally subject to U.S. income tax on amounts that are effectively connected with the conduct of a trade or business within the United States (ECI). A foreign person that directly or indirectly is engaged in a trade or business in the United States must file a U.S. income tax return and pay any tax due. To ensure the collection of tax, in certain circumstances, the Code imposes withholding requirements on payments or allocations of ECI to foreign persons. The amount withheld may be claimed as a credit against the amount of tax due and shown on the foreign person's tax return.

Previously released regulations did not address potential issues that may arise if a foreign person is a taxpayer eligible to elect to defer certain gains under Sections 1400Z-1 and 1400Z-2. These regulations specifically address:


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- Coordination of the deferral election under section 1400z-2(a) with the withholding rules under sections 1445, 1446(a) and 1446(f),
- Requirement for certain persons to obtain eligibility certificate,
- Elimination or reduction of withholding based on an eligibility certificate, and
- Flexibility with respect to working capital safe harbor plans in the event of a federally declared disaster.

IRS Releases Fact Sheet on Reporting Foreign Bank Accounts

The IRS has released a Fact Sheet on "How to Report Foreign Bank and Financial Accounts." U.S. persons that maintain overseas financial accounts must file Reports of Foreign Bank and Financial Accounts (FBAR) because foreign financial institutions may not be subject to the same reporting requirements as domestic financial institutions. The Fact Sheet offers guidance on who needs to file an FBAR and how to report and file an FBAR, along with other information covering amendments, penalties and recordkeeping.

IRS Extends Relief from Penalty for Failure to Deposit Employment Taxes

The IRS has released Notice 2021-24, which extends the penalty relief provided in Notice 2020-22 to apply to certain paid sick and family leave credits, certain employee retention credits, and certain COBRA credits. (See our coverage on Notice 2020-22 here.) Under the Notice, an employer is not subject to the penalty imposed by Section 6656 of the Code for such employer's failure to timely deposit employment taxes in certain situations detailed therein.