

IRS Provides Guidance on How to Answer Digital Asset Question on Tax Return

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Last year, the Internal Revenue Service (IRS) revised a question regarding digital assets that appears at the top of certain 2022 income tax returns. Now, in [IR-2023-12](#), the IRS has provided guidance on how to answer that question.

The question, revised to update terminology by replacing “virtual currencies” with “digital assets,” appears at the top of [Forms 1040, Individual Income Tax Return](#); [1040-SR, U.S. Tax Return for Seniors](#); and [1040-NR, U.S. Nonresident Alien Income Tax Return](#).

The Question

For the 2022 taxable year, the question asks:

“At any time during 2022, did you: (a) receive (as a reward, award or payment for property or services); or (b) sell, exchange, gift or otherwise dispose of a digital asset (or a financial interest in a digital asset)?”

The guidance describes a digital asset as a digital representation of value that is recorded on a cryptographically secured, distributed ledger. It lists as common digital assets:

- Convertible virtual currency and cryptocurrency,
- Stablecoins, and
- Non-fungible tokens (NFTs)

Every taxpayer filing Form 1040, Form 1040-SR, or Form 1040-NR must check either the “Yes” or “No” box. *Do not leave this question unanswered.*

Should I Answer “Yes” or “No”?

To help taxpayers understand how to answer the question, the IRS provides examples of when the “Yes” box should be checked and when the “No” box should be checked. Normally, taxpayers should answer “Yes” if they:

- Received digital assets as payment for property or services provided;
- Transferred digital assets for free (without receiving any consideration) as a bona fide gift;
- Received digital assets resulting from a reward or award;
- Received new digital assets resulting from mining, staking, and similar activities;
- Received digital assets resulting from a hard fork (a branching of a cryptocurrency's blockchain that splits a single cryptocurrency into two);
- Disposed of digital assets in exchange for property or services;
- Disposed of a digital asset in exchange or trade for another digital asset;
- Sold a digital asset; or
- Otherwise disposed of any other financial interest in a digital asset.

A key point for taxpayers to remember is that using digital assets to purchase a good or pay for a service during the taxable year requires the “Yes” box to be checked. While taxpayers generally will know when they have engaged in a transaction that involves a digital asset, it may not be obvious (or may be easy to overlook) when they receive a digital asset as an award under a loyalty program. For example, a taxpayer may use an online financial services product, such as a credit card, that awards digital assets for using the service. If digital assets are awarded during the taxable year, the taxpayer should check the “Yes” box.

Possibly the most helpful guidance provided by the IRS is when to check the “No” box. Taxpayers who own digital assets during the taxable year but who do not engage in any transactions involving digital assets should check the “No” box. Taxpayers also can check the “No” box if their activities were limited to one or more of the following:

- Holding digital assets in a wallet or account;
- Transferring digital assets from one wallet or account they own or control to another wallet or account they own or control; or
- Purchasing digital assets using U.S. or other real currency, including through electronic platforms such as PayPal and Venmo.

While purchasing digital assets with U.S. or other real currency allows the “No” box to be checked, as noted above, using digital assets to purchase a good or service requires the “Yes” box to be checked.

How Do I Report Digital Asset Income?

Digital Asset Held as a Capital Asset. If a taxpayer holds a digital asset as a capital asset and sells, exchanges, or transfers it during the taxable year, the taxpayer must use IRS [Form 8949, Sales and Other Dispositions of Capital Assets](#), to calculate the gain or loss on the transaction, and then report that gain or loss on [Schedule D \(Form 1040\), Capital Gains and Losses](#), or [Form 709, United States Gift \(and Generation-Skipping Transfer\) Tax Return](#), in the case of a gift.

Digital Asset Received as Compensation. If an employee is paid with digital assets, the employee must report the value of assets received as wages. The employee's employer should provide this value on the Form W-2

furnished to the employee. If an individual works as an independent contractor and is paid with digital assets, the independent contractor must report the value of the digital asset as income on [Schedule C \(Form 1040\), Profit or Loss from Business \(Sole Proprietorship\)](#). It would appear that the value of the digital asset at the time it is received is the amount of income that must be reported, even if the value of the digital asset is higher or lower at the time the income tax return for the individual is filed. Schedule C also is used by anyone who sold, exchanged, or transferred digital assets to customers in connection with a trade or business.

In addition to the recently released guidance, more information is provided on page 15 of the [Tax Year 2022 \(and 1040-SR\) Instructions](#). The IRS also has a set of frequently asked questions (FAQs) and other details on its webpage on [Digital Assets](#).

While the utility of digital assets is much debated, there is little debate over whether engaging in transactions with digital assets creates challenging tax compliance issues for taxpayers.

Related people

Douglas W. Charnas

Aaron P. Kouhought

Robert W. Savoie