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Stolen \$600M Crypto Is Returned, Can IRS Tax It?

It's no secret that the IRS is after crypto in a big way, with warnings, a series of [cryptocurrency John Doe Summonses](#) served on exchanges and even a crypto question on *every* tax return. Selling crypto can obviously trigger taxes, but even *buying* something with crypto can trigger taxes. In fact, even paying *taxes* in crypto can trigger *more* taxes. This tax paradox started when the IRS ruled that cryptocurrency is property in [Notice 2014-21](#). That classification has some big tax consequences, accentuated by wild price swings. If you pay off a \$5,000 debt with crypto, as long as the crypto is worth \$5,000 when you pay, you're home free, right? Not really. You need to consider the *sale* you just made. The transfer of the crypto to pay your debt is a sale, and that could mean more taxes for the year of the payment. If you bought the crypto for \$5,000 the day you pay the debt, there's no gain. But if you aren't paying a debt but buying something, it's even worse.

Paying employees or independent contractors in crypto results in taxes to them when they receive it. And when you pay them, you too can have a tax hit, since on your side of the equation, you just *sold* your crypto. If you are paying

with crypto, remember that most transfers of crypto are taxable, unless the transfer qualifies as a gift or a charitable contribution.



There have been plenty of hacked crypto owners who claimed tax deductions for their loss. But deductions are usually limited to their tax basis (purchase price) in the asset, not the market value. If just about every crypto transfer triggers taxes, how about a theft and return? When the \$600 hack of Poly Network occurred, someone claiming losses seemed inevitable, until amazingly, [nearly all of \\$600 million in crypto was returned](#). On a more modest scale, think about crypto loans too, since some crypto “loans” might be taxable. After all, if you want to avoid taxes, a loan of property should generally require the return of the *same* property. With loans of cryptocurrency, the parties probably *intend* the cryptocurrency lent to be treated as fungible currency, rather than like property. And that makes the

\$600M hack and return a good example of an exception to the normal concept that tax can apply where you might not expect it.

If you buy stock but the company refunds your money, was it two transactions or none? Going back to square one may sound simple, but the tax system is rigid and rarely simple. And the annual IRS tax return filing requirement means in most cases every tax year stands on its own. Fortunately, the IRS agrees that *some* transactions can be unwound and that tax effects can be ignored. To pretend a deal never happened you must meet two tough conditions: (1) Each party must go back to its position before the transaction as if it never occurred. Rescission isn't a one-sided deal. (2) The go-back must occur in the same tax year as the deal. See [Revenue Ruling 80-58](#). It's this timing rule that's usually the problem. Say you sell your house and the buyer claims the house is infected with mold. The dispute is unlikely to be resolved immediately. Often that means a subsequent tax year.

To the IRS, each tax year must stand on its own. Some taxpayers who don't meet the IRS's strict same-year timing rule may argue that a rescission qualifies as long as the transaction is unwound before they've reported the transaction on their tax return. Example: You sell your car to your brother-in-law for \$25,000 in September 2011. He has some problems so gives you the car back in May 2012 and you refund the money. Although your 2011 tax return was due April 15th, you went on extension, so you haven't yet filed when you take the car back. When you file your 2011 return in August 2012, can you treat this sale as never having occurred? The IRS says no, but some advisers *might* say yes.

Even the IRS may be loosening up. In several rulings, the IRS has approved rescissions even though one could argue that the parties didn't exactly go back to square one. For example, in [IRS Letter Ruling 200952036](#), a partnership

was converted into a corporation, and then was converted back to a limited liability company (LLC). The partners didn't *entirely* go back to square one. After all, when the smoke cleared they were members of an LLC not partners in a partnership. An LLC is not exactly the same as a partnership. Nevertheless, the IRS treated the transaction as rescinded and having no tax affect. Any rescission involves at least two parties. Even in the simple car example, what if your brother-in-law has already filed his 2011 tax return before the rescission, perhaps even depreciating or writing off the car? In more complicated deals, there may be many parties, but [I still love rescission](#).

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