10 JULY 2025 VOL 3, ISSUE 10

KEY SERVICE INSIGHTS

INDIVIDUAL TAX NEWSLETTER

TAXPAYER CAN'T USE 2020 CRYPTO LOSSES TO OFFSET PRIOR-YEAR GAINS

KIM V. COMMISSIONER

Case Overview

Issue

Does the Annual Accounting Principle Apply to Virtual Currencies?

Held

The annual accounting principle "dictates that a taxpayer's income for a particular year be calculated on the basis of events occurring during that year."

Key Insight

Virtual currencies can have large swings in values from year to year. Where large gains are recognized in one year that are then followed by large losses in a following year, under the annual accounting principle and the Internal Revenue Code the Taxpayer cannot use a capital loss in a future tax year to offset capital gains in a previous tax year.

Brief Overview

The IRS received information reports from Coinbase reporting the Taxpayer's transactions in various virtual currencies for tax years 2013–2017. The Taxpayer timely filed federal income tax returns for years 2013–2017 but did not report any gains or losses from the virtual currency transactions.

The Taxpayer's 2018 tax return reported gross proceeds from virtual currency transactions of

$18.6 million but reported a gain of only $42,069 based on the Taxpayer's reported basis of the virtual currencies that were sold.

The IRS audited the Taxpayer's 2013–2017 tax returns, and when the Taxpayer did not provide adequate support for the Taxpayer's basis calculation, the revenue agent used the records from Coinbase to reconstruct the basis. Based on this information the revenue agent determined the Taxpayer had short-term capital gain of $75,400 for 2013, short-term capital gain of over $4 million for 2017, and long-term capital gain of $74,565 for 2017.

Taxpayer's Argument and Court's Response

The Taxpayer did not contest the character or amount of the gains calculated by the revenue agent, but instead argued that in 2020, the virtual currencies that produced the gain were wiped out during the early stages of the COVID-

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19 pandemic, forcing the Taxpayer to liquidate his virtual currencies and resulting in large losses for 2020. The Taxpayer further argued:

that the actions (or inactions) of the U.S. Government in response to the COVID epidemic "directly cause [that] harm" and that, "under the Clean Hands doctrine of US law," the IRS should be estopped from collecting tax on his 2013 and 2017 gains.

The Tax Court concluded that the "unclean hands" principle was inapplicable as the government was not seeking equitable relief but to recover taxes due under the Internal Revenue Code. The Court further found that the annual accounting principle "dictates that a taxpayer's income for a particular year be calculated on the basis of events occurring during that year."

Conclusion

Currently, the Internal Revenue Code only allows Taxpayers to carry capital losses realized in 2020 forward, meaning that the Taxpayer cannot use capital losses incurred in 2020 to offset the capital gains recognized in tax years 2013 and 2017.

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