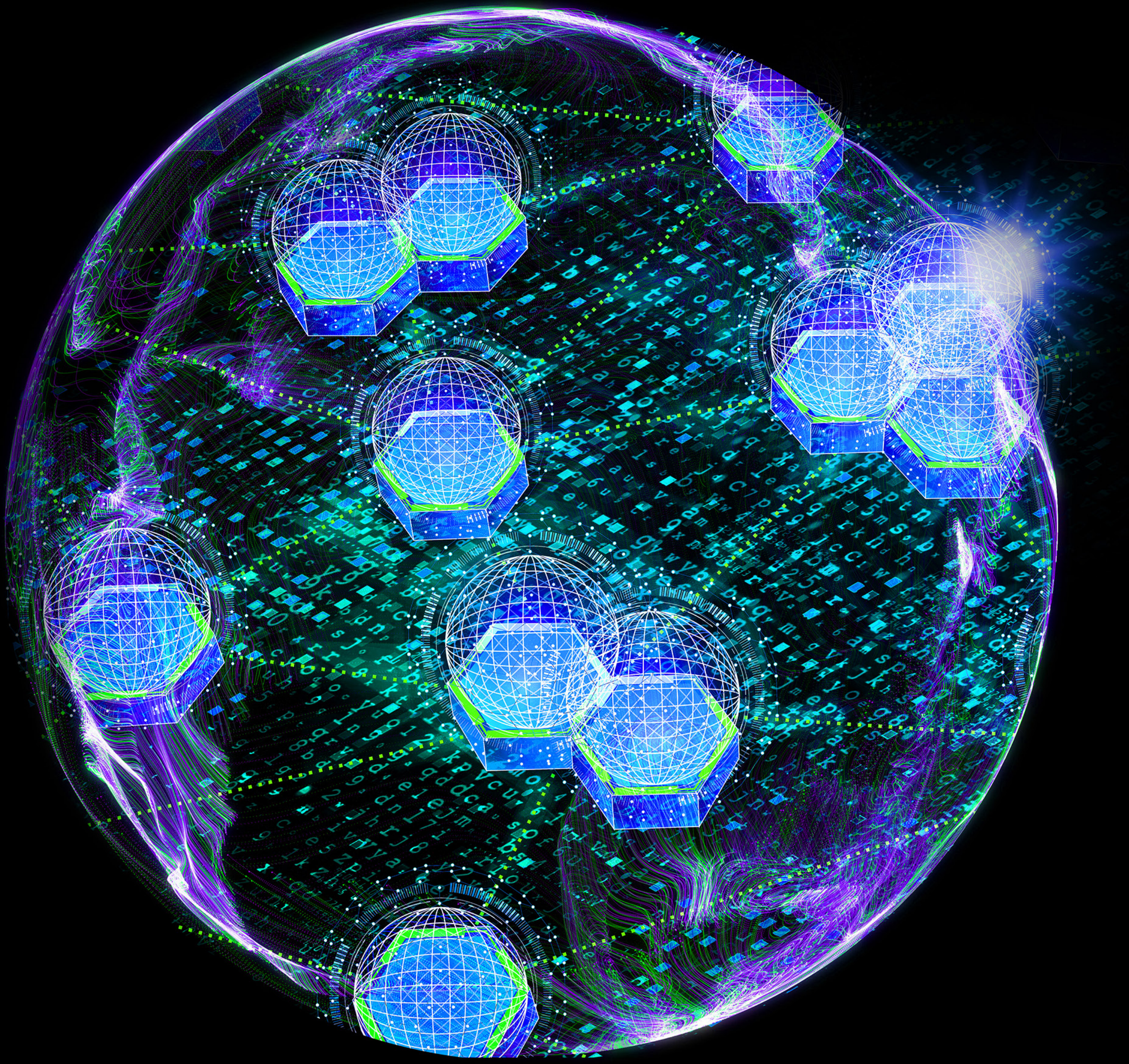


Tax controversy in crypto

Getting ready for the IRS exam

How IRS exam trends may reshape crypto compliance

As the use of digital assets expands in the U.S., the Internal Revenue Service (IRS) likely will focus its attention on these ever-evolving asset types. While there has been some additional guidance issued by Treasury and the IRS on the taxation of crypto, there remains need for additional guidance on many common transactions. This article offers perspectives, based on our experience, that include likely areas of focus, practical insights, best practices, recommendations, and what to expect going forward—as related to crypto-related IRS exams.

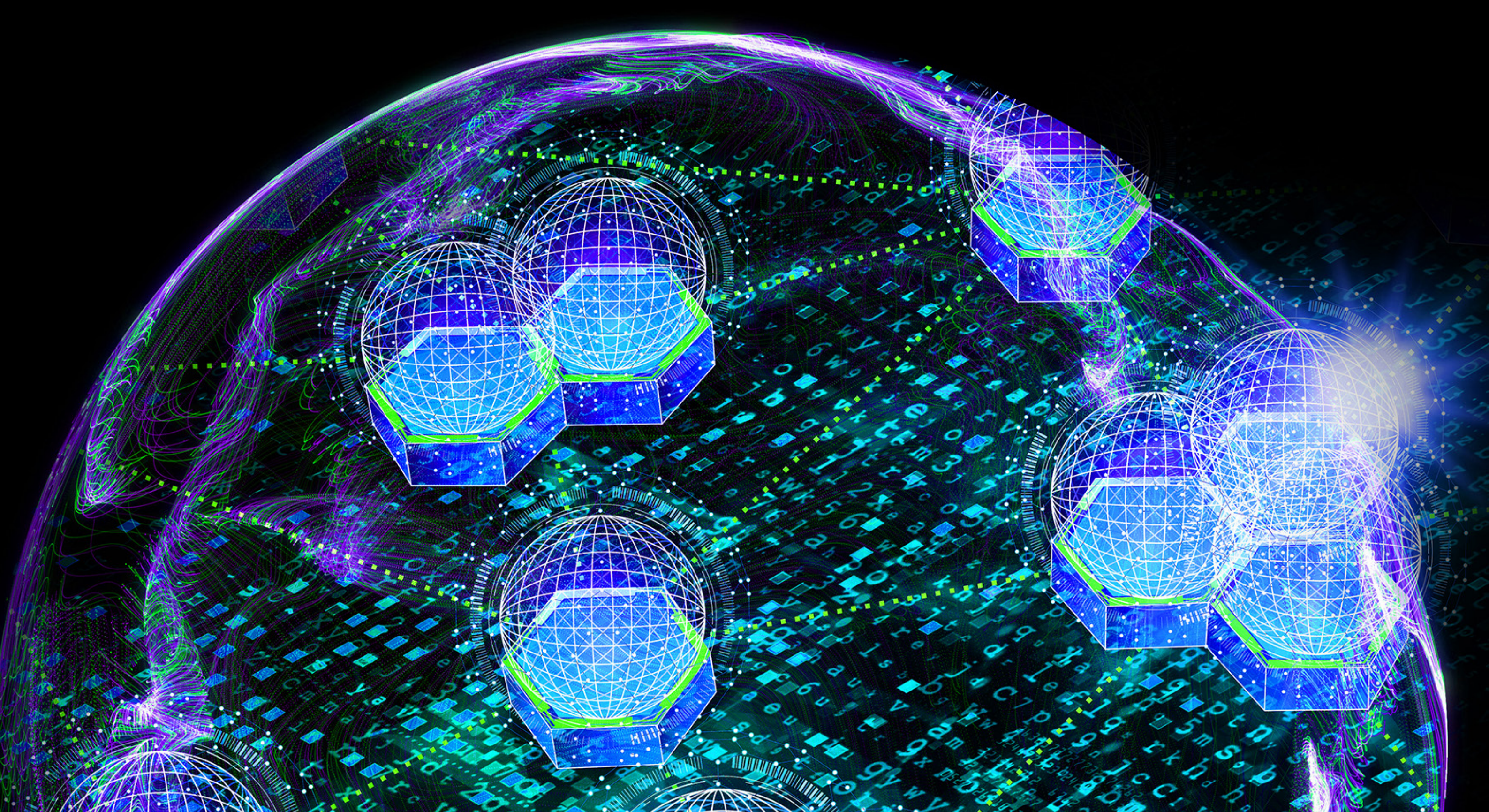
Key Takeaways

Potential for increased IRS exam scrutiny. As digital assets move into payments, treasury, and broader business use, we expect the IRS to increase scrutiny through targeted Information Document Requests (IDRs), blockchain review, and 1099-DA matching.

Documentation is key. Contemporaneous, complete, and intelligible records -especially for basis, wallet-by-wallet activity, and valuation—will heavily shape the course, and often results, of an exam.

Uncertainty remains. Staking, DeFi, lending, and asset classification remain areas where guidance is incomplete, which means taxpayers need to monitor new IRS, Treasury, and congressional developments closely.

The reporting environment is tightening fast. With Forms 1099-DA entering the ecosystem, IRS exam teams should have more visibility into reported transactions and we expect them to ask more sophisticated questions earlier in the process.



State of crypto

Crypto has moved beyond its origins as a speculative asset class and is increasingly being used in payments, settlement, and corporate treasury and investment strategies, even as the tax treatment of digital asset transactions remains unsettled and administratively complex.

Globally, tax authorities continue to face challenges keeping pace with the rate of innovation in digital assets. Few countries have developed a coherent regulatory framework for taxing digital asset transactions.

United States policy and legislative environment: In the United States, although the broader policy environment has become generally more supportive of digital assets,[1] the IRS appears to be increasing its examinations of crypto activity, likely due to the increase in individual and business taxpayer trading and transacting with digital assets Common trends on exam could include:

- Standard initial Information Document Requests (IDRs) that include questions about crypto assets and exchanges, followed by more targeted crypto-focused IDRs;
- Follow-ups for wallet-by-wallet tracking and blockchain records, which can lead to disputes over supporting documentation; and
- Forms 1099-DA matching to transactions reported by taxpayers.

These trends are mutually reinforcing—the IRS will likely work to build a workforce conversant in crypto activity, improving its access to transaction data in real time, and incorporating both into how it approaches examinations, in real time.

[1] The bipartisan Infrastructure Investment and Jobs Act (IIJA) led to final regulations, published in June 2024, addressing reporting requirements for digital asset brokers; Executive Order 14178, signed in January 2025, established a President's Working Group on Digital Asset Markets to propose a federal regulatory framework within roughly 180 days; and in July 2025, the GENIUS Act established the first federal framework for payment stablecoins. Meanwhile, the CLARITY Act has advanced in Congress but remains pending, underscoring that even as market-structure regulation evolves, important questions about the characterization, reporting, and taxation of digital assets remain unresolved.

Likely areas of focus in IRS exams

Though the facts and circumstances of each exam are different, there likely will be a handful of common focus areas and approaches by IRS examiners. These are expected to include transaction reconciliation, basis substantiation, wallet-by-wallet tracking, and value substantiation.

1 Transaction reconciliation

Much like other commonly examined aspects of a company's tax filings, we expect IRS exams of crypto activity to follow a consistent progression: ensure completeness first, accuracy second. Before an examiner evaluates whether gains and losses were calculated correctly, step one is ensuring completeness of all reported activity—every wallet, exchange account, and on-chain address. That threshold question can be much harder to satisfy than it sounds when it comes to crypto transactions.

Blockchain tracing tools are a standard part of the IRS examiner's toolkit.[2] Several commercial analytics platforms are used regularly to test whether a taxpayer's disclosed accounts represent their full crypto footprint. Publicly available tools are able to utilize known wallet addresses which can be used as seeds for attribution analysis, surfacing connected addresses and transaction flows that may not have appeared in the taxpayer's initial response and that may have been unknown to the taxpayer to begin with (e.g., movements by administrators between "hot" and "cold" wallets to effectuate trades). Unlike traditional financial accounts, transactions recorded on a public blockchain are, by design, a permanent and openly accessible record. Every transaction is written to a distributed ledger that anyone, including the IRS, can view, and each entry remains there indefinitely. Once the IRS connects a wallet address to a taxpayer, it can trace the full history of activity tied to that address without needing to request records from the taxpayer or a third party. As a result, taxpayers should be prepared to document and explain any on-chain movements of digital assets, whether or not a given transaction results in a taxable event.

The practical challenge is that taxpayers themselves may not always have a complete picture of their crypto history. Examples include wallets opened years earlier and long forgotten, exchange accounts at platforms that have since closed, and one-off interactions with DeFi protocols.

These issues are frequently the product of the same complexity that makes crypto recordkeeping difficult for everyone. A thorough pre-exam reconstruction, conducted before the first IDR response is submitted, is far preferable to a series of supplemental productions that can inadvertently raise questions about completeness and credibility.

Once completeness is reasonably established, the exam will likely shift to accuracy: did the taxpayer correctly identify which lots were disposed of, recover the right tax basis, and report the correct gain or loss? That is where the issues addressed in the following sections, basis substantiation, wallet-by-wallet tracking, and value substantiation, become the central focus.

2 Basis substantiation

A transaction reconciliation is about establishing what happened, whereas basis substantiation focuses on proving what it cost upon purchase or acquisition. Taxpayers bear the burden of proving basis and where proof is absent, substantiating basis in an asset with the IRS can be complex and cause significant tax implications.

Challenges substantiating basis do not only arise at the point of original acquisition and often occur as a result of transfers between wallets and accounts over time. A taxpayer may have solid records of their initial purchases on a major exchange, but if those assets were subsequently moved across wallets, into cold storage, through DeFi protocols, or onto other platforms, and those transfers were not systematically tracked with basis continuity in mind, the documentation chain fractures. Each undocumented transfer creates a potential gap and corresponding exposure associated with the taxable gain or loss on subsequent dispositions. Reconstructing the true picture after the fact is painstaking with many practical challenges.

[2] Internal Revenue Service Criminal Investigation [IRS-CI], Pub. 3583.

The problem is exacerbated by the various ways crypto assets can be acquired. Purchases are the most straightforward; there is typically at least a transaction record, even if the exchange no longer exists.
But airdrops and hard forks present a structurally different challenge. Under current IRS guidance, the basis in an airdropped or forked asset depends on whether the taxpayer recognized and reported income at the time of the event. If they did, the fair market value included in income becomes the basis. If they did not, which describes a significant portion of early crypto participants who either were not aware of the guidance or operated before it was clearly articulated, then the basis question becomes entangled with a prior-year income inclusion question. Resolving one can implicate the other, and examiners scrutinizing basis in these situations are often, simultaneously, scrutinizing whether the original income event was properly reported. That dual exposure makes airdrops and hard forks among the most difficultbasisdifficult basis disputes in exam settings.

The practical implication for exam preparation is that basis documentation needs to be approached as a chain-of-custody exercise, tracing each asset from its origin acquisition through every subsequent transfer to the point of disposition. Where links in that chain are missing, the priority is to reconstruct what is recoverable - exchange records, blockchain transaction histories, contemporaneous communications. Those who have this documented are in a much more favorable position should the IRS request those records.

3 Wallet-by-wallet (or account-by-account) tracking

For much of crypto's early history, taxpayers and practitioners operated without clear IRS guidance on how to track cost basis across multiple wallets and exchange accounts. The approach that some taxpayers took was a “universal” view: all assets were treated as if held in a single pool, regardless of where and how they were custodied. Under that framework, transferring assets from one exchange to another was irrelevant for purposes of tracking tax basis; the pool simply moved with the taxpayer. It was a practical solution to a recordkeeping problem that neither the IRS nor most software providers had yet addressed directly. Many of the early basis tracking software platforms reinforced this approach simply because universal methodology was the only option they offered.

The simplicity of that approach was its primary virtue. It was not necessarily more or less favorable to taxpayers; it was just easier to administer. But the arrival of broker reporting under T.D. 10000 changed the calculus entirely.[3] With crypto brokers now required to report gross proceeds and, eventually, cost basis to their customers and the IRS, the agency's matching program depends on broker-reported figures aligning with what taxpayers report. A universal methodology applied by a taxpayer, layered on top of account-specific reporting from brokers, creates a structural mismatch that undermines any potential utility of that matching program. This tension, more than anything, is what drove the formalization of the wallet-by-wallet (or account-by-account) requirement.

The transition and the Rev. Proc. 2024-28 Safe Harbor

Moving to a wallet-by-wallet lot selection methodology is not simply a change in accounting convention, it requires taxpayers to reconstruct where their basis actually lives across every account and wallet they hold. For taxpayers with long histories, multiple platforms, and years of transfers between wallets, that is a genuinely difficult exercise.

Rev. Proc. 2024-28 offered a structured path for making that transition.[4] To take advantage of it, taxpayers were required to identify all their holdings across every account and wallet as of December 31, 2024, and then reasonably allocate (as described in the Rev. Proc.) the cost basis to each asset in each account or wallet at that point in time. In concept, this was a reasonable mechanism for resetting the basis tracking framework. In practice, it was a significant undertaking.

That gap has direct exam implications. For exams that straddle the pre-2025 and post-2025 periods, the IRS will likely request substantiation showing that the safe harbor was properly implemented. A taxpayer who cannot produce that documentation faces a meaningful risk: the IRS could recalculate gains and losses using the default FIFO methodology. For taxpayers who had been applying specific identification methods, such as HIFO, the difference between their reported figures and an IRS-calculated FIFO result could be material. The safe harbor was designed to provide certainty; without it, that certainty evaporates, and the basis allocation question becomes open to challenge precisely at the point where the old methodology ends and the new one is supposed to begin. In these circumstances, it is prudent for the taxpayer to carefully assess their facts, firm up their books and records, along with lot relief methodologies, and determine supportable positions in prospective filings.

[3] T.D. 10000, codified at Treas. Reg. § 1.6045-1.

[4] Rev. Proc. 2024-28, §§ 5.01–5.02(2), 2024-31 I.R.B. 326.

4 Value substantiation

Valuation questions in crypto exams begin at the most basic level: proving that dollars actually left a taxpayer's bank account and were used to acquire crypto assets. Bank records showing transfers to exchanges, combined with corresponding exchange records showing the purchase, form the foundation of any cost basis claim denominated in fiat. Where that linkage is clean and documented, the valuation question is straightforward. Where it is not, even the most basic purchase basis becomes contestable.

From that foundation, the valuation challenges grow more complex across a range of transaction types.

- **Crypto-to-crypto exchanges:** Each crypto-to-crypto swap is a taxable disposition, and the fair-market-value ("FMV") of the asset received generally dictates the amount of proceeds realized by the seller. When both legs of the transaction involve liquid, exchange-traded assets, the valuation exercise may be manageable. When a taxpayer exchanges a liquid asset for an illiquid asset with minimal market activity, the amount realized in the transaction may be more difficult to discern. The complexity compounds when both assets are illiquid, because there is no reliable reference point on either side of the transaction, leaving the taxpayer to defend a methodology without the benefit of an observable market price to anchor it.
- **Hard Forks, Airdrops, Mining, and Staking Rewards:** For assets acquired through hard forks, airdrops, mining, or staking, existing IRS guidance suggests taxpayers recognize income for the FMV at the time the taxpayer has dominion and control of the assets.[5] This recognition event would simultaneously establish the asset's basis in the hands of the recipient. The practical problem is that many of these events involve assets that were illiquid or thinly traded when they were received. Further, the point at which dominion and control over said assets has been established may be difficult to discern. Establishing a defensible FMV when reliable market data is sparse or nonexistent requires methodological care, and examiners will scrutinize both the valuation figure and the source used to support it.
- **Compensation Paid in Crypto:** Where crypto is used to compensate employees or independent contractors, FMV at the time of receipt generally governs revenue recognition for the recipient and establishes their basis in the asset. The USD value of these payments may also be reported to the IRS and recipient on forms 1099 or W-2 filed by the payor. Substantiating that FMV, particularly for payments made in smaller or less liquid tokens, requires the same sourcing rigor as any other receipt-based valuation.
- **Illiquid and Thinly Traded Tokens:** Cutting across all of the above is a broader question of what constitutes an acceptable valuation source when exchange data is unreliable or unavailable. Taxpayers relying on data from low-volume exchanges, aggregated pricing services, or internal estimates should be prepared to defend both the source and the methodology. The IRS has not issued comprehensive guidance on acceptable valuation methods for illiquid crypto assets, which leaves the field somewhat open but also means examiners retain significant latitude to challenge the approach.
- **Donations of Crypto Assets:** Because cryptocurrency is treated as property, donations of crypto to charitable organizations require a qualified appraisal for deductions exceeding the applicable threshold, just as a donation of artwork or real estate would. This is an area where taxpayers frequently err, either because they assume crypto is treated more like cash for charitable purposes, or because they are unaware of the appraisal requirement entirely. An examiner scrutinizing a large charitable deduction involving crypto will look for the qualified appraisal, and its absence can result in full disallowance of the deduction regardless of the asset's actual value.

[5] Rev. Rul. 2019-24, 2019-44 I.R.B. 1004; Rev. Rul. 2023-14, 2023-28 I.R.B. 1103.

Developing friction points and unresolved issues

In addition to these high-level trends, several areas of exam questions are evolving:

Staking

Through Revenue Ruling 2023-14, the IRS provided guidance that staking rewards are generally includible in gross income when the taxpayer obtains dominion and control over the reward tokens, measured by their fair market value at that time.[6] More recently, in Paschall v. Commissioner, the Tax Court came to a similar conclusion.[7] However, tax uncertainty remains, not only about timing of revenue recognition for such transactions but also the appropriate characterization and sourcing of any revenue recognized from the acquisition of assets from these activities and/or subsequent disposition of those assets. Taxpayers should ensure they maintain adequate documentation and support for their tax treatment of staking activities, and that tax lot tracking of staking rewards is consistent with their reporting of these transactions and sufficiently supports their tax basis in digital assets.

Decentralized finance (DeFi)

Decentralized finance enables peer-to-peer digital asset trading and lending through decentralized applications (“dApps”) and self-executing smart contracts. No authoritative tax guidance directly applicable to these novel transaction types currently exists, and the facts surrounding these transactions and the associated DeFi platforms may vary significantly. Transferring assets to a DeFi platform generally is an observable on-chain transaction that may raise questions during an exam. Taxpayers should ensure that they retain adequate documentation and support for the tax treatment of these transactions, and that this treatment is appropriately reflected in their records supporting tax basis in digital assets.

Lending and collateralization

Crypto lending and posting crypto as collateral to support borrowings (which in some specific circumstances may be viewed as a crypto lending transaction) has become more common in recent years. Typically, these transactions may result in a transfer of the associated assets out of a taxpayer’s wallet or account, which could give rise to questions in an IRS exam. Although IRC Section 1058 provides rules for treatment of certain securities lending transactions as non-taxable, most digital assets would not meet the definition of securities for this purpose. Taxpayers should ensure they have documentation and support for their treatment of these types of transactions, and that the impact of the transaction is appropriately reflected in their records supporting tax basis in digital assets.

[6] Rev. Rul. 2023-14, 2023-28 I.R.B. 1103.

[7] Paschall v. Comm’r, T.C. Memo. 2026-46 (June 4, 2026).

Key lessons and practice pointers

Documentation best practices

A few essential documentation best practices include being contemporaneous, complete, intelligible, and consistent with what the IRS already knows (e.g., third-party filings or publicly available information, including press releases, filings, social media posts, etc.).

- **Contemporaneous—**The beginning of substantiation should always be maintaining acquisition and disposition information contemporaneously with the transaction. In practice, every event between acquisition and disposition should be traceable and intelligible to an IRS exam team. Questions that tend to matter in exams include what software was used to create original records; whether that software still functions; whether its reports are comparable to reports generated from earlier software or earlier software versions; and whether there is an explanation for discrepancies in how records are kept. Wallet-tracking algorithms are frequently updated, and the same request can generate different information as an algorithm is refined. Keeping records of the original search parameters can help examiners understand how information tracked by the current algorithm relates to earlier iterations.
- **Complete, Clear and Consistent—**The IRS will likely seek to confirm details supporting claimed gains and losses, including price, wallet information, broker information, transfer timing, and agreements governing crypto uses (including debt agreements). Each element of how crypto is held or used should be considered when maintaining records within and between wallets and other crypto holdings. Better records provide more points of confirmation for reliability. Transaction reporting provides varying degrees of usefulness, with older records sometimes limited by less sophisticated approaches to tracking digital assets. Making them logical and complete is essential for reliability and efficiency.
- **Consistent with what the IRS already knows—** A key documentation development is the IRS's increasing access to third-party and publicly available information. Brokerages that began issuing Forms 1099-DA for transactions beginning January 1, 2025 are providing exam teams with transaction information for document requests and potential adjustments.[8] It's best to assume transactions may be subject to reporting, confirming that Forms 1099-DA are accurate, and requesting corrections timely and in writing. As the IRS learns from early form-matching exercises, exam teams may ask sophisticated questions about how crypto is used within financial portfolios. The IRS also can use public sources (e.g. press releases, filings, social media posts, etc.) to identify potential crypto transactions and relevant information; IRS training materials already reference resources such as CoinMarketCap.com to establish token market values, for example.[9]

Opening conference opportunities

As with any IRS exam, the opening conference is an opportunity to proactively set the tone, expectations, and working relationship with the IRS exam team. The exam team focusing on cryptocurrency likely has relevant experience or support personnel with direct crypto experience. They will have access to Forms 1099-DA, allowing them to review some information prior to meeting. It is also possible that certain complex transaction types or business applications are new to the exam team and time spent educating them could be productive to establishing a positive rapport. Seek to understand what crypto issues they have already identified and explain what records were maintained and, if applicable, why they may differ from records pulled prior to the exam. Providing context on how cryptocurrencies are held and used generally supports more efficient discussions later.

IDR draft period considerations

When discussing draft IDRs with the exam team, keep in mind the practical realities of the available records and resources. Are transaction reports complete and intelligible? Are contemporaneous reports consistent with reports generated now? Is the request focused on material items? How much work and time will be required to explain a given record? Be clear and provide context when addressing whether requested deadlines are reasonable.

[8] Treas. Reg. § 1.6045-1.

[9] Internal Revenue Service, FAQ #27. See also HigherGov, IRS Contract Opportunity 23-326-OITA

What we expect next

The enforcement landscape shifts materially beginning with the 2025 tax year. For the first time, the IRS will have Form 1099-DA, a dedicated digital asset information return reported by brokers and fed directly into its matching program. The implications for both compliance and enforcement are significant. The agency's ability to identify mismatches between reported proceeds and taxpayer returns, and to flag non-filers entirely, will be exponentially greater than anything it had available during previous years.

That increased visibility is the straightforward part. The complication is that the Form 1099-DA, at least in its early iterations, will frequently paint an incomplete picture. Cost basis reporting from brokers is being phased in, and many brokers will report gross proceeds without corresponding basis information. Transfers between wallets and exchanges, assets acquired before the broker reporting regime, and transactions involving DeFi or self-custodied wallets will leave gaps that the form simply cannot capture. The result is a matching program that could be powerful enough to generate notices at scale, but not always accurate enough to distinguish a genuine underreporting issue from a fully compliant return that simply does not reconcile cleanly to an incomplete Form 1099-DA.

Practically speaking, it's possible that IRS notices go out to taxpayers who filed accurate returns. Taxpayers and practitioners should be prepared for this. Having clean, contemporaneous records that reconcile to broker reporting, and that explain any differences, will be essential to responding to those notices efficiently and avoiding unnecessary assessments.

Ongoing Crypto Tax Guidance and Authority: While there has been very little authoritative tax guidance issued on crypto since Laszlo bought his famous pizzas using bitcoin in 2010, the IRS and Treasury have been more active in recent years, with signs that more may be on the horizon. To remain current, taxpayers should monitor new guidance and assess its impact on both past positions and current activities. They should also consider historical exposures and potential method changes if the IRS or Treasury adopts a view that differs from a prior filing position. New guidance could also trigger revisiting the intended tax treatment of current or planned transactions.

One example is clarifications made in Treas. Reg. § 1.1012-1 for determining the basis used in digital asset disposals. Many taxpayers have historical methodologies that do not adhere to the guidance and did not take advantage of the safe-harbor reallocation in Rev. Proc. 2024-28. With the IRS engaging more deeply in crypto exam methodologies, and specific attention on proving basis, it is time to evaluate compliance and consider remediation strategies where needed.

Further, with crypto adoption increasing across mature enterprises and integration with financial products, congressional action is likely to modernize tax rules to bring additional certainty. Such action would underscore the need to pay close attention to evolving tax guidance and appropriately assess its impact on current and historical transactions.

How we can help

Returns and reporting: We utilize our subject matter specialists with many years of experience with our clients' digital asset activities as we help prepare tax filings to help taxpayers comply with applicable tax law and IRS examiners' current expectations. Our experiences inform how we advise on documentation standards, recordkeeping, and identification of potential risks and mitigations.

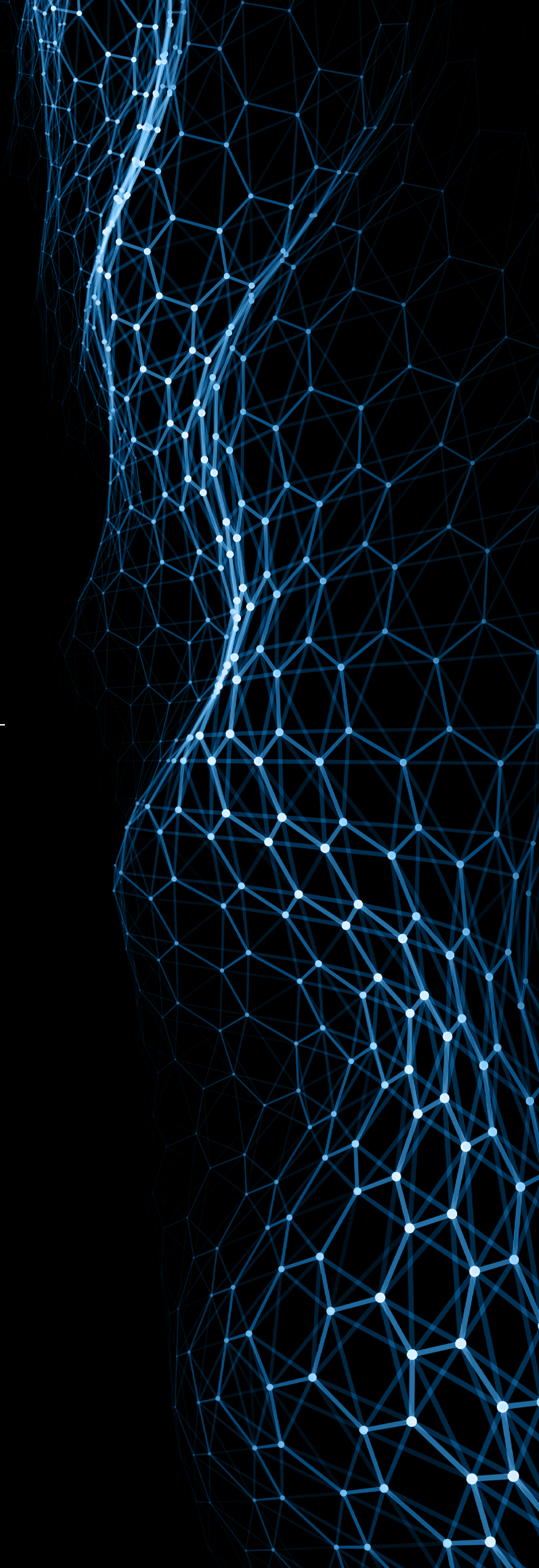
Examination Preparation: With the increasing crypto exam activity, our clients are benefitting from undergoing IRS Examination Preparation. Our Washington National Tax Controversy team works hand in hand with our cryptocurrency engagement teams to review overall tax exposure areas and identify documentation shortfalls or transaction reporting weaknesses. By comparing current experiences assisting clients with exams against a taxpayer's records, examination prep engagements can help a client understand any gaps they need to address before an examination begins.

We also see state and local tax (SALT) and sales and use tax (SUT) examinations identifying cryptocurrency issues. State taxing authorities are requesting copies of federal Forms 1099-DA, and that information can lead to state income tax exams and flow into sales and use tax samples. Identifying SALT and SUT implications is essential to reviewing cryptocurrency tax exposures before they become exam adjustments.

IRS exam support: Our Washington National Tax Controversy specialists have years of experience seeing crypto develop as an audit issue and assisting at all stages of exams. Those efforts begin with assessing taxpayer data as soon as the IRS exam notice arrives. Items like basis tracking and compensation paid in crypto are increasingly common in exams, and the IRS has expressed increased interest in how crypto is being integrated into finance (e.g., staking, lending, peer-to-peer trading).

Deloitte specialists assist clients in preparing for the opening conference, preparing IDR responses and support, protesting adjustments, and bringing the issue all the way through IRS Appeals when required.

Conclusion



Digital assets have crossed the threshold from being an emerging topic to mainstream tax controversy. The IRS is no longer asking whether crypto matters; it will be building the data, tools, and exam capability to enforce the rules it can see, while taxpayers are still operating in an environment where many details remain unresolved. Further, digital assets continue to evolve—not only the technology and business applications but also relevant legislative and judicial authority. The tax treatment of a transaction could be unclear at the time, but then clarified by relevant guidance before a tax return is filed.

That combination creates a clear imperative to move beyond reactive compliance and treat digital asset tax governance as a strategic discipline. The organizations that will be best positioned are those that invest now in recordkeeping, basis integrity, wallet-level tracking, valuation support, and cross-functional readiness, rather than waiting for notices, exams, or new guidance to force the issue. In crypto tax, ambiguity is not a reason to delay—it is the reason to get organized.

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Together makes progress

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