

BITCOIN & DIGITAL ASSET ESTATE PLANNING

TAX SUMMARY FOR HEIRS

*What you need to know about taxes on inherited Bitcoin
before you sell, transfer, or report*

Prepared by
Asaf David Fulks, Esq.
California State Bar #343622
asaffulkslaw.com

Document 5 of 8 — Bitcoin Inheritance Kit · Version 1.7 (June 2026)
© 2026 Asaf Fulks Law. All Rights Reserved.

IMPORTANT DISCLAIMERS

This document is provided for informational and educational purposes only and does not constitute legal advice.

No attorney-client relationship is created by your use of this document.

Consult a licensed attorney in your jurisdiction for advice specific to your situation.

This summary is not tax advice. Tax law is complex, changes frequently, and varies by jurisdiction. The information below reflects federal tax law and California state tax law as of mid-2026. Consult a qualified CPA or tax attorney before making any decisions about selling, transferring, or reporting inherited Bitcoin.

Prepared by Asaf David Fulks, Esq. — California State Bar #343622

The Stepped-Up Basis: The Most Important Tax Concept for Heirs

If you inherit Bitcoin, the single most important tax concept you need to understand is the stepped-up basis. Depending on your facts, it can remove very large unrealized gains from capital gains tax.

What Is “Basis”?

In tax terms, your “basis” in an asset is what you (or the person you inherited it from) paid for it. When you sell an asset, you pay capital gains tax on the difference between the sale price and your basis.

If the decedent bought 1 bitcoin for \$5,000 in 2017 and it was worth \$100,000 at the time of death, the decedent had \$95,000 in unrealized capital gains. If the decedent had sold it during their lifetime, they would have owed tax on that \$95,000 gain.

How the Stepped-Up Basis Works

Under IRC § 1014, when property is inherited (as opposed to gifted or sold), the heir’s basis is “stepped up” to the fair market value (FMV) on the date of the decedent’s death. This means the \$95,000 in unrealized gains from the example above disappears for tax purposes.

EXAMPLE: THE STEPPED-UP BASIS IN ACTION

Decedent purchased 2 BTC at \$8,000 each in 2019. Original basis: \$16,000

Decedent died on March 15, 2026. BTC price on that date: \$92,000 each.

Heir’s stepped-up basis: 2 BTC × \$92,000 = \$184,000

If the heir sells both BTC for \$95,000 each (\$190,000 total):

Capital gain = \$190,000 – \$184,000 = \$6,000

The heir pays tax on \$6,000, NOT on \$174,000 (\$190,000 – \$16,000).

If the heir sells at \$92,000 per BTC, there is no capital gain; a sale below that basis produces a deductible capital loss.

This is one of the most powerful tax benefits in the U.S. tax code. It is the reason many advisors recommend holding appreciated assets until death rather than selling during the owner’s lifetime. It applies to Bitcoin just as it applies to stocks, real estate, and other capital assets.

IMPORTANT EXCEPTION — BITCOIN IN AN IRA OR RETIREMENT ACCOUNT (NO STEP-UP)

The stepped-up basis described above applies to Bitcoin inherited as property — self-custodied bitcoin, bitcoin on an exchange, and shares of a spot Bitcoin ETF (such as IBIT or FBTC) held in an ordinary taxable brokerage account. It does NOT apply to Bitcoin held inside a traditional IRA, Bitcoin IRA, or other tax-deferred retirement account: those assets are income in respect of a decedent and receive no stepped-up basis (IRC § 1014(c)) — distributions are taxed as ordinary income to the beneficiary, just as they would have been to the decedent. (A Roth IRA is treated differently again; qualified distributions are generally tax-free.) Retirement accounts and ETF/brokerage positions also commonly pass by a beneficiary or transfer-on-death (TOD) designation, where one is in place — bypassing probate, your will, and your Digital Asset Memorandum — so confirm those designations separately. Consult a tax professional about any retirement-held Bitcoin.

Community Property Considerations (California)

California is a community property state. If the decedent was married and the Bitcoin was acquired during the marriage with community funds, the surviving spouse may receive a full stepped-up basis on the entire community property interest — not just the decedent's half. Under IRC § 1014(b)(6), both halves of community property receive a stepped-up basis at the first spouse's death.

This is a significant advantage over non-community-property states, where only the decedent's half of jointly held property receives a step-up. Consult a California tax attorney or CPA to confirm that this treatment applies to your specific situation.

Determining Fair Market Value at Date of Death

Your stepped-up basis is the fair market value (FMV) of the Bitcoin on the date of the decedent's death. Establishing this value accurately is essential for future tax reporting.

How to Determine FMV for Bitcoin

The IRS has not issued definitive guidance on which pricing source to use for cryptocurrency FMV. However, the following approaches are generally accepted:

Method	Description
Exchange closing price	Use the closing price (UTC midnight or 11:59 PM) on the date of death from a major exchange where the decedent held an account (Coinbase, Kraken, Gemini, etc.). This is the simplest and most defensible method.
Average of high and low	Take the average of the highest and lowest trading prices on the date of death across one or more major exchanges. This mirrors the IRS's approach for publicly traded securities (Treas. Reg. § 20.2031-2(b)).
Index price	Use a recognized cryptocurrency index such as CoinDesk Bitcoin Price Index (XBIX), CoinGecko, or CoinMarketCap aggregate pricing. These aggregate prices from multiple exchanges.
Alternate valuation date	The executor may elect to value estate assets six months after the date of death instead (IRC § 2032). This election is available only if it decreases both the value of the gross estate and the combined estate and generation-skipping transfer tax that would otherwise be due (IRC § 2032(a), (c)), and only if the estate is required to file Form 706. It applies to the entire estate, not individual assets.

DOCUMENT YOUR VALUATION

Whatever method you choose, document it thoroughly. Save screenshots of the pricing source showing the date and price. Print the page to PDF. Record the source URL, the date, the time, and the price. You may need to substantiate this value years later if the IRS questions your basis. Consistency matters: use the same method for all cryptocurrency assets in the estate.

Valuation for Non-Bitcoin Digital Assets

If the estate includes other cryptocurrencies, NFTs, or tokens, the same FMV principles apply, but pricing may be more difficult. For illiquid or thinly-traded assets, consider obtaining a qualified appraisal. For assets with no established market, the FMV may be zero or nominal, but document the basis for that conclusion.

Capital Gains Treatment on Subsequent Sale

Once you have inherited Bitcoin and established your stepped-up basis, any future sale or exchange triggers capital gains (or losses) measured from that new basis.

Short-Term vs. Long-Term Capital Gains

The holding period for inherited property is automatically treated as long-term, regardless of how long the decedent held it or how long you hold it before selling. This is a specific rule under IRC § 1223(9). You do not need to hold inherited Bitcoin for one year to qualify for long-term rates.

Tax Rate Category	2026 Federal Rates	Applies When
Long-term capital gains (inherited property)	0%, 15%, or 20% depending on taxable income	Always — inherited assets are deemed long-term by statute
Net Investment Income Tax (NIIT)	Additional 3.8% on the lesser of your net investment income or the amount by which your modified AGI exceeds the threshold	Modified AGI exceeds \$200K (single) or \$250K (married filing jointly)
California state capital gains	Taxed as ordinary income (up to 13.3%)	Any gain recognized by a California resident

Calculating Your Gain or Loss

The formula is straightforward:

CAPITAL GAIN FORMULA

Capital Gain (or Loss) = Sale Price – Stepped-Up Basis – Transaction Costs

Sale Price: The amount you receive when selling (in USD)

Stepped-Up Basis: FMV on the date of death (established earlier, under “Determining Fair Market Value at Date of Death”)

Transaction Costs: Exchange fees, network fees, and broker commissions

If you sell for less than your stepped-up basis, you have a capital loss, which can be used to offset other capital gains or up to \$3,000 of ordinary income per year (with remaining losses carried forward).

Gift of Inherited Bitcoin

If you gift inherited Bitcoin to another person instead of selling it, the recipient takes your stepped-up basis (this is called a “carryover basis” for gifts). The stepped-up basis does not reset again on a gift. Gifting may trigger gift tax reporting obligations if the value exceeds the annual exclusion (\$19,000 per recipient in 2026). Gifting to a qualified charity may generate a charitable deduction equal to the FMV at the time of the gift.

Reporting Obligations

Even if you do not owe any tax, you may still have reporting obligations. Failure to report can result in penalties.

For the Heir (Individual Tax Return)

Form / Question	What to Do
Digital asset question (Form 1040, page 1)	Form 1040 page 1 prominently asks (paraphrased): at any time during the year, did you receive, sell, exchange, gift, or otherwise dispose of a digital asset? If you inherited Bitcoin, received it into your wallet, or sold any of it, answer YES.
Form 8949	Report each sale or disposition of inherited Bitcoin. List the date acquired as “INHERITED,” the date sold, the proceeds, and the stepped-up basis. Use Part II (long-term) because inherited property is deemed long-term.
Schedule D (Form 1040)	Summarize your Form 8949 entries. Transfer totals from Form 8949 to Schedule D.
Form 1099-DA / 1099-B	U.S. cryptocurrency brokers must report gross proceeds for transactions on or after January 1, 2025 (Form 1099-DA, with first filings for the 2025 tax year); broker reporting of cost basis on covered assets phases in for 2026 transactions. Review any forms you receive and ensure consistency with your own records. Important: inherited Bitcoin is a non-covered asset, so no broker will report your stepped-up basis — and for 2025 transactions the form shows gross proceeds only. Report the correct stepped-up basis and adjust as needed on Form 8949.

For the Estate (Fiduciary Tax Return)

Form	When Required
Form 706 (Estate Tax Return)	Required if the gross estate exceeds the federal estate tax exemption (approximately \$15 million per individual for 2026 deaths, indexed for inflation thereafter). The One Big Beautiful Bill Act of 2025 made the elevated exemption permanent at this level — the previously scheduled 2026 TCJA sunset did not

Form	When Required
	occur. Bitcoin holdings are included in the gross estate at FMV on date of death. Always verify the current-year exemption with a tax professional.
Form 1041 (Fiduciary Income Tax Return)	Required if the estate earns income (including capital gains from selling Bitcoin) during the administration period. If Bitcoin is sold by the estate before distribution to beneficiaries, the gain is reported on Form 1041, and the estate pays the tax or passes the income through to beneficiaries on Schedule K-1.
Schedule K-1 (Form 1041)	If the estate passes income or capital gains through to beneficiaries, each beneficiary receives a K-1 and reports the income on their individual return.
Form 8971 (Basis Consistency)	Required when an estate is required to file Form 706 (not when a 706 is filed only to elect portability — that is, solely to carry a deceased spouse's unused exemption to the survivor). Identifies beneficiaries acquiring property from the estate and reports the basis assigned to each. Under IRC § 1014(f) the heir's basis cannot exceed the value reported on Form 706 — this is the 'basis consistency' rule. Provide each beneficiary with Schedule A of Form 8971 documenting their stepped-up basis.

FBAR and International Reporting

If the decedent held cryptocurrency on a foreign exchange (an exchange not based in the United States), there may be additional reporting obligations:

- **FBAR (FinCEN Form 114):** FinCEN — which administers the FBAR rules — has not issued a final rule making cryptocurrency on a foreign exchange a reportable “foreign financial account,” but it has stated that it intends to apply FBAR requirements to cryptocurrency. Conservative practice is to report foreign exchange accounts on FBAR if the aggregate value exceeds \$10,000 at any point during the year.
- **Form 8938 (FATCA):** Similar ambiguity. If specified foreign financial assets exceed the applicable threshold (\$50,000–\$600,000 depending on filing status and residency — the \$50,000 floor applies to single U.S. residents; the \$600,000 figure only to married couples filing jointly who live abroad), conservative reporting includes foreign-held cryptocurrency.

Consult an international tax specialist if the decedent held assets on exchanges such as Binance (non-U.S.), Bitfinex, OKX, or other non-U.S. platforms.

California-Specific Considerations

California has several unique tax characteristics that affect inherited Bitcoin:

Topic	California Rule
State estate / inheritance tax	California does not impose a state estate tax or inheritance tax. There is no state-level tax triggered solely by inheriting Bitcoin.
State capital gains tax	California taxes capital gains as ordinary income. The top marginal rate is 13.3% for taxable income above \$1 million — and that 13.3% already includes the 1% Mental Health Services Tax described below (it is the 12.3% top bracket plus that 1%), not a separate charge on top of it.

Topic	California Rule
	There is no preferential long-term capital gains rate at the state level. This means selling inherited Bitcoin in California can result in a combined federal + state rate exceeding 33% — and over 37% once the 3.8% Net Investment Income Tax applies.
Community property step-up	As noted earlier (see “Community Property Considerations (California)”), both halves of community property receive a stepped-up basis under IRC § 1014(b)(6). This is a major advantage for married couples in California. However, the Bitcoin must be characterized as community property (acquired during marriage with community funds) for this treatment to apply.
Separate property vs. community property	Bitcoin purchased before marriage, or with separate funds, or by gift/inheritance during marriage is separate property. Only the decedent’s separate property interest receives a step-up; the surviving spouse’s separate property does not.
Proposition 19 (real property)	Not applicable to Bitcoin. Prop 19 governs reassessment of inherited real property; there is no equivalent reassessment concept for Bitcoin.
Mental Health Services Tax	California imposes a 1% Mental Health Services Tax on taxable income exceeding \$1 million (Proposition 63). This 1% is the component that raises the 12.3% top bracket to the 13.3% figure shown above — it is not a separate charge stacked on top of 13.3%. If selling inherited Bitcoin pushes your taxable income above \$1 million, it applies to the excess.

When to Consult a Tax Professional

This summary provides a general framework, but tax planning for inherited Bitcoin can be complex. You should consult a CPA or tax attorney experienced in cryptocurrency taxation in any of the following situations:

- The total value of inherited digital assets exceeds \$100,000
- You are considering selling a significant amount of inherited Bitcoin and want to optimize the timing for tax purposes
- The decedent held Bitcoin in multiple wallets and you need to establish basis for each
- The estate includes mining income, staking rewards, airdrops, or hard fork proceeds that may have different tax treatment than purchased Bitcoin
- The decedent was not a U.S. citizen or resident, or held assets on foreign exchanges
- The estate may be subject to federal estate tax (gross estate near or above the exemption threshold)
- You are a surviving spouse in California and need to confirm community property treatment
- The decedent made gifts of Bitcoin during their lifetime that may affect the estate tax calculation
- You received a Form 1099-DA or 1099-B from an exchange that does not reflect your stepped-up basis

- The decedent died near or above the federal estate tax exemption threshold, or in a year when the exemption amount is changing

What to Bring to Your Tax Professional

To make the consultation productive, gather the following before your appointment:

1. **Date of death** (needed to establish FMV for stepped-up basis)
2. **Complete inventory of digital assets** (from your Custody Audit Checklist or estate inventory)
3. **FMV documentation** (screenshots or printouts of Bitcoin price on date of death from your chosen pricing source)
4. **Transaction history** (exchange account statements, on-chain transaction records, and any Forms 1099 received)
5. **The decedent's prior tax returns** (at least the last 3 years, to identify whether Bitcoin was reported and how)
6. **Estate planning documents** (will, trust, Digital Asset Memorandum) showing the disposition of digital assets
7. **Any correspondence from the IRS or FTB** related to the estate or the decedent's prior returns

Need Help With Your Bitcoin Inheritance?

Asaf Fulks Law offers consultations on Bitcoin estate planning, executor guidance, and coordination with tax professionals who understand digital assets.

asaffulkslaw.com • asaf@asaffulkslaw.com

End of Tax Summary.

Continue to Document 6 (Shamir's Secret Sharing) and Document 7 (Node & Mining). © 2026 Asaf Fulks Law. All Rights Reserved.