

CLIENT ALERT

IRS Revenue Procedure 2025-31 Attempts to Put Stake Through Heart of Concerns about Staking by Digital Asset Exchange-Traded Products

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IRS Revenue Procedure 2025-31 (the “Revenue Procedure”), released on November 10, 2025, provides a safe harbor permitting exchange-traded trusts that hold a single digital asset like Ethereum (“Digital Asset ETPs”)¹ to earn staking rewards while maintaining tax classification as grantor trusts.

What’s at Stake?

Digital Asset ETPs allow retail investors to invest in digital assets through the purchase of securities issued by a pooled vehicle similar to an ETF. Digital Asset ETPs are modeled on precious metal ETPs: they hold a single asset (such as gold or Ethereum); provide investor access through publicly traded units; seek tax classification as grantor

¹ This alert refers to these trusts as exchange traded products (“ETPs”) to distinguish them from exchange traded funds (“ETFs”), which are typically taxed as regulated investment companies (“RICs”).

trusts with simplified tax reporting on a Form 1099; and add to, or reduce, their holdings when authorized participants contribute assets to, or redeem shares from, the trust. Unlike precious metal ETPs, which earn no income on their holdings, Digital Asset ETPs holding an asset like Ethereum that uses a proof-of-stake consensus mechanism may be able to earn income from staking. This activity, however, could jeopardize the trust's status as a grantor trust for tax purposes.

As background, transactions in a digital asset must be validated before they are added to the network's decentralized digital ledger (or "blockchain"). Each protocol uses a consensus mechanism that enables a distributed set of unrelated computers (or "nodes") to agree on the authoritative record of transactions. In a proof-of-stake consensus mechanism, certain validator nodes commit or "stake" digital assets and agree to provide validation and related activities in exchange for "rewards" consisting of newly minted digital assets or fees, subject to the risk of forfeiting a portion of the staked digital assets (referred to as "slashing") if the validator fails to act in accordance with the consensus mechanism. A digital asset owner can participate in staking by making its digital assets available to validators through a custodian, and sharing in an agreed portion of the staking rewards. Ethereum is the largest digital asset that uses a proof-of-stake consensus mechanism. Bitcoin, by contrast, uses a proof-of-work consensus mechanism; Digital Asset ETPs holding Bitcoin and similar digital assets, therefore, are not affected by the tax uncertainties around staking.

In seeking to be classified as grantor trusts for tax purposes, Digital Asset ETPs avoid entity-level tax and provide an attractive vehicle for retail investors, who receive simplified tax reporting each year similar to reporting by an ETF or mutual fund (on a Form 1099). If the Digital Asset ETP did not qualify as a grantor trust, it might be treated as a partnership, which would still avoid entity-level tax but with more complicated tax reporting. However, because of the uncertain tax treatment of income and gains from digital assets, the fund might also fail to qualify as a partnership, in which case it would be subject to entity-level tax as a taxable C corporation. (The fund could not qualify as a RIC because it would not be registered under the Investment Company Act of 1940, among other reasons.) Make no mistake: the stakes of the staking issue are high.

A state-law trust cannot be treated as a grantor trust for tax purposes if there is a power to vary the investments of the certificate holders. A power to vary exists where there is a managerial power under the trust instrument that enables a trust to take advantage of variations in the market to improve the investments of the certificate holders. Under case law and prior IRS guidance, a power to vary does not include carefully circumscribed actions by a trustee to preserve trust assets, such as investing cash in short-term investments until the next quarterly distribution date or consenting to changes in credit support. The concern with staking is that it might fall outside these limits.

Revenue Procedure Stakes Out a Safe Harbor

A July 30 report by the White House crypto working group prompted the recent IRS guidance. The tax concerns about staking prevent retail investors from sharing in the income from staking rewards. The reluctance of Digital Asset ETPs, which are significant holders of digital assets, to participate in staking can also harm the validation

process, which cannot ensure the security and integrity of a digital asset's blockchain if one validator or group of validators can control a majority of the total staked digital assets.

As discussed in more detail below, the safe harbor in Revenue Procedure 2025-31 leverages limitations placed on Digital Asset ETPs by the Securities and Exchange Commission ("SEC") and the national securities exchanges on which their units trade to ensure that any staking activities do not constitute a power to vary the investments of the certificate holders.

The Revenue Procedure is effective for tax years ending on or after November 10, 2025; thus, it applies to the current year of a calendar-year trust. Under the Revenue Procedure, trusts with trust agreements that already permit staking may start doing so. Other trusts may, without jeopardizing their grantor trust classification, amend their trust instruments to permit staking within the 9-month period beginning with the Revenue Procedure's November 10, 2025 issue date.

The 14 elements of the safe harbor can be grouped and summarized as follows::

- The trust must have interests that are traded on a national securities exchange and it must have written liquidity risk policies and procedures that comply with the rules of that exchange. The trust must comply with the SEC's regulations and rules, and disclosure on its staking activities must have been reviewed and approved by the SEC. The trust's assets and activities must also be described in the May 29, 2025, Statement on Certain Protocol Staking Activities of the SEC's Division of Corporation Finance.
- The trust must own only cash and units of a single type of digital asset, transactions for which are carried out on a permissionless network that uses a proof-of-stake consensus mechanism. The trust's activities relating to digital assets must be limited to accepting deposits of and holding cash and digital assets, using them to pay trust expenses or (in the case of cash) to purchase additional digital assets, distributing them to holders in redemption of their interests, selling them when the trust liquidates, and directing the staking of digital assets in accordance with the requirements of the national securities exchange and the Revenue Procedure.
- The trust's staking of its digital assets protects and conserves trust property by mitigating the risk that another party or group could control a majority of the total staked digital assets of that type and engage in transactions that could reduce the value of the trust's digital assets. To protect or conserve the trust's property, the trust's digital assets must be indemnified from slashing due to the activities of staking providers.
- The trust's digital assets must be held by a custodian, acting on behalf of the trust, and the trust must retain ownership of the digital assets at all times, including while they are staked. The trust directs the staking of its digital assets through one or more custodians, who facilitate the staking with one or more staking providers that are unrelated to the trust and its sponsor. The allocation of staking rewards between the staking provider and the custodian on behalf of the trust is an arm's length allocation that is independent of the expenses of the staking provider or custodian, and may be stated as a percentage of the staking rewards derived from staking

the trust's digital assets. The trust, the custodian in its capacity as such, and the sponsor cannot have any legal right or arrangement to participate in or direct or control the activities of the staking provider in any way, and do not do so, except to direct the staking and unstaking of the trust's digital assets.

- The Revenue Procedure attempts to constrain any discretion that would apply to the staking of the trust's digital assets. Thus, all of the digital assets of the trust must be made available to the staking provider to be staked at all times, except (i) as necessary, in the trustee's or sponsor's reasonable judgment, to comply with the trust's liquidity risk policies and procedures required by the national securities exchange; (ii) for digital assets held on a short-term temporary basis to pay fund expenses or following the contribution or purchase of digital assets or the receipt of digital assets as staking rewards; (iii) in connection with the trust's liquidation, protective measures against potential systemic vulnerabilities in the network's protocol or related software, changes in its relationship with a custodian or staking provider, or changes in applicable law or regulation; and (iv) in connection with a contingent liquidity arrangement, such as a borrowing or "repo" facility, intended to mitigate an adverse liquidity event that otherwise would prevent the fund from distributing digital assets or cash to investors in redemption of their interests.
- The only new assets received by the trust from staking are additional units, in the same form, of the single type of digital asset held by the trust. The trust's staking rewards, net of trust expenses, must be distributed in kind or sold and distributed as cash, in proportion to the trust interest holders' relative interests in the trust; these distributions must occur no less frequently than quarterly. The trust must treat all staking rewards consistently.

If you have any questions regarding this client alert, please contact the following attorney or the Willkie attorney with whom you regularly work.

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