7 Things You Should Know About Cryptocurrency Taxes

Taxes are just around the corner, including for cryptocurrency.

December 31, 2018 5 min read

Opinions expressed by *Entrepreneur* contributors are their own.

Cryptocurrency is just like any other asset class when tax season comes around. Unfortunately, cryptocurrency taxes appear so complex that few people file them. Others see cryptocurrency as a means to move money illegally — which means avoiding cryptocurrency taxes entirely.

As cryptocurrency becomes more mainstream and the Internal Revenue Service (IRS) shifts its focus to digital assets, it's more important than ever to pay cryptocurrency taxes. Here's how to approach cryptocurrency this upcoming tax season.

All cryptocurrency trades and sales are taxable.

You have to report gains and losses on *all* individual trades to the IRS. Specifically, exchanging a cryptocurrency for another, converting it back to USD or spending cryptocurrency are taxable events.

The IRS is increasingly focused on

crypto taxes.

What happens if you don’t pay cryptocurrency taxes? Like any other type of tax fraud, avoiding cryptocurrency taxes can result in a maximum sentence of five years in prison or a maximum fine of $250,000.

From 2013 to 2015, fewer than 900 people filed cryptocurrency taxes annually. But the IRS’ focus has increasingly shifted towards cryptocurrency taxes. Following a 2017 court case, Coinbase now has to release information about investors who have traded over $20,000 to the IRS.

Two main types of cryptocurrency taxes.

According to the IRS’ Guidance on Virtual Currencies, cryptocurrency is property, not currency. This means that you have to pay capital gains tax.

There are two different types of capital gains taxes: long-term and short-term. Long-term means a that you held a currency for over a year before selling or trading it while short-term applies to cryptocurrencies you’ve had for less than a year. These rates depend on your state and your tax bracket, though long-term capital gains tax is typically lower.

Crypto can also be subject to income tax. This is when you’re paid in cryptocurrency by an employer, and your crypto is classified as earnings. You pay the same amount in crypto income tax as you would in USD. This means that cryptocurrency income taxes are divided into the same seven IRS tax brackets, ranging from 10 percent to 37 percent. Fortythree states also have their own income taxes.

Overall, employees and employers have to report cryptocurrency

earnings and withholdings, respectively, as they would with USD.

Related: Cryptocurrency and the Allure of a Cashless Cannabis Industry

Crypto taxes typically require two tax forms.

The majority of investors interested in cryptocurrency taxes are investors. Specifically, they use Sales and Other Dispositions of Capital Assets Form 8949 to report on digital trades.

This is where the investor describes the assets they've traded, including the dates they acquired and sold it, how much they made, the cost of doing the trade, and their net gain or loss. The form also distinguishes between short-term and long-term capital gains and losses.

The second form that concerns crypto trades is Form 1040 Schedule D. This one covers your total short-term and long-term gains and losses, going off information from Form 8949.

Cryptocurrency miners have to pay taxes.

Cryptocurrency miners have to pay taxes on their earnings, meaning that their cryptocurrency is subject to income taxes. Additionally, mining qualifies as self-employment. This requires a self-employment tax, which is typically around 15.3%. As self-employed, miners can also deduct expenses, such as electricity.

Related: New Research Shows Bitcoin's Meteoric Rise Was a Scam

Not everything crypto-related is taxed.

Investors aren’t taxed for just buying and holding cryptocurrency. In other words, you need to sell or trade in order to be subject to taxes. And more broadly, capital gains taxes for crypto functions as it does for other assets: If you lose money on your cryptocurrency trades, you can claim a loss and save on capital gains taxes.

Cryptocurrency tokens are potentially tax-exempt.

The IRS last updated its guidance on cryptocurrency taxes in 2014. Since then, a lot has changed in the cryptocurrency space. Specifically, there is speculation that tokens—cryptocurrency that represents a service or asset, not a currency—are not subject to federal tax laws. This is because the IRS defines taxable crypto as “virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency.” Tokens can theoretically fall outside of this definition.

However, consult with a certified accountant or lawyer before making any decisions on what you choose to include or exclude from your cryptocurrency taxes.

Cryptocurrency tax checklist

Cryptocurrency investors have a lot of information to compile before April 15. Here’s what the typical crypto investor needs to do:

- Determine whether they’re a trader, an employee paid in cryptocurrency or a crypto miner

- Create a complete list of all trades for that taxable year, including the following information. All these amounts must be calculated in USD based on the exchange rate at the time of the trade:
- Complete appropriate forms, most likely 8949 and 1040 Schedule D, or submit the necessary information to an accountant.

Cryptocurrency taxes are still in flux.

Paying cryptocurrency taxes is just like paying any other type of capital gains or income tax, except for one big factor: It's generally up to the investor to compile the information himself or herself. This means going through hundreds or thousands of trades, recording the necessary data, and planning to do it all again next year.

Additionally, there is a lot we don't know about the nitty-gritty of cryptocurrency taxes yet. For example, the IRS' status on cryptocurrency airdrops and tokens remains unclear.

But like everything tax-related, the sooner you start preparing for April, the easier it'll be.

https://www.entrepreneur.com/article/324382