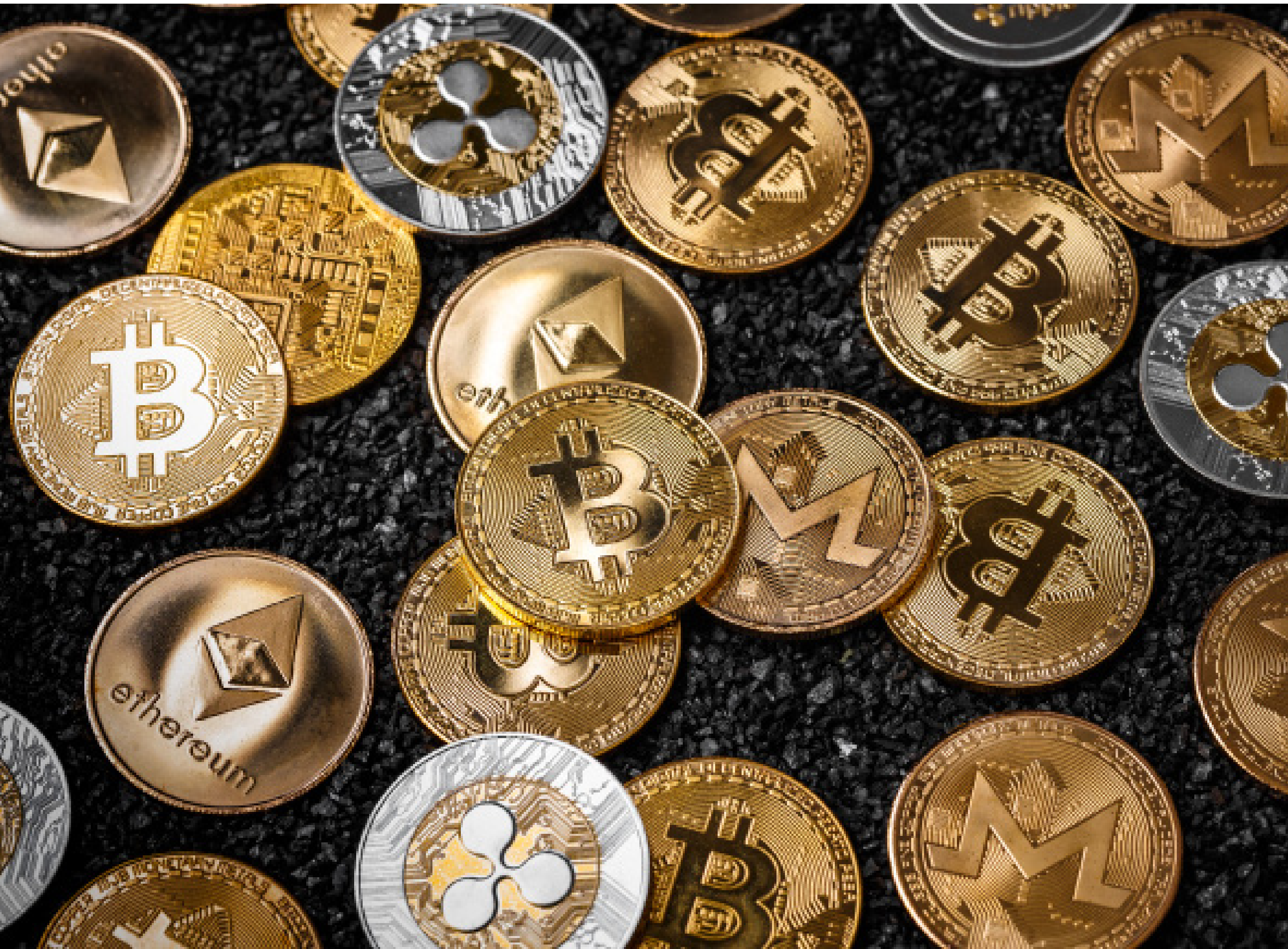
Larson Gross
CPAs & Consultants



Understanding Cryptocurrency Taxation

The use of cryptocurrency has been growing. In 2021 alone, more than 10% of Americans traded cryptocurrency. Yet, many crypto users aren't aware of the tax rules and regulations that govern cryptocurrency transactions.

While digital currency is a relatively new concept and many laws have yet to catch up, American crypto traders are required to pay taxes on cryptocurrency transactions.

This document explains how and when cryptocurrencies are taxed, as well as how to report transactions to the IRS.

What is Cryptocurrency?

Cryptocurrency is a digital currency that can be exchanged for goods, services, or other currencies. Transactions are recorded on a blockchain, which is essentially a decentralized digital ledger that records completed transactions.

Cryptocurrency is not regulated by any government or financial institution and is instead powered by a decentralized network of users. This unique characteristic has made it popular among those who want to make financial transactions instantly, from anywhere in the world, with minimal transaction fees.

When Are Cryptocurrencies Taxed?

There are two general situations that are taxable: you may profit from changes in the value of the cryptocurrency you bought and sold, or you may receive cryptocurrency as payment for products or services you sold. More specifically, the following types of transactions are taxable:

1. Trading cryptocurrency for fiat currency such as the U.S. Dollar or Euro,
2. Exchanging cryptocurrency for another digital currency, like trading Bitcoin for Ethereum,
3. Purchasing a tangible item with cryptocurrency, and
4. Earning cryptocurrency, which includes mining crypto.

Merely purchasing and holding cryptocurrency, like an investment, is not taxable. But when you sell or exchange the crypto, the profit from its change in value is taxable.

In general, the IRS taxes cryptocurrency the same way it taxes stocks and bonds: based on short and long-term capital gains. If you own crypto for less than a year and sell or exchange it for a gain, you will need to pay short-term capital gains tax on the profit. If you sell or exchange crypto you've owned for more than a year, you will have to pay long-term capital gains tax on the profit.

While most cryptocurrency transactions are subject to capital gains taxes, there are circumstances where crypto users might be subject to income tax. If you are paid in cryptocurrency in exchange for services, including crypto mining, the payment is taxable as income.

Finally, if your business receives payment for goods or services, the transaction and recognition of revenue is treated the same way as if paid in cash.

Cryptocurrency Deductions

Much like stock holdings, crypto investors can deduct their losses from their taxable income. If you sold or exchanged your cryptocurrency for less than you purchased it, you can deduct that loss as a tax write-off. The IRS allows taxpayers to deduct up to $3,000 in net capital losses per year. If you have more than $3,000 in net capital losses, you can carry the excess over to subsequent years.

Also, the IRS recognizes charitable donations made with crypto, providing crypto users with another possible tax deduction. If you donate cryptocurrency to a 501(c)(3) organization, you can claim a charitable deduction on your taxes.

Likewise, you can give or receive cryptocurrency as a gift. With the annual gift exclusion, you can give or receive up to $16,000 in 2022 per recipient annually without having to pay taxes on the transaction.

How to Report Cryptocurrency Transactions

Taxpayers are required to report crypto transactions on their tax returns and pay taxes on any gain or loss realized from its sale or exchange. The cost basis for the transaction depends on how you acquired the currency.

- If you acquired the crypto as a result of mining, your basis is the fair market value of the cryptocurrency at the time you received it.
- If you purchased crypto with fiat currency, like the U.S. dollar, your basis is the fair market value of the cryptocurrency at the time of purchase.
- If you received crypto as a gift, your basis is the lessor of the donor's basis or fair market value of the cryptocurrency on the date of receipt.

To report cryptocurrency transactions, you will need to file Schedule D with Form 8949. Some trade exchanges may provide you with a Form 1099-B, which will detail any cryptocurrency gains or losses over the previous tax year. If you do not receive one of these forms, however, it will be your responsibility to create a spreadsheet outlining your cryptocurrency transactions.

Taxation of Cryptocurrency and the New Infrastructure Deal

The $1.2 trillion Infrastructure Investment and Jobs Act calls for mandatory annual tax reporting from cryptocurrency brokers, such as Coinbase, beginning in January 2023. The new format will require crypto brokers to record transactions for both customers and the IRS similar to the way financial institutions need to report securities transactions.

Ensure You Are Reporting Your Crypto Transactions to the IRS

If you sold, earned or received cryptocurrency, it's important to ensure you're reporting the transactions to the IRS to avoid potential tax penalties and fines.

Final Thoughts

This document is meant to provide an overview of cryptocurrency taxation and is not a substitute for speaking with one of our expert advisors. If you have questions or would like to discuss cryptocurrency taxation, please contact our office for more information.

About Larson Gross

Ted Larson and Dennis Gross founded our firm in 1949. They built the business based on excellence, passion, integrity, trust and pro-action — values still important to us more than seven decades later.

Even well into their retirement years, Ted Larson and Dennis Gross continued to have the best interest of the firm at heart. Mr. Larson would come into the office on a regular basis to meet every new face and make a personal connection with each of our team members. He remembered the name of every employee, as well as the names of their spouses and children, and would greet clients by name as he passed by the reception desk. Sometimes, you'd even find a newspaper clipping on your desk that Mr. Larson dropped off, highlighting that your son made the honor roll. This is the example of a genuine relationship we strive to embody with our people and clients.

Today, we're led by ten partners who are growing our firm with respect for where we've come from and a new vision for future success. Our 120-plus team members and three offices located in Bellingham, Lynden and Burlington make us the 10th largest public accounting firm in the Puget Sound region. While we're determined to expand our impact and help strengthen as many businesses and individuals as we can, we're also committed to remaining a locally-owned organization. We're incredibly proud of where we've come from and look forward to a future of possibility

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