Top Five Most Common Mistakes People Make with Cryptocurrency and Taxes

I have heard the following misconceptions multiple times, but they are all false

“I don't need to pay any taxes on my cryptocurrency because I have not received a 1099”

Not reporting your crypto tax gains/losses is tax fraud. The IRS does not require coin exchanges to report taxable gains (yet), but they are not going to let you get wealthy without taking their piece of the pie. Failing to pay taxes on your gains is not only a federal offense, but it can have costly long-term tax consequences. The IRS has already taken steps to identify those who have (and more importantly those who have not) been reporting, but for now, you are responsible for keeping track of and reporting your gains and losses

“Trading one coin for another is not a taxable event”

This is probably the biggest misconception out there. Cryptocurrency is classified as “property” by the IRS, which means that you must recognize a gain or loss every time you exchange a coin for something else, whether that be for USD or for another coin. Gains (or losses) are calculated by subtracting the cost basis from the proceeds at the time of sale. This means that if you bought some Bitcoin for $10, it went up in value to $100, and then you used it to buy $100 worth of Ethereum, you would have a $90 taxable gain.

“HODLing doesn’t matter from a tax perspective”

How long you hold your coins for does matter when it comes to taxes. Selling, trading, or using appreciated coins that you have held for less than one year will result in gains taxed at your ordinary tax rate. These rates range from 10 - 39.6% in 2017, and 10 -37% in 2018. Waiting to sell, trade, or use your appreciated coins until you have held them for at least one year will allow your gains to be taxed at preferential tax rates. In 2017 and 2018, these rates range from 0 - 20%. Waiting for that one year mark can result in you paying about half as much tax.

“Buying goods or services with my cryptocurrency has no tax consequences”

It might sound cool to buy your lunch with cryptocurrency, but doing so will result in a taxable gain or loss. If your lunch is $10, and you use $10 worth of Bitcoin Cash in which you have a $2 cost basis to buy it, you will have to recognize (and keep track of) the $8 gain that was created. You will also need to keep track of how long you held the Bitcoin Cash for in order to determine if it is a long-term or short-term gain. As much as I would love crypto to be used more broadly, until the IRS changes this law, or treats it like foreign currency, we will have to continue to keep track of and report every transaction.

“I owe taxes when a fork happens”

This is a tricky one because there is no official guidance from the IRS when it comes to forks. However, we can use guidance that we have on similar assets, and either (1) recognize the fair market value of the altcoin created from the fork as “other income” and then use this value as the cost basis going forward, (2) prorate the basis of the new coin against the original coin based on the fair market value of both coins at the time of the fork, or (3) the original coin keeps its original basis and the altcoin assumes a basis of 0. In case 2 and 3, you would not recognize tax until you sell, trade, or use the altcoin.