

Have bitcoin, other crypto investments? Tax season could be a minefield: Here's what to know

By Ken Schachter

Updated February 8, 2022 5:00 AM

The IRS is watching.

That's the message accounting experts are delivering to cryptocurrency enthusiasts as tax season unfolds.

"The IRS is very, very active in looking at cryptocurrency and other digital assets," said Robert Tobey, a tax partner at Jericho-based Grassi Advisors & Accountants.

That includes demanding records from some cryptocurrency exchanges, where investors trade government-backed currencies for bitcoin and other digital assets.

"The IRS is issuing 'John Doe' summonses to some of those small exchanges," allowing it to sweep up account information on many account holders, said Tobey, a member of the Wall Street Blockchain Alliance, a not-for-profit trade association.

Other cryptocurrency exchanges voluntarily report transactions directly to the government, but only in 2023 will all U.S. exchanges be required to report under the Infrastructure Investment and Jobs Act of 2021, which was enacted in November.

Until then, the system largely operates on the "honor system," said Brandon Blitzer, tax director in Marcum LLP's alternative investments group.

Withholding information about transactions could backfire, Blitzer warned. "You could be playing with fire."

Tobey said that he urges clients to keep good records, including the cost basis (the price at which you bought the cryptocurrency) "especially if you're churning your portfolio."

Taxable events include:

- buying and selling cryptocurrency for cash;
- selling one digital asset for another;
- purchasing goods or services with a cryptocurrency.

For example, Blitzer said, a car buyer might use bitcoin to purchase a Tesla. If the bitcoin was originally bought for \$35,000 and was valued at \$65,000 at the time of the sale, the car buyer would be taxed on the difference.

Likewise, if the bitcoin was worth less than originally paid, the car buyer could take the loss on his or her taxes.

Similar tax consequences or benefits also could come into play for people who take their wages in cryptocurrency or immediately convert their paychecks into cryptocurrency.

Prominent examples: New York City mayor Eric Adams and Los Angeles Rams wide receiver Odell Beckham Jr., who both said they planned to take paychecks in bitcoin.

Much of the tax treatment of cryptocurrencies aligns with that of stock. For instance, both are taxed at lower rates for long-term capital gains if held for more than a year.

Crypto miners, who use their computing power to validate transactions and earn cryptocurrency, have those digital payments taxed as ordinary income and must report them at the market value on the day they were received, according to a primer by tax software firm TurboTax.

One area where cryptocurrency investors have an edge is the "wash sale" rule.

If an investor sells 10 shares of General Motors at a loss, they can't write off that loss on their taxes if they repurchase 10 shares of GM within 30 days of the sale.

By contrast, crypto investors could sell a bitcoin at a loss and take that loss on their taxes even if they bought a bitcoin within 30 days, Blitzer said.

In general, cryptocurrency capital gains and losses would be recorded on Schedule D of IRS Forms 1099 and Form 8949.

Still, other cryptocurrency tax situations are less clear.

Some crypto holders loan their coins to the network to help validate transactions and are paid a percentage similar to a dividend.

Blitzer said the IRS has yet to offer definitive guidance on this "gray area."

Some do-it-yourself tax preparation software packages are touting their ability to handle cryptocurrency and at least one, TurboTax, allows filers to take their refund in cryptocurrency.

Still, Blitzer cautioned that a tax professional might be needed for more complex returns.

"As a word of advice, if you trade a lot in crypto, get a tax adviser," he said. "In the last five to six years, the number of tax law changes is absurd... The crypto world is an ever-evolving place with regulation and taxation. Just be aware of what you're doing and keep track of your gains and losses."