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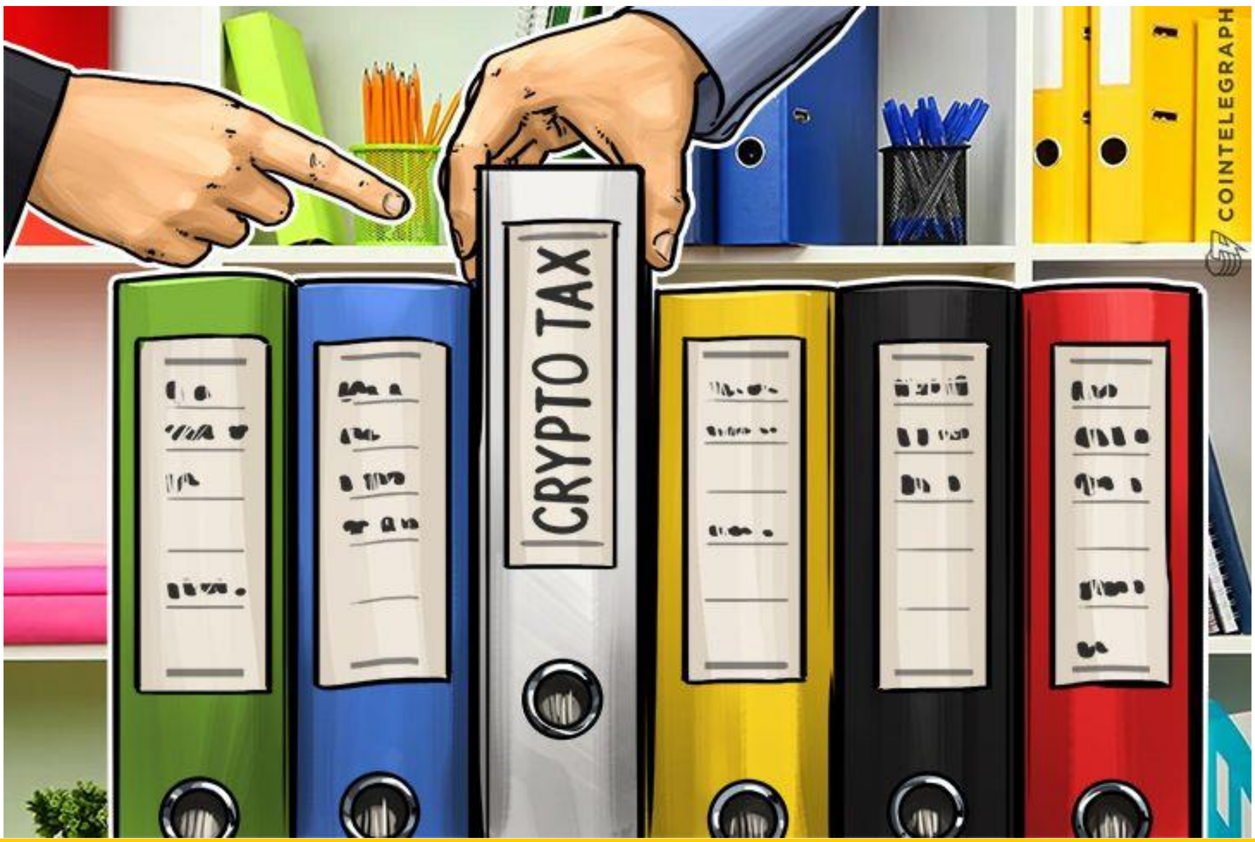
Crypto Tax Tips To Start 2018 Right



NEW YEAR SPECIAL

Even though cryptocurrencies are getting more and more exposure, their legislation seems to be a grey area for most governments, especially when it comes to declaring your income in digital currencies. The Internal Revenue Service, the US tax collection agency, has issued Notice 2014-21 stating that Bitcoin and altcoins are subjects to federal income and payroll taxes. So what to do with your crypto money and how to declare your taxes right?

Records

Let’s start with the dreary subject of records. Yes, that applies to crypto investors too. You’d better have some if you are thinking about taxes. If you’ve ever tried to tell the IRS “I lost my receipt,” you don’t want to do it a second time.

The IRS has heard every excuse in the book. While it is not without sympathy, you’ll find it far easier not having to go to the additional effort of proving something by another means. Periodically, the IRS issues reminders to taxpayers regarding the importance of safeguarding your tax records.

That’s especially true in cases of natural disasters that make traditional record-keeping go haywire. But think of it year-round wherever you are. The IRS suggests creating a backup set of records stored away from the originals. It is good advice for crypto investors.

Selling some assets?

If you are sitting on some big gains, you might consider how your tax picture will look for the entire year. It isn’t too soon to start thinking this way. In fact, try to do it long before year-end so you can make adjustments. You might want to sell or hedge some, even if you think the market is still headed up.

There is a lot more than taxes involved in such decisions. But it can be wise to at least think about it. For example, what if your tax year already has a big capital loss in it, or you have a big carryover loss from prior years? In general, unused capital losses can be used to absorb up to $3,000 per year in ordinary income.

But unless you have capital gains to offset your capital losses that $3,000 would be the extent of your tax benefit. Some people sit for years and years with unused capital losses that carryover each year. So, if you also have unrealized capital gains, you might consider selling some gain assets, to be able to absorb your losses. Run some numbers and see how it looks.

And what exactly are you selling?

Another topic as tax time nears is to ask whether you really know what you are selling. That is, if you have 100 Bitcoins and you sell 10, which 10 did you sell? There is no perfect answer to this question. Most of the tax law considers shares of stock, not cryptocurrency.

However, many advisers think that the same kinds of rules should be applied in the case of multiple crypto assets that you hold. If so, specific identification of what you are selling, when you bought it, and for what purchase price, is likely to be the cleanest. But that may not be possible.

Some people use an averaging convention, where you essentially average your cost across a number of purchases. Consistency and record-keeping are important. You don’t want the IRS to claim that you denied the government its fair share of each sale. And remember, if you are claiming long-term capital gain treatment, being able to prove that you held the cryptocurrency for more than a year before selling is key.

Loans with interest and hedges

Loaning money shouldn't be a taxable event to either the borrower or the lender, except for interest payments. So, can you loan out your cryptocurrency to people? You can, but the question is whether that loan will be treated the same as a loan of money by the IRS.

The jury is still out on that question. The IRS says cryptocurrency is property for tax purposes. You don't want the loan and the repayment (of different cryptocurrency?) to be treated as taxable dispositions. Some of it may depend on your documents, and how much you make it look and feel like a real loan.

Hedges of cryptocurrency are another hot topic to consider. Hedges can help to avoid some of the volatility that has characterized the various crypto markets. But be careful that you are doing your best to avoid a disposition, meaning a sale for tax purposes, that you don't want.

Gifts

The holidays may be over, but probably everyone in your family would still like some Bitcoin or other crypto issues. The prices have been so ever-present in the news, that gifts and donations are still very much in the news. But is it smart tax-wise?

A charitable contribution would be the best type of transfer. If you give to a qualified charity, you should get an income tax deduction for the full fair market value of the crypto. If you bought for $500, and donate to a 501(c)(3) charity when it is worth $15,000, you should get a $15,000 charitable contribution deduction. What's more, you won't have to pay the capital gain tax on the $14,500 spread.

Giving to private parties is not as impressive. The same gift to your niece gets you no tax deduction. And it requires you to file a gift tax return since the gift is worth more than $15,000. For 2018, $15,000 is the amount of so-called "annual exclusion" gifts you can give to any number of people each year with no reporting required.

Any gifts over that $15,000 amount require a gift tax return, even though you probably won't pay any gift tax. You normally would use up a small portion of your lifetime exclusion from gift and estate tax. For 2018, that number just went up dramatically. The amount you can transfer tax-free during your life or on death just went up to $11.2 mln per person. That is $22.4 mln per married couple.

Forms 1099

Finally, don't forget about the coming onslaught of IRS Forms 1099. Normally, these not-so-fun little tax forms arrive around the end of January, reporting income paid to you in the previous calendar tax year. The IRS says that wages paid to employees using virtual currency are taxable, must be reported on a Form W-2, and are subject to federal income tax withholding and payroll taxes.

Similarly, payments using virtual currency made to independent contractors are taxable to them, and payers who are engaged in business must issue Form 1099. A payment made using virtual currency is subject to Form 1099 reporting just like any other payment made in property. That means if a person in business pays virtual currency worth $600 or more to an independent contractor for services, Form 1099 is required.

If you are a recipient of Form 1099, as most everyone is, keep track of them. Each one gets reported to the IRS and applicable state tax authorities. If you don’t report or otherwise address the reported income on your tax return, you can expect that the IRS will follow up.

This may seem confusing, but you shouldn’t worry. The IRS is usually much more lenient to those who fill in taxes, even with mistakes, rather than to those who avoid doing it at all.