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Keeping Track of Crypto Tax Matters is Complex and Important

By Robert W. Wood

THe dreaded April 15 tax filing deadline is behind us. But if you are like millions of other Americans, you went on extension for your personal tax returns. An automatic extension gives you until October 15 to prepare and file your returns, even though your payment was due April 15th. If among your tax items for 2023 you have crypto tax issues, it is worth drilling down into the range of possible tax and recordkeeping hassles that you and your tax preparer may face.

Keeping Records.

Even if you have a CPA doing your taxes, you may want to stay on top of all your recordkeeping with one of the crypto tax software platforms. There are many, but some of the more popular ones—not in any particular order—include CoinTracker, CoinTracking, Koinly, and TurboTax Premium. Like any other tax matter, trying to collect and organize after the fact is always harder than staying caught up on it. How essential this is may depend on whether you just buy and hold or are a very active trader. But whatever you are doing, good contemporaneous records are always going to help.

Transfers Trigger Taxes.

You may not agree with them, but the IRS says crypto is property. The IRS made this clear in Notice 2014-21. Cryptocurrency isn't foreign currency, and it isn't domestic currency, regardless of how you use it. That means every time you transfer it, you might trigger gain or loss. That means taxes.

Section 1031 Will Not Help.

Crypto to crypto trades are taxable. Section 1031 of the tax code is now limited to real estate. The IRS tax rules on barter are decades old, and crypto hasn't changed them. Property trades are taxed to both sides, even if one party just wants credit for later. Swapping one product or service for another is taxable, as the IRS explains on its Bartering Tax Center.

Earning trade or barter dollars through a barter exchange is also taxable income, just as if your product or service was sold for cash. Plumbing for dental work? The IRS taxes it. You name the swap, it's income to both sides. Both must report the fair market value of goods or services received on their tax returns.

Not Everything is Long-Term Capital Gain.

IRS Notice 2014-21 says that crypto is property, but that doesn't mean everyone holds cryptocurrency as a capital asset. If you are paid for services with it, it is ordinary income, and might even be wages. If you hold crypto and later sell it, whether you have capital gain or loss depends on whether it is a capital asset in your hands. For long-term treatment, you must hold it for more than a year. Once again, keep good records.

Crypto is Less Anonymous Than You Think.

The IRS has long been hunting crypto via John Doe summonses, software and by other methods. Besides, new 1099 tax forms are coming; IRS changes to make this a reality are already in the works. The safe bet is to accurately report your income. Tax returns must be filed under penalty of perjury.

Paying for Services.

Wages paid to employees using virtual currency are taxable and must be reported on a Form W-2. Plus, they are subject to withholding and payroll taxes. If you pay someone in property, how do you withhold taxes? You could pay some cash and some crypto, withholding plenty on the cash. Payments to independent contractors are taxable, and payers must issue Form 1099. When you pay an independent contractor and issue Form 1099, you can't enter a unit of crypto; you must value it in dollars as of the time of payment.

Loans of Crypto.

This is still a developing field, so be careful. Borrowers and lenders think of loans as non-taxable. If a loan is forgiven, that triggers income to the borrower. Also, there may be interest income to lenders, and interest deductions to borrowers. Mostly, though, loans traditionally seem neutral from a tax viewpoint. You might think that crypto loans should be the same, and most people probably assume that.

But is it a real loan and will the IRS respect it as such? It may depend on the nature and details of the loan and its documentation. When you receive a loan in cash, everyone understands that you will pay the lender back with other money. But the same is not necessarily true with a loan of property. In general, if you want to avoid taxes, a loan of property should require the return of the same property. With loans of crypto, the parties often intend the cryptocurrency lent to be treated as fungible currency. Just be careful, especially where it looks like the crypto you lent is going to be swapped.

Beware the IRS Crypto Question.

Finally, don't ignore the crypto tax question at the top of every tax return. The IRS asks this question with variations for corporations, partnerships and estates and trusts:

"At any time during 2023, did you: (a) receive (as a reward, award or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?" Yes or No?

By "digital asset," the IRS means "any digital representations of value that are recorded on a cryptographically secured distributed ledger or any similar technology. For example, digital assets include non-fungible tokens (NFTs) and virtual currencies, such as cryptocurrencies and stablecoins."

You are not supposed to leave it blank, and everyone who files Forms 1040, 1040-SR, 1040-NR, 1041, 1065, 1120, 1120, and 1120S must check one box answering either "Yes" or "No." In addition to checking the box, you must report all income related to digital asset transactions.

This question is surprisingly important, for it sounds similar to the foreign account question included on Schedule B to Form 1040. The question could set you up for big penalties or even committing perjury for checking the wrong box. If you answer “no” and are later discovered to have engaged in transactions with cryptocurrency during the year, the fact that you explicitly answered no to this new question (under penalties of perjury) could be used against you.

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