Crypto Taxes: Your Guide to Navigating the Chaos

Here's how cryptocurrencies like Bitcoin and Ethereum are taxed in 2022.

Emma Kerr

January 21, 2022

Failing to properly report and pay taxes on cryptocurrency holdings might have gone unnoticed in years past, but experts say those days are over.

The Internal Revenue Service has again and again signaled its efforts to not only enforce the tax code in the world of virtual currency, but to target cryptocurrency owners seen by the agency as low-hanging fruit. These efforts began around 2014 and have escalated as legislators, too, have turned their focus on the increasingly popular cryptocurrency assets, exchanges and lending.

In 2019, the IRS sent letters to virtual currency owners urging them to amend past returns and pay back taxes. The same year, the IRS began information gathering by including a question on tax returns asking whether taxpayers own cryptocurrency assets. The 2020 IRS Form 1040 explicitly asked if taxpayers "received, sold, exchanged, or otherwise disposed of any financial interest in any virtual currency."

This year, Nicole DeRosa, senior tax manager at Wiss & Company, says there is no excuse for failing to report crypto earnings and income.

"Everyone at this point is aware of it. Nobody should really be hiding behind, 'I didn't know I needed to report that,' anymore," DeRosa says. "If they don't and the IRS finds out about it, which they will, you can have interest penalties and, depending on how extreme it is, possible jail time. You don't want to play that Russian roulette."

This reality, DeRosa says, only stands to worsen as the IRS adds more virtual currency experts to its staff and receives more funding.

"I would not be surprised if crypto was one of their main targets once that happens," she says.

The Infrastructure Investment and Jobs Act, which Nicholas Anthony of the Cato Institute called "the beginning of an attack on the cryptocurrency industry," added new levels of complexity for cryptocurrency traders and miners when it was signed into law in 2021. With more legislation addressing crypto assets likely to follow in the coming years, the time to get a handle on what your crypto activity means for your taxes is now.

How Is Cryptocurrency Taxed?

Virtual currency is taxed like any other sort of property for federal income tax purposes, meaning the tax principles that apply to assets like stocks and bonds also generally apply to Bitcoin, Ethereum and other cryptocurrencies.

If you sell cryptocurrency, you must recognize any capital gain or loss. It's more costly from a tax perspective to trade cryptocurrency frequently and quickly because virtual assets are subject to short-term and long-term capital gains taxes.

"(The IRS) is just trying to get to a point where it's like any asset," says Mark Jaeger, vice president of tax operations at TaxAct. "If you trade in crypto, it's no different from any of those stocks or assets in their mind. Depending on how long you hold it, you should pay some sort of taxes on that gain."

Virtual currency held for one year or less before selling or exchanging will be subject to a short-term capital gain or loss. Short-term capital gains are taxed at a rate of 10% to 37% in 2021, while virtual currency held for more than one year is subject to lower long-term capital gains tax rates of 0% to 20%.

You may also incur a tax liability from sending or exchanging cryptocurrency, which can occur in many ways.

"There are many different ways of gifting crypto. My personal one is sending crypto from one wallet to another," says Tally Greenberg, head of business development at Allnodes, a non-custodial platform for digital assets. "There are also gift cards available that you can purchase, mainly for the bigger known crypto assets like Bitcoin and Ethereum."

If that gift of cryptocurrency, regardless of how it was transferred, has a fair market value of more than $15,000, you must complete Form 709, a gift tax return.

However, simply buying cryptocurrency with real currency isn't a taxable event, so long as that cryptocurrency is not received as a gift, sold, given as a gift or exchanged.

How to Prepare for Tax Season if You Own Crypto

Step one in getting through tax season as a crypto owner is to gather as much information as possible – and hand it over to your tax professional if you use one.

Throughout the year, you should be keeping records of your crypto transitions. If you haven't kept good records, your crypto platform may allow you to export your trading data from the year or even provide you with important tax documents. Your cost basis, or the original value of the crypto asset when it was purchased, will be of particular importance when completing your taxes, so be sure to have those details on hand.

The tax forms relevant to virtual currencies include Form 8949, the sales and other dispositions of capital assets form where all cryptocurrency trades or sales must be reported, and Form 1099-B, a broker or barter exchange that you may receive from crypto platforms.

This information and these forms can then be used to complete your tax return. However, note that even if your crypto trading platform did not issue you a 1099, you are still required to report that income.

What the Infrastructure Investment and Jobs Act Means for Crypto Owners

The Infrastructure Investment and Jobs Act signed into law in 2021 modifies that tax code to require reporting on business transactions involving $10,000 or more in digital assets. In addition, the law categorized exchanges like Coinbase and Kraken as well as miners and other individuals as brokers – a key detail for those who participate in crypto mining in the U.S.

These changes go into effect in 2023 and specific guidance regarding the new law has not yet been released by the IRS.

Beyond these basics, your tax situation can become significantly more complex depending on your crypto activities.

If you participate in crypto mining, for example, you may be considered self-employed for tax purposes and need to complete a Form 1040 Schedule C to report your business' profits or losses.

Being paid in cryptocurrency or paying employees in cryptocurrency; undergoing a permanent split in a blockchain, called a hard fork, followed by an airdrop in which a new cryptocurrency token is deposited into users' accounts; and trading in crypto even when it's not on any exchange are all examples of events with tax consequences.