



## **FIVE MYTHS ABOUT CRYPTOCURRENCY TAXATION**



## Five Myths About Cryptocurrency Taxation

**Myth No. 1:** There is no need to report any gain or loss for exchanges between one cryptocurrency and another if the transaction occurred before January 1, 2018.

That is not true. Every time when you sell a cryptocurrency, whether for fiat currency or another cryptocurrency (e.g. sell Bitcoin for Ethereum), you need to report the transaction and calculate gain or loss for tax purposes. Many people thought an exchange between two cryptocurrencies qualified for section 1031 like-kind exchange if it was done before January 1, 2018. Under the new tax law signed by the President on December 22, 2017, only real property qualifies for section 1031 like-kind exchange tax treatment starting 1/1/2018. However, it does not mean that cryptocurrency qualified for like-kind exchange tax treatment before the new law kicks in. There is no tax law, old or new, supports the conclusion that cryptocurrency ever qualified for like-kind exchange tax treatment. People taking such position are at risk for losing their battle with IRS.

**Myth No. 2:** There is no need to report commission or any other income received in cryptocurrency if the cryptocurrency is kept in a wallet or exchange and not sold for fiat currency.

As explained in IRS Notice 2014-21, a taxpayer who received cryptocurrency as payment for goods or services must include the cryptocurrency's fair market value, measured in US Dollars, as of the date that the cryptocurrency was received, in computing gross income. Such amount then becomes the taxpayer's basis for calculating gain or loss in disposition of the cryptocurrency in the future.

**Myth No. 3:** There is no need to report cryptocurrency received from mining as income on tax return unless the mined coin was exchanged for fiat currency.

According to IRS Notice 2014-21 Section 4 A-8, fair market value of the cryptocurrency mined by a taxpayer is includible in gross income as of the date of receipt of the cryptocurrency. Mining income

is also subject to self-employment tax if the mining operation is considered a trade or business unless it is done through a corporation.

**Myth No. 4:** There is no need to report any gain or loss for using cryptocurrency to pay for goods or services.

IRS classified cryptocurrency (or “digital currency”) as property, not as currency. Any exchange of a cryptocurrency for something else (including another cryptocurrency) is a taxable event. You need to report a gain or loss based on the difference between fair market value in USD of the cryptocurrency at the time of the transaction and your cost basis in the cryptocurrency. Unless there is a new law providing exemption, using cryptocurrency to purchase goods (e.g. to buy a cup of coffee) or services (e.g. to pay your employee) is a taxable event.

**Myth No. 5:** Cryptocurrency received due to a hard fork is “free money”, there is no need to report anything.

There is no such thing as free money. Hard fork is a taxable event, because the taxpayer has gained the right to use the forked coin. There are two approaches currently being adopted by tax professionals: (1) to treat the forked coin as having a zero basis; and (2) to recognize income at fair market value in USD of the forked coin at the time of receiving the coin. So far IRS has not issued any guidance on taxation of forked coins. The American Bar Association Section of Taxation requested a temporary “safe harbor” for 2017 hard fork transactions in a March 19, 2018 letter to IRS, in which ABA suggested that the deemed value of the forked coin at the time of the realization event be zero, which would also be the taxpayer’s basis in the coin. Some experts doubted that IRS would allow such an approach, as that essentially allows taxpayers to defer payment of taxes until he/she sells the forked coin. We expect IRS to want to collect taxes sooner than later.

**Disclaimer:**

The above discussion is for information only, it cannot be used as tax advice for any purposes. Please consult your tax advisor regarding your particular tax situation.

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