

TaxBrief

Keeping you informed

Buying Crypto

If you're like many taxpayers, you've probably heard friends or family talking about Bitcoin, Ethereum, NFTs or other forms of digital currency. Maybe you've even thought about getting in on the action. Whether you're planning to buy your first cryptocurrency or already have a little sitting in a digital wallet, it's essential to know one thing up front: **The IRS treats digital assets as property, meaning transactions involving them can trigger taxable events.**

That's right. Buying, selling, trading or even using crypto to make a purchase can have tax consequences. If you've never invested in digital assets, here's what you need to know before diving in.

What is a digital asset?

The IRS defines **digital assets** as any digital representation of value that's recorded on blockchain technology. That includes:

- Cryptocurrency, like Bitcoin, Ethereum and Litecoin
- Stablecoins, such as USDC or Tether
- Non-fungible tokens (NFTs)
- Other digital tokens or coins that may be used for investment, payments or trading

Even if you never take your crypto out of your online wallet, the IRS still requires disclosure. That's why there's a specific question on Page 1 of Form 1040 asking whether you received, sold, exchanged or otherwise disposed of any digital assets during the year.

Buying is tax-free, but transactions aren't

Here's some good news: Simply buying crypto with cash and holding it is not a taxable event. If you bought \$500 worth of Bitcoin and just let it sit in your account, you won't owe anything (yet).

However, the moment you do something with that crypto, like selling it for cash, trading it for another coin or using it to buy something online, it's considered a **taxable transaction**.

Example

Let's say you bought 1 Ethereum for \$1,200 in February. In August, Ethereum is worth \$2,000, and you sell it. That \$800 gain (\$2,000 - \$1,200) is considered a capital gain, and you must report it on your tax return.

If you hold the asset for more than one year, the gain is taxed at long-term capital gains rates (typically lower / more favorable). If you sell it in less than a year, it's taxed at short-term rates, which are the same as your regular income tax rate.

Other taxable crypto activities

Selling isn't the only time the IRS may come knocking. The following actions are also taxable:

- Trading one crypto for another (e.g., swapping Bitcoin for Ethereum)
- Using crypto to buy goods or services
- Receiving crypto as payment for work or business
- Mining or staking rewards
- Receiving airdrops or promotional tokens

Depending on how you receive and use the asset, these events may trigger either capital gains or ordinary income recognition.

Crypto as income

If you're **mining** crypto or earning tokens as compensation for services, the value of that digital asset is taxed as **ordinary income** at the time you receive it. You'll report it just like wages or business income, based on the fair market value on the day you receive it. You may receive an annual reporting

document, such as Form 1099 NEC, if you are paid for any services in cryptocurrency. (Even if you don't receive a form, the income still needs to be reported.)

You'll have a capital gain or loss if you sell the same crypto for more or less than that original value.

Received crypto as a gift?

Receiving crypto as a gift isn't a taxable event. However, if you sell or exchange it later, you'll need the donor's original cost basis to calculate gain or loss. If the donor can't provide that information, you might have to assume a basis of zero, which could result in a higher taxable gain.

Keeping good records is critical

Because most crypto exchanges don't issue complete **Form 1099s** (yet), it's your responsibility to track every transaction, including:

- Dates of acquisition and sale
- The amount you paid (basis)
- The amount you received upon sale, or the value of the asset exchanged
- Transaction fees
- Wallet and exchange details

This might feel overwhelming, especially if you've made multiple trades. Fortunately, many exchanges now offer downloadable transaction histories, and several apps can help track crypto cost basis and gains.

How to report digital asset activity

If you had any pertinent digital asset activity during the tax year, you'll need to:

- Check "Yes" on the Form 1040 digital asset question
- Report gains or losses on Schedule D and Form 8949
- Report any income from mining or payments on Schedule 1, Schedule C or Schedule B, depending on the source

Our office can help you determine the correct reporting form and ensure nothing is missed.

What if you lose money on crypto?

Crypto losses can be used to offset gains from other investments. If your losses exceed your gains, you

can deduct up to \$3,000 in capital losses per year against other income and carry any remaining loss forward to future years.

If you lose access to your crypto due to a lost password or a failed exchange, that's not considered the same as selling it. You may not be able to claim a deduction unless you can prove the asset is permanently worthless, which can be difficult under IRS rules.

Watch for future IRS enforcement

The IRS has made it clear that it's cracking down on unreported digital asset transactions. New rules will require crypto exchanges to issue Form 1099-DA beginning in 2025 to help the IRS track crypto transactions more effectively.

If you've dabbled in crypto but haven't reported your transactions in past years, now's the time to get compliant. Amending prior returns can help you avoid penalties and reduce the chance of any audit-related surprises.

Getting started the right way

If you're just starting your crypto journey, treat it like any other investment: track everything, understand the rules and plan for the taxes before you make the trade.

Here are a few tips:

- Keep a separate spreadsheet or use a crypto tax app
- Don't trade just to follow trends – tax consequences can sneak up fast
- If you're self-employed or mining, set aside funds for taxes
- Consult with our office before year-end to plan for gains and losses

Crypto may be digital, but the tax consequences are very real. Whether you're holding a few dollars' worth or actively trading, make sure your tax strategy keeps up with your investments. When in doubt, don't hesitate to ask for our help, because the IRS is paying attention, even if your coins are virtual. If you're thinking about investing in digital assets, or you've already made your first crypto purchase, let's talk. A little planning now may save a lot of headaches next April.