



### Cryptocurrency

Did you know the term “cryptocurrency” includes many different forms of payment? Most of us are familiar with Bitcoin, but many vendors we encounter frequently are venturing into the cryptocurrency realm — Apple, Facebook, Amazon, and Walmart are a few examples. Starting with the 2019 tax return, you will be required to answer the question “At any time during the tax year did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?”

#### **SUMMARY**

The IRS considers virtual currency property, not securities or currency. Cryptocurrency uses cryptography to secure the funds and transactions. There are many versions of cryptocurrency (1,300 versions+), the most well-known being Bitcoin. Since the IRS does not consider virtual currency “currency” there is no foreign currency, income or asset reporting required.

As with many things in the tax world, taxation of cryptocurrency can fall under many different scenarios, depending on the situation, facts and circumstances.

If you are paid in cryptocurrency for work performed as an employee, the income is ordinary income, taxed as wages normally would be taxed.

If you are a self employed individual and accept cryptocurrency as payment, the income is self employment income and subject to self employment taxes, just like it normally would be when you receive cash, check or credit card payments. This includes individuals who mine cryptocurrency on their own and are not employees of a cryptocurrency mining organization, company or employer.

Most people find themselves in the investment category when it comes to cryptocurrency. Many of the rules that apply to stocks and mutual funds apply to cryptocurrency. There are short term and long term holding periods to consider. Gains and losses are calculated the same way, including using FIFO method or specific share method. Gifting rules similarly apply in the sense that a donor’s basis and holding period follows the gift to the recipient of the gift. These transactions are reported on schedule D, the same as for sales of stocks, bonds, mutual funds, other capital assets, etc.

#### **Contact Us:**

100 BridgePoint Dr  
Suite 120  
South St Paul, MN 55075

Office: 651-455-4621  
FAX: 651-552-9641

[www.nelsoncpasmn.com](http://www.nelsoncpasmn.com)



**WHAT IS IT?**

According to the IRS frequently asked questions, virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency (“real currency”), that functions as a unit of account, a store of value, and a medium of exchange. Some virtual currencies are convertible, which means that they have an equivalent value in real currency or act as a substitute for real currency.

Cryptocurrency is a type of virtual currency that uses cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. A transaction involving cryptocurrency that is recorded on a distributed ledger is referred to as an “on-chain” transaction; a transaction that is not recorded on the distributed ledger is referred to as an “off-chain” transaction.

**HOW IS IT TAXED?**

When you sell virtual currency, you must recognize any capital gain or loss on the sale, subject to any limitations on the deductibility of capital losses. If you held the virtual currency for one year or less before selling or exchanging the virtual currency, then you will have a short-term capital gain or loss. If you held the virtual currency for more than one year before selling or exchanging it, then you will have a long-term capital gain or loss. The period during which you held the virtual currency (known as the “holding period”) begins on the day after you acquired the virtual currency and ends on the day you sell or exchange the virtual currency.

Your gain or loss will be the difference between your adjusted basis in the virtual currency and the amount you received in exchange for the virtual currency, which you should report on your Federal income tax return in U.S. dollars. Your basis (also known as your “cost basis”) is the amount you spent to acquire the virtual currency, including fees, commissions and other acquisition costs in U.S. dollars. Your adjusted basis is your basis increased by certain expenditures and decreased by certain deductions or credits in U.S. dollars.

**WHAT IF I BUY SOMETHING USING CRYPTOCURRENCY?**

If you pay for a service using virtual currency that you hold as a capital asset, then you have exchanged a capital asset for that service and will have a capital gain or loss. Your gain or loss is the difference between the fair market value of the services you received and your adjusted basis in the virtual currency exchanged.

If you exchange virtual currency held as a capital asset for other property, including for goods or for another virtual currency, you will recognize a capital gain or loss. Your gain or loss is the difference between the fair market value of the property you received and your adjusted basis in the virtual currency exchanged.

**WHAT RECORDS DO I NEED TO KEEP?**

The Internal Revenue Code and regulations require taxpayers to maintain records that are sufficient to establish the positions taken on tax returns. You should therefore maintain, for example, records documenting receipts, sales, exchanges, or other dispositions of virtual currency and the fair market value of the virtual currency.

**HARD FORK**

A hard fork occurs when a cryptocurrency undergoes a protocol change resulting in a permanent diversion from the legacy distributed ledger. This may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. If your cryptocurrency went through a hard fork, but you did not receive any new cryptocurrency, whether through an airdrop (a distribution of cryptocurrency to multiple taxpayers' distributed ledger addresses) or some other kind of transfer, you don't have taxable income.

If a hard fork is followed by an airdrop and you receive new cryptocurrency, you will have taxable income in the taxable year you receive that cryptocurrency. When you receive cryptocurrency from an airdrop following a hard fork, you will have ordinary income equal to the fair market value of the new cryptocurrency when it is received, which is when the transaction is recorded on the distributed ledger, provided you have dominion and control over the cryptocurrency so that you can transfer, sell, exchange, or otherwise dispose of the cryptocurrency.

If you receive cryptocurrency from an airdrop following a hard fork, your basis in that cryptocurrency is equal to the amount you included in income on your Federal income tax return. The amount included in income is the fair market value of the cryptocurrency when you received it. You have received the cryptocurrency when you can transfer, sell, exchange, or otherwise dispose of it, which is generally the date and time the airdrop is recorded on the distributed ledger.

**SOFT FORK**

A soft fork occurs when a distributed ledger undergoes a protocol change that does not result in a diversion of the ledger and thus does not result in the creation of a new cryptocurrency. Because soft forks do not result in you receiving new cryptocurrency, you will be in the same position you were in prior to the soft fork, meaning that the soft fork will not result in any income to you.