

CRYPTOCURRENCY: HOBBY VS BUSINESS



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With cryptocurrency on the verge of its 10th anniversary, the public's interest in investing and mining hasn't skipped a beat. High costs and volatility of the market translates to prospective miners and investors needing to do their research and setting feasible goals before jumping in. In fact, for most, crypto mining is more realistic as a hobby than as a true business.

What is crypto mining?

Cryptocurrency mining is essentially 24/7 bookkeeping in which transactions are verified and then added to the blockchain digital ledger. In return for their accounting services, miners are paid in that block's coin. Crypto mining requires specialized hardware and an efficient "cooling system." The major variables of mining include coin profitability, power costs, and processing device lifespan.

Mining often starts off as a hobby, similar to many other types of small businesses. However, not all hobbies graduate to business status - especially in the eyes of the IRS. Each differs fundamentally in their basic purpose and time commitment. While it's not as clear cut as checking off a box, distinguishing between hobbies and businesses becomes incredibly important when tax season rolls around.

Hobby vs Business... What's the Difference?

According to the IRS, a legitimate business is an activity carried out with continuity and with the primary purpose of making a profit. A hobby, on the other hand, is done for personal enjoyment and can also provide a source of income.

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Why Does This Matter for Taxes?

Whether your endeavor is classified as a business or a hobby, it will affect your tax liability. Regardless of the source, taxpayers are required to report all income on their returns. However, hobbyists are limited in the deductions they can make, even if they incur a loss.

Under the tax code, it is illegal to claim hobby expenses as business losses. It is only permissible to deduct hobby expenses up to the amount of income made from the hobby, and should you file incorrectly (either unknowingly or willfully), you can put yourself at risk of an IRS audit and may face hefty penalties and significant lost time if pursued. Individuals who repeatedly claim losses for their mining activities will undoubtedly face more scrutiny by the IRS.

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How Can I Turn My Hobby Into a Business?

Although it typically takes start-ups a few years before they begin seeing a profit, there are several important actions an entrepreneur can take to help legitimize their business to the IRS including:

1. **Registering with the state.**
2. **Establishing a business account with a financial institution, separate from the location of personal accounts.**
3. **Complying with Federal and State laws.**
4. **Maintaining complete and accurate records.**
5. **Devoting sufficient time and resources into the activity and indicating an intention to make a profit. For example, creating a company website and promoting the business through marketing.**
6. **Maintaining knowledge of current industry standards to maintain standardized operations and create a growing and profitable business.**

In Summary

With Cryptocurrency investing and mining still actively making headlines, it is important to understand how you should classify your participation in this market for tax purposes. Taking the appropriate proactive measures can help reduce the chances of an IRS audit of your hobby or startup business.

Crypto mining is a complex, competitive, and risky venture. When considering whether to turn your cryptocurrency hobby into a real business, it is best to speak with a licensed CPA to identify if the benefits outweigh the costs of operating as a hobby vs a business. Ready to start a conversation? We would love to help!

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