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# Cryptocurrency Taxes 2021: What You Need To Know



**David Rodeck, John Schmidt**

Contributor, Editor

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some Ethereum, only to turn around and sell it off for a quick buck. Either way, your crypto transaction may impact your 2021 tax bill.

## How Do Cryptocurrency Taxes Work?

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For better or worse, [capital gains tax](#) rules apply to cryptocurrencies like Bitcoin and Ethereum. The Internal Revenue Service (IRS) treats all [cryptocurrency](#) as capital assets, and you owe taxes when they're sold at a profit. This is exactly what happens when you sell more traditional investments, like stocks or funds, at a gain.

How much you own in capital gains taxes depends on whether you've held your crypto for less than a year or more than one year. If you haven't quite reached 12 months, your profits are taxed at short-term capital gains rates, a.k.a. your regular income tax rate. But if it's been at least one year since you purchased your coins, you'll qualify for a long-term capital gains rate that's lower than most income taxes, depending on your taxable income.

And just like if you sell any other investment at a loss, if your crypto investment has fallen in value when you sell it, you are able to claim a capital loss, which you may be able to use to [offset other income taxes](#).

But cryptocurrency taxes comes with a couple of additional wrinkles.

### Crypto Taxes If You Use Cryptocurrency for Purchases

If you purchase goods or services with [cryptocurrency](#), your purchase counts as a sale of that crypto. This means you'll owe capital gains taxes if your coins have increased in value over what you originally paid for them. And what's more, you'll also owe any applicable sales tax.

### Crypto Taxes When You Mine Crypto

If you earn cryptocurrency by mining it, or receive it as a promotion or as payment for goods or services, it counts as part of your regular taxable income. You owe tax on the entire fair market value of the crypto on the day you received it, at your regular income tax rate.

And if you hold the same cryptocurrency you mined or earned from these activities, its value increases, and you either spend it or sell later at a profit, you would also owe capital gains taxes on the profits, based on how long you've held it.

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### How to File Your Crypto Taxes

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It's never too early to get organized with your crypto taxes. The standard Form 1040 tax return now asks whether you engaged in any virtual currency transactions during the year. If the answer is yes, here's what you need to keep in mind:

You must keep track of all your cryptocurrency transactions, including how much you paid for crypto, how long you held it for and how much you sold it for, as well as receipts for each transaction.

While your crypto exchange may provide a 1099-B reporting your crypto transactions to both the IRS and you, it might not record the cost basis, or original amount you paid for your crypto, if you transfer coins between offline cold wallets and your account.

To help address issues like these, “software companies have emerged that will scrub the blockchain to detect transfers between your wallets, whether on an exchange or not, and give you reports of all transactions related to the wallets you give it within a given tax year,” says Jon Feldhammer, tax partner at Baker Botts.

Tools like [Koinly](#) and [Cointracker](#) connect to exchanges and crypto wallets to track your crypto transactions and complete the forms you need to file your cryptocurrency taxes.

## 2. Fill Out the Proper Tax Forms

Once you have a record of your crypto transactions, you’ll need to fill out certain tax forms depending on how you used your crypto:

**Form 8949.** This form logs every purchase or sale of crypto as an investment. This should include the total number of coins, the date and price you bought, the date and price you sold and your gain or loss for each transaction.

**Schedule D.** This form summarizes your total capital gains and capital losses from all investments, including crypto.

**Schedule C.** If you received coins from mining, you need to disclose whether you received them as a business or as a hobby. If you’re running a crypto mining business, you may owe self-employment taxes if your income exceeded your expenses for the year.

**Schedule 1.** If you report your crypto mining as a hobby, you’d report this income on Line 8 of Schedule 1. You won’t owe self-employment tax, but you become more limited on what you can deduct as an expense.

## 3. File Your Taxes

If you keep records in software like Koinly or CoinTracker, you can connect them with your [online tax software](#) of choice. Then use the online tax software to file your overall state and federal tax returns. For those looking for one-stop services, [TokenTax](#) provides a full suite of accounting services to track and prepare both your crypto and regular taxes.

## 4. Hire a Professional

certified public accountant (CPA) who specializes in this type of tax work, so you don't have the IRS chasing you down later.

## How to Minimize Crypto Taxes

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If you think you might owe cryptocurrency taxes in the future, here are six ways to help minimize them:

### 1. Hold Cryptocurrency for the Long-Term

If you hold a crypto investment for at least one year before selling, your gains qualify for the preferential long-term capital gains rate. Depending on your taxable income for the year, this can almost halve your tax rate, going from a maximum rate of 37% for short-term gains to a maximum rate of just 20% for long-term gains.

### 2. Offset Gains with Losses

As with any investment, you can take advantage of crypto gains by also claiming losses on other investments the year you realize your profit. That means if you made \$10,000 for selling Bitcoin but lost \$10,000 for selling Ethereum, you wouldn't owe any tax since you broke even.

These losses aren't limited to other forms of cryptocurrency, though. If you are about to cash in a large crypto investment, look through the rest of your portfolio to see if there are other losing investments you could sell to offset your gains. And if you end up losing substantially more than you gain in a year, you can deduct up to \$3,000 in the excess losses against your personal income taxes as well as carry forward any unused losses to offset your future investment gains.

### 3. Time Sales with Your Tax Rate

If you have the luxury of time on your side, you can always try to wait out a lower tax rate, says Jeff Hoopes, an associate professor at the University of North Carolina and research director of the UNC Tax Center.

"Perhaps you got laid off, retired, went back to school or moved to a lower tax state. Then you might find yourself in a lower tax bracket, which would allow you to sell your crypto while owing less in taxes," he says.

### 4. Claim Expenses for Mining

While it might seem like a low-cost activity in theory, mining crypto comes with considerable expenses, including computers, servers, electricity and internet service provider charges. If you are

## 5. Consider Investing Through a Retirement Plan

If you invest in crypto using a retirement plan like a [traditional IRA](#) or [Roth IRA](#), you can defer or avoid investment gains entirely, though it's not as easy as investing through a normal brokerage account.

“There are ways to get crypto into tax advantaged vehicles like an [individual retirement account \(IRA\)](#), but it is not that common and not that easy (although many expect it to get easier),” says Hoopes. Right now if you'd like to open a crypto or Bitcoin IRA, you'd need to open a specialty account called a self-directed IRA with boutique firms that offer crypto investing.

## 6. Donate to Charity

If you don't need all of the profit from your crypto investment, you can decrease your tax burden by donating at least some of your crypto to charity. You'll get a deduction worth the full value of your crypto, including any gains. But this generally only makes sense if you planned on donating to charity already.

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