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November 21, 2022 – Wealth Planning Commentary

How Crypto is taxed and timely planning opportunities

Crypto has recently received more media coverage than usual, largely driven by the collapse of a popular exchange called FTX. The reasons for the exchange's demise are complex, but one of the main causes is the rapid decrease in the value of most cryptocurrencies this year. Cryptocurrency holders and sellers may take comfort in the fact that there are likely tax savings opportunities available.

Firstly, if you are confused about how crypto is taxed, then you share something in common with most holders of the virtual currency. Many owners use crypto to make payments and it's tempting to view it as a currency, but the reality is more complex. The Commodity Futures Trading Commission (CFTC) currently classifies crypto as a commodity. The SEC is pushing to classify crypto as a security. But most importantly, the IRS considers crypto property.

The classification as property means that crypto is taxed similarly to marketable securities. There are long and short-term capital gains and losses depending on how long the asset was held. Purchasing crypto with dollars and holding it within an account does not incur tax, much like a stock. The events that trigger capital gains and losses include selling crypto for dollars, exchanging one cryptocurrency for another, and paying for goods and services with crypto. From a tax perspective transacting in crypto can be challenging, and it's important to keep track of the cost basis. One difference between crypto and marketable securities is 'wash sales.' Virtual currencies are not subject to the 'wash sale' rules.

Other types of transactions are taxed as income. The recipient of a payment made in crypto is taxed on the amount received. Miners who create a whole or partial coin must report it to the IRS at the fair market value on the day it was created.

Many cryptocurrencies have had a challenging year. Bitcoin is down 65% YTD. Since crypto is treated as property, clients may have an opportunity to harvest losses before year-end. Like any property transaction, the taxpayer may offset gains in stocks, bonds, and other investments with losses experienced in crypto. The losses may be carried forward each year until they are entirely offset by gains. If there are no gains to offset, $3,000 of capital losses may be used to offset ordinary income each year. When donating crypto to a charity, think of it as a security: the fair market value is the deductible amount, the AGI limits apply, and the donor avoids paying capital gains taxes.

Please reach out to your CPA and Wealth Manager if you have questions about potential tax opportunities related to your crypto.