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Crypto taxes, reporting and tax audits in 2021

Just remember, the IRS is quite interested in crypto and is taking steps to unearth those who do not report.



This year was like no other. Now that it has limped to a close and we look at the promise of a better 2021, it is time to think about taxes. Although there were many other notable things about 2020, there were some tax points to savor — and some to fear.

Gains and losses

It is hard to look at crypto and 2020 without commenting on gains and losses. Bitcoin ([BTC](#)) [ballooned in price](#), making a lot of investors happy. Of course, if you had taken short positions, you are less content. And if you were invested in [XRP](#), the news that the

United States Securities and Exchange Commission is unhappy with XRP has [caused some price impact](#) in the unwanted direction. When it comes to real and perceived value and buying power, these developments matter. But what about taxes?

Tax day delay: IRS more lenient?

Tax returns for 2020 are due on April 15, 2021, which is not too far away. Don't count on a delay like last year. In 2020, the Internal Revenue Service gave us all a [90-day reprieve on return filing and payments](#), until July 15, 2020 (IRS [Notice 2020-17](#)). The world may still be in COVID-19's grip during the upcoming tax-filing season, but most observers do not expect the same kind of latitude from the IRS when it comes to 2020 tax returns.

The same can be said for the IRS easing up on many of its enforcement activities. Early in 2020, the IRS Commissioner Chuck Rettig [announced](#) the "People First Initiative." Need to pay your taxes in installments? The IRS will help because it has a well-worn process for working out installment payments. Plus, installment payments due between April 1 and July 15, 2020, were suspended, as were tax liens and levies. Even new passport debt certifications when delinquent tax debts exceed \$50,000 were on hold, and most new tax audits were on hold, too.

How about now in early 2021? Many IRS employees are still working mostly remotely, but don't assume that this means you are going to be cut some slack in early or mid-2021 that taxpayers received in 2020. It is highly unlikely. How about arguing with the IRS or in court that you shouldn't have to pay IRS penalties because you were adversely impacted by the pandemic? You can try it, but the IRS commissioner has already pushed back hard on suggestions that the IRS should have a special pandemic allowance for penalties. Again, don't count on it.

IRS forms for crypto taxes

Two years ago, the IRS made crypto a kind of everyman's tax issue by [adding a question to everyone's tax return](#), and the same thing has [happened with 2020 tax returns](#). It means that starting with 2019 tax returns filed in 2020, the IRS asks you a simple question:

"At any time during 2019, did you receive, sell, send, exchange or otherwise acquire any financial interest in any virtual currency?"

It's pretty simple: just yes or no; it does not ask for numbers or details, though that would go elsewhere on your tax return.

This addition for 2019 returns is being continued for the 2020 returns you file in 2021. In fact, you should assume it will be a standard feature of tax returns from now on. Because the IRS [classifies crypto as property](#), any sale is going to produce either a gain

or loss, and a yes or no box can turn out to be pretty important. In fact, given the IRS' track record with offshore bank accounts, it could even mean big penalties or even jail.

The Department of Justice's Tax Division has successfully argued that the mere failure to check a box related to foreign account reporting is willfulness. Willful failures carry higher penalties and an increased threat of criminal investigation. The IRS' Criminal Investigation Division is even meeting with tax authorities from other countries to share data and enforcement strategies to find potential cryptocurrency tax evasion. This seems reminiscent of the foreign bank account question included on [Schedule B](#).

If a taxpayer answers "No" and then is discovered to have engaged in transactions with cryptocurrency during the year, the fact that they explicitly answered No to this new question (under penalties of perjury) could be used against them. What if you just have a kind of "signature authority" over crypto owned by your non-computer-savvy parents or other relatives? That way, you can help them manage their crypto.

If you sell a parent's crypto on their behalf, at their request and/or for their benefit, should you answer "Yes" or "No" to the question? Various escrow and trust arrangements — some informal, some not — have blossomed. They can be sensitive, particularly now with the IRS' much greater access to information. But be careful of who is selling and how such activities are reported.

Should you attach an explanatory statement to the return explaining your relationship to the digital currency? There probably aren't perfect answers to this question, but what is clear is that answering "No" if the truth is "Yes" is a big mistake. Skipping the boxes entirely might not be as bad, but it isn't good either if the truth is "Yes." If the truth is "Yes," say so, and remember to disclose and report your income, gains, losses, etc. Maybe that's the point of the question: to be a prominent reminder.

Other tax forms

Don't think that your tax return is the only tax form you'll see. Although crypto still escapes some reporting forms, that is much less true today than it once was. How about IRS Forms [1099-MISC](#), [1099-K](#), [1099-B](#) or [Schedule K-1](#)? There's even the new [Form 1099-NEC](#) for the 2020 tax return season.

All of these forms can and do report crypto payments and transactions. These forms arrive around the end of January for reporting payments or transactions made in the previous calendar tax year. Wages paid to employees in digital currency must be reported on a [Form W-2](#) and are subject to federal income tax withholding and payroll taxes.

Salaries made in digital currencies made to independent contractors are taxable to them, and payers engaged in business must issue [Form 1099-NEC](#). A payment made

using a digital currency is [subject](#) to Form 1099 reporting just like any other payment made in property. That means if a person in business pays crypto worth \$600 or more to an independent contractor for services, a Form 1099 is required.

If you receive any Forms 1099, keep track of them. Each one gets reported to the IRS (and state tax authorities). If you don't report or otherwise address the reported income on your tax return, you can expect the IRS to follow up.

Transactions trigger taxes

In 2014, the IRS announced that crypto is property. If you have 100 BTC and you sell 10, which 10 did you sell? There is no perfect answer to this question. Most of the tax law considers shares of stock, not cryptocurrency. Specific identification of what you are selling, when you bought it, and for what purchase price is likely to be the cleanest. But that may not be possible. Some people use an averaging convention, where you essentially average your cost across a number of purchases. Consistency and record-keeping are important.

IRS audits and information access

The IRS [uses software to track crypto](#) and has also gotten access to records via other sources. Besides, with the forms 1099 and K-1 being issued, many reports are now being dropped in the IRS' lap. That should be a cause for concern for taxpayers.

The IRS has crypto training now for its auditors and criminal investigation division agents. Should the latter scare you? I think so. The IRS and Department of Justice still bring criminal charges primarily involving crypto use for illegal purposes involving other crimes, such as money laundering or child pornography. But that is no guarantee.

Besides, most criminal tax cases historically [come out of regular old civil IRS audits](#). The IRS auditor sees something it thinks is fishy and invites the criminals to the IRS to take a look. It's called a referral, and you don't know if it is happening. In fact, you usually don't know until it is too late. If you forget to report your crypto gains in past years, then you ought to reconsider this. Don't wait for the IRS to find you even if you did not get one of those 10,000 IRS [crypto warning letters](#).

Taxpayers may think they will not be caught, but the risks are growing — and the best way to avoid penalties is to disclose and report as accurately as you can. IRS commissioner Chuck Rettig has even moved to increase criminal investigations, too, so be careful out there.

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