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Can You Defer Bitcoin or Crypto Capital Gains Taxes?

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Yes, there are several ways that you can defer or reduce your crypto tax bill and capital gains taxes on bitcoin or cryptocurrency investments. Using one of these mechanisms can save you hundreds or potentially even thousands of dollars in your crypto taxes payments. However, misusing one of these tax-saving tools can lead to allegations of tax evasion, which can carry financial penalties that far outstrip the savings to be had, and can even lead to criminal sanctions.

Some Background: Cryptocurrency Investments and the IRS

Since 2014, the Internal Revenue Service (IRS) has treated cryptocurrencies as a form of property for federal income tax purposes – not as a form of currency. According to Notice 2014-21, cryptocurrency is treated much like a stock or a bond, even though it is increasingly used in ways that are similar to cash.

U.S. taxpayers have an obligation to both report their cryptocurrency transactions to the IRS and pay taxes on it. Despite the legal requirement to report cryptocurrency on tax forms, many people with bitcoin or other forms of crypto did not mention it when filing their taxes. Starting in 2019, the IRS started to crack down on this by including a question on Form 1040 that asked, specifically, whether the filer had transacted in crypto at any point during the tax year.

The inclusion of such a pointed question betrayed the IRS's intent to get more serious about enforcing the reporting requirements for crypto and spooked many investors who speculated in bitcoin and other cryptocurrencies.

Just because the potential for a tax enforcement action has increased for not reporting, though, does not mean that crypto owners and investors are powerless to mitigate their tax liability. You pay capital gains taxes depending on the type of capital gain you have. There are still several ways for you to defer your capital gains tax when you cash out your crypto investments.

Long-Term Investments Carry Lower Capital Gains Tax

One of the easiest ways to reduce the capital gains tax that you pay on your crypto investment and lower your capital gains tax burden is to make it a long-term investment rather than a short-term one.

The difference between a long-term and short-term investment is the one-year benchmark. If you have only had the investment for less than a year, it is a short-term one. If you have had it for a year or longer, it is a long-term investment.

Both are subject to the capital gains tax. If you hold anything that's considered property for under a year, it's taxed at ordinary income tax rates. If it's held for longer, it generally qualifies for lower long-term capital gains tax rates.

When you cash out on a short-term investment, the capital gains tax is equal to the taxable income rate that you would ordinarily pay on your wages. Depending on your income tax bracket, this can be quite high. For single filers in 2021, it was:

- 10 percent on your first $9,950
- 12 percent from $9,951 to $40,525
- 22 percent from $40,526 to $86,375
- 24 percent from $86,376 to $164,925
- 32 percent from $164,926 to $209,425
- 35 percent from $209,426 to $523,600
- 37 percent on all income over $523,601

But the capital gains tax for long-term investments is considerably lower. For single filers in 2021, it was:

- 0 percent up to $40,400
- 15 percent between $40,401 and $445,850
- 20 percent over $445,851

Cash Out in a Down Year

Because the capital gains tax that applies to your crypto investment will depend on your income during the year that you cashed out that investment, you can also reduce your tax liability by disposing of your bitcoin investment in a year where you had a relatively low income.

This works for both long-term and short-term crypto investments.

For example, if you had a long-term bitcoin investment and you lost your job, you can potentially avoid all capital gains taxes on your investment if you cash out your crypto shares and end up with less than $40,400 of income for the year.

Offset Your Capital Gains With Capital Losses

One of the most common ways to defer your capital gains taxes on cryptocurrency investments is to offset your capital gains with capital losses.

You can use this tax-saving technique only if you have multiple investments.

If one of those investments is going to provide a positive return, while the other one is at a loss, if you cash them both out at the same time, the capital gains tax will look at them in the aggregate rather than as individual investments. In short, your losses from the one investment

will reduce or potentially even cancel out the capital gains tax from the investment that returned a positive amount.

This can be very useful if you have an investment that has done quite well, but also another investment that has done poorly and you want to cut your losses on it. By timing the transactions so they are taxed together, the tax savings that you can net can drastically reduce the loss on the disappointing investment.

Move to a State With Low Income Taxes

If your cryptocurrency investment is going to get taxed at a rate that is based on your income tax, in some cases it can save thousands of dollars by moving to a state that has low or no state income tax. While this can sound like more of a hassle than it would be worth, there are numerous circumstances where it can make financial sense.

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