The IRS Knows About Your Crypto and Has Known Since 2019 -- What You Need to Do Now

Capital Gains. Cost Basis. Taxable Events. FIFO vs HIFO. Staking Income. The CLARITY Act Reporting Framework. What Ignorance Will Cost You. -- Q2 2026

Since 2019, the IRS has placed a question at the top of Form 1040 -- the main US individual income tax return filed by approximately 150 million Americans annually -- asking: at any time during the tax year, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? The question was added because the IRS had observed widespread non-compliance with existing cryptocurrency tax obligations that had been in place since 2014, when the IRS issued Notice 2014-21 establishing that cryptocurrency is property for federal tax purposes and that every crypto transaction that results in a gain or loss is a taxable event. By 2026, the IRS has significantly expanded its enforcement infrastructure for crypto tax compliance. The Infrastructure Investment and Jobs Act of 2021 extended broker reporting requirements to crypto exchanges, requiring Coinbase, Kraken, Binance US, and every other regulated exchange to issue 1099 forms to customers and report transaction data to the IRS. The CLARITY Act, currently advancing through the Senate, includes comprehensive reporting framework provisions that will require digital asset brokers to report customer transaction data to the IRS on a standardized basis beginning in 2027. The IRS has also engaged Chainalysis and other blockchain analytics firms to trace on-chain transactions and identify wallet holders who have unreported crypto gains. The era of crypto tax invisibility is over. The question is not whether the IRS can see your crypto transactions. The question is whether your tax filings accurately reflect them. This report gives you the complete framework for understanding what crypto taxes you owe, which transactions trigger tax obligations, how to minimize your tax liability legally, and what happens if you ignore it.

01 -- THE FOUNDATIONAL RULE: CRYPTO IS PROPERTY NOT CURRENCY

The entire US crypto tax framework flows from a single IRS determination made in Notice 2014-21: cryptocurrency is property for federal tax purposes, not currency. This classification has profound practical implications for every crypto investor because it means that every time you dispose of cryptocurrency -- sell it, exchange it for another cryptocurrency, use it to buy something, or transfer it in certain circumstances -- you have a taxable event that must be reported on your tax return.

If cryptocurrency were classified as currency -- like foreign currency held in a bank account -- the tax treatment would be different and more favorable for most investors. Foreign currency gains below certain thresholds are exempt from tax, and the reporting requirements are simpler. But the IRS has consistently maintained since 2014 that cryptocurrency is property, not currency, and the tax courts have upheld this classification in every challenge brought before them.

The property classification means that every crypto transaction is analyzed the same way as a stock transaction: you have a cost basis -- the price you paid for the asset plus any fees -- and when you dispose of the asset, the difference between your cost basis and the disposal price is your taxable gain or loss. If you bought one Bitcoin at $30,000 and sold it at $70,000, your taxable gain is $40,000. If you bought one Bitcoin at $80,000 and sold it at $63,000, your taxable loss is $17,000 -- a loss you can use to offset gains from other transactions.

The CLARITY Act does not change the property classification of cryptocurrency for tax purposes. The bill addresses market structure regulation -- defining digital commodities and securities -- not tax treatment. Regardless of whether the CLARITY Act is signed, the IRS property classification from Notice 2014-21 continues to govern crypto tax treatment. Investors who are waiting for regulatory clarity before addressing their crypto tax obligations are waiting for a change that will not come.

> ***IRS FOUNDATIONAL RULE: Cryptocurrency is property for federal tax purposes since Notice 2014-21. Every disposal is a taxable event. Cost basis equals purchase price plus fees. Taxable gain equals disposal price minus cost basis. This rule applies regardless of the CLARITY Act and regardless of the holding period unless long-term capital gains rates apply.***

02 -- TAXABLE EVENTS: THE COMPLETE LIST OF WHAT TRIGGERS A TAX OBLIGATION

The most common misconception in crypto tax compliance is that taxes are only owed when you sell crypto for dollars. This misconception leads to significant under-reporting because the IRS considers many transactions beyond simple fiat sales to be taxable disposal events. Understanding the complete list of taxable events is essential for accurate reporting.

Selling cryptocurrency for fiat currency is the most obvious taxable event. Selling one Bitcoin for $70,000 when you purchased it for $30,000 creates a $40,000 capital gain that must be reported on Schedule D of your tax return. The gain is short-term -- taxed at ordinary income rates up to 37% -- if you held the Bitcoin for one year or less. The gain is long-term -- taxed at preferential rates of 0%, 15%, or 20% depending on your income -- if you held the Bitcoin for more than one year.

Trading one cryptocurrency for another cryptocurrency is a taxable event that surprises many investors. When you exchange one Ethereum for Solana, the IRS treats the transaction as if you sold your Ethereum for its fair market value in dollars at the moment of the exchange and then purchased the Solana at that same dollar value. If your Ethereum had appreciated since you purchased it, you have a taxable gain on the exchange even though you never received any dollars. This treatment applies to every crypto-to-crypto trade regardless of whether you use a centralized exchange, a decentralized exchange, or a direct peer-to-peer swap.

Using cryptocurrency to purchase goods or services is a taxable event. If you use one Bitcoin worth $70,000 to purchase a car, and your cost basis in that Bitcoin was $30,000, you have a $40,000 taxable gain on the purchase transaction. The practical implication is that merchants who accept crypto payments are not your tax advisors -- every crypto purchase you make is potentially a taxable event that you need to track.

Receiving cryptocurrency as income -- from staking rewards, mining, referral bonuses, airdrops, or employment compensation -- creates ordinary income equal to the fair market value of the crypto received at the time of receipt. If you receive 0.1 ETH as a staking reward when ETH is trading at $3,000, you have $300 in ordinary income to report. The cost basis of the received ETH is $300 -- the value at which you recognized ordinary income. If you later sell that ETH at $4,000, you have an additional $100 capital gain.

Non-taxable events include transferring crypto between wallets you own, buying crypto with fiat dollars, donating crypto to a qualified charity, and holding crypto without any transaction. The simple act of holding Bitcoin in your wallet -- for one day or ten years -- does not create any tax obligation until you dispose of it.

03 -- COST BASIS METHODS: FIFO HIFO AND SPECIFIC IDENTIFICATION

When you have purchased cryptocurrency at multiple prices over time and you sell a portion of your holdings, you must determine which specific units you are selling in order to calculate your cost basis correctly. The IRS allows several methods for determining cost basis, and the choice between them can significantly affect your tax liability in any given year.

First In First Out -- FIFO -- is the default method if you do not specify otherwise. FIFO treats the earliest purchased units as the first ones sold. If you bought one Bitcoin at $20,000 in January 2022, one Bitcoin at $60,000 in November 2021, and one Bitcoin at $30,000 in March 2023, and you sell one Bitcoin today at $70,000, FIFO assumes you are selling the $20,000 purchase first -- generating a $50,000 gain. FIFO tends to maximize taxable gains in a bull market because the oldest purchases typically have the lowest cost basis.

Highest In First Out -- HIFO -- treats the highest-cost units as the first ones sold. Using the same example, HIFO would assume you are selling the $60,000 purchase first -- generating a $10,000 gain instead of $50,000. HIFO minimizes taxable gains in a given year and is the method that most tax optimization strategies recommend for investors who have purchased crypto at varying prices. HIFO is a permissible method under IRS rules as long as you maintain adequate records that identify the specific lots being disposed of.

Specific identification allows you to designate exactly which units you are selling by identifying the specific acquisition date and price of each lot. Specific identification is the most flexible method and can produce any result between FIFO and HIFO depending on which lots you designate. To use specific identification, you must document your selection before or at the time of the transaction -- not retrospectively at tax time.

The practical recommendation for most investors is to use HIFO through a crypto tax software platform -- Koinly, CoinTracker, TaxBit, or CryptoTrader.Tax -- that automatically tracks your cost basis across all exchanges and wallets, applies the optimal lot selection method, and generates the IRS-required tax forms including Form 8949 and Schedule D. Manual cost basis tracking across multiple exchanges and wallets is error-prone and time-consuming. Crypto tax software is the most cost-effective investment most crypto investors can make at tax time.

COST BASIS METHODS: FIFO default, sells oldest units first, maximizes gains in bull market. HIFO sells highest-cost units first, minimizes current year gains. Specific identification designates exact lots, most flexible. Use HIFO through crypto tax software: Koinly, CoinTracker, TaxBit. Adequate records required for all non-FIFO methods.

04 -- STAKING INCOME TAX TREATMENT: THE JARRETT CASE AND IRS GUIDANCE

The tax treatment of staking rewards has been one of the most contested areas of crypto tax law -- and the outcome of a landmark legal case combined with subsequent IRS guidance has produced a framework that every staking investor needs to understand.

In 2021, Joshua and Jessica Jarrett filed a lawsuit against the IRS seeking a refund of taxes paid on Tezos staking rewards they had received in 2019. The Jarretts argued that newly created cryptocurrency received as staking rewards should be treated like other newly created property -- comparable to crops harvested by a farmer or books written by an author -- and should not be taxable as income until sold. The IRS offered a full refund rather than litigate the case, but the Jarretts rejected the refund and continued the lawsuit seeking a definitive ruling. The case has worked through the courts without producing the definitive precedent the crypto community was hoping for.

The IRS issued Revenue Ruling 2023-14 confirming its position that staking rewards are includible in gross income at their fair market value at the time of receipt -- meaning staking rewards are ordinary income in the year received, not capital gains. This is the conservative interpretation and the one that most crypto tax professionals recommend following until a court definitively rules otherwise. The cost basis of the staking rewards is the fair market value at time of receipt, establishing the starting point for any subsequent capital gain calculation when the rewards are eventually sold.

The practical implication for staking investors: keep records of every staking reward you receive, the date of receipt, and the fair market value of the reward at the time of receipt. Crypto tax software platforms automatically pull this data from supported networks and exchanges, calculating your ordinary income from staking and your subsequent capital gains or losses when you sell the rewarded tokens.

05 -- THE CLARITY ACT REPORTING FRAMEWORK: WHAT IS COMING IN 2027

The CLARITY Act includes a comprehensive broker reporting framework that will require digital asset brokers -- exchanges, custodians, and certain DeFi platforms -- to issue 1099-DA forms to customers and report transaction data to the IRS beginning with transactions that occur in calendar year 2027. Understanding the CLARITY Act reporting framework helps investors prepare for the enhanced compliance environment that is coming regardless of current reporting practices.

The 1099-DA -- the digital asset equivalent of the 1099-B form that stock brokers issue for securities transactions -- will include the gross proceeds from each digital asset transaction and, where available, the cost basis information that allows the IRS to calculate gains and losses without relying solely on self-reported data from taxpayers. The CLARITY Act reporting requirements apply to digital asset brokers as defined in the bill -- entities that regularly provide facilitation services for digital asset

transactions.

The Infrastructure Investment and Jobs Act of 2021 had previously enacted broad broker reporting requirements for crypto that were scheduled to take effect in 2023, but the IRS delayed implementation multiple times due to concerns about the breadth of the definition and the practical challenges of applying traditional broker reporting requirements to decentralized protocols. The CLARITY Act provides a more precise definition of digital asset broker that exempts validators, developers, and non-custodial software providers from the reporting requirements -- aligning with the CLARITY Act Sections 309 and 409 protections for these participants documented in the Alain AI Lab developer protections report.

06 -- TAX LOSS HARVESTING: THE LEGAL STRATEGY THAT REDUCES YOUR TAX BILL

Tax loss harvesting is the practice of selling crypto assets that have declined in value below your cost basis to realize capital losses that can offset capital gains from other transactions -- reducing your overall tax liability. Unlike stock investments, crypto assets are not subject to the wash sale rule that prevents stock investors from repurchasing the same security within 30 days of selling it at a loss.

The absence of a wash sale rule for crypto is one of the most significant tax advantages available to crypto investors. If you bought one Bitcoin at $80,000 and it is currently trading at $63,000, you can sell it to realize a $17,000 capital loss -- and immediately repurchase Bitcoin at $63,000, establishing a new cost basis, without any waiting period. The $17,000 loss can offset $17,000 in capital gains from other crypto or stock transactions in the same tax year, reducing your tax liability by up to $6,800 if you are in the 40% combined federal and state tax bracket.

The CLARITY Act includes a provision that would apply the wash sale rule to digital assets beginning after its enactment -- meaning the crypto tax harvesting window that currently exists may close when the CLARITY Act is signed. Investors who want to capture the wash sale advantage for crypto losses should consult with a qualified tax professional about harvesting losses before the CLARITY Act takes effect.

07 -- CONCLUSION: THE COST OF IGNORANCE IS HIGHER THAN THE COST OF COMPLIANCE

The IRS treats unreported crypto gains the same way it treats unreported gains from any other investment: as tax evasion, subject to civil penalties of 20% to 75% of the unpaid tax plus interest, and in cases of willful evasion, criminal prosecution. The IRS John Doe summons program -- which has compelled Coinbase, Kraken, Poloniex, and other exchanges to turn over customer transaction data -- has resulted in thousands of taxpayers receiving IRS notices requiring explanation of unreported crypto gains.

The cost of getting crypto taxes right -- crypto tax software subscription of $50 to $200 annually, and potentially a consultation with a CPA who specializes in crypto taxation -- is trivially small compared to

the cost of IRS enforcement, penalties, and the stress of responding to a tax examination. The investors who have built significant wealth through the Bitcoin and crypto institutional adoption thesis documented throughout the Alain AI Lab research library need to protect that wealth with the same diligence they applied to building it.

The practical action items from this report are simple: open an account with a crypto tax software platform and connect all your exchanges and wallets, review your transaction history for the current and prior tax years, consult with a crypto-specialized CPA if your situation is complex, and file accurate returns that reflect all taxable events. The blockchain is permanent and transparent. The IRS has the tools to read it. Proverbs 11:3 says the integrity of the upright guides them. In crypto taxes as in everything else, doing the right thing is both the ethical choice and the strategically sound one. The cost of ignorance is always higher than the cost of compliance.

> ***IRS rule since 2014: crypto is property and every disposal is a taxable event. Selling, trading, spending, and receiving crypto as income all trigger tax obligations. FIFO is default but HIFO minimizes gains. Staking rewards are ordinary income at fair market value upon receipt. Tax loss harvesting is legal and powerful. CLARITY Act adds 1099-DA reporting from 2027. Use crypto tax software. The cost of ignorance is higher than compliance.***
