Earning rewards

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Staking & Yield Farming

Uber summary

- **Staking**: Putting a crypto asset on deposit to earn a yield.
- **Yield farming**: Putting crypto assets, commonly as a pair, into a pool to earn a yield.

Staking overview

Staking is depositing crypto assets to earn returns, referred to as ‘rewards’. Some staking platforms are flexible, allowing the depositor to withdraw at an time. Others offer a variety of terms, with the longer durations offering a higher yield. From a taxation perspective, staking a coin which can appreciate in value while receiving rewards is often compared to owning rental home which can appreciate in value while receiving rental income or like owning a business which generates income.

Yield farming overview

Yield farming refers to when a user provides capital, usually in the form of two and occasionally three different cryptos, to a decentralized exchange, which is used to provide a pool of liquidity from which traders can buy and sell. The pool generates fees, which then in turn provides a ‘yield’ to the depositor. The yield is often paid in the form of that platform’s tokens, the tokens that are in the pool, or any combination of those.

Terms

- Reward: In the financial area of cryptocurrency a ‘reward’ is a generic term that refers to some type of earning that a user receives. It can be in the form of payment in exchange for providing capital to a liquidity pool, or for fees generated from a crypto service. Rewards would typically be quite comparable to “payment” or “interest” in terms of traditional finance.
- Liquidity provider aka LP: A liquidity provider is an individual who provides crypto to a decentralized platform so that traders will have a pool of capital to access for buying and selling.
- Divergence loss (aka impermanent loss): Divergence loss is an item associated with yield farming. It occurs most commonly when two assets in a liquidity pool go out of balance, triggering a mechanism in the pool to sell one asset at a loss compared to the market price, or to buy the other at a premium above market price, in order to bring the pool back into balance. The common variant “impermanent loss” is likely a comfort term, referring to the possibility that the divergence losses incurred can be offset gradually over time as the depositor earns a yield by being a participant in the pool. To make a real estate analogy: You buy a rental property for $500,000 and rent it out to receive $1,500 in monthly rent. It then drops in value to $450,000. The $50,000 loss is “impermanent” because the loss can be gradually offset by the rental income. The use of comfort terms can muddy the waters, so the term “divergence loss” is superior.

Staking & Yield farming compared

- Staking often (but not always) has a set time frame before you can withdraw. Some staking platforms offer a variety of terms, with a higher yield offered for a longer term. Yield farming is usually flexible, allowing for withdrawals at any time.
- Yield farming often offers higher yields than staking in order to offset the risk of divergence loss.
- Yield farming platforms sometimes offer the flexibility to aim for higher yields (such as in “concentrated liquidity pools), but the offsetting issue is that it requires more monitoring, is likely to result in more frequent payment of fees to adjust, and can result in larger divergence losses.
- Staking: Simpler, lower risk, usually lower yields
- Yield farming: More complex, higher risk, more management, usually higher yields

What we bring to the table:

- Extensive experience in crypto, business, and taxation strategies.
- A team comprised 100% of crypto enthusiasts who are personally familiar with crypto platforms, products, and taxation.

How we can help you:

- Get us working for you to generate your annual tax reports, to implement a tax-smart crypto plan, and to collaborate with your tax advisor.
- Get in touch for a host of free resources and to join one of our private crypto communities so you can learn from others, participate in routine webinars, AMAs, and round table events.
- Initial consultations are always free.

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