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Treasury Delivers Mother Lode of Tax Reporting Rules to the Crypto Industry's Doorstep

On August 29, 2023, the IRS published detailed proposed regulations addressing digital asset broker reporting requirements (the “[Proposed Regulations](#)”). The Proposed Regulations elaborate on the 2021 changes to the Internal Revenue Code that expanded the definition of broker to include “any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person” (as we discussed [here](#)).

The 282 pages of Proposed Regulations can be boiled down to these bullets:

- Digital assets subject to crypto broker reporting include (among others) cryptocurrencies, stablecoins, and non-fungible tokens;
- Players treated as reporting brokers include crypto platforms and exchanges, payment processors, and certain wallet providers, BUT NOT miners and stakers;
- The proposed rules take effect in two stages: first, reporting of gross proceeds from digital asset sales begins in 2025, and second, reporting of tax basis and tax character from digital asset sales begins in 2026; and
- Only the largest of the digital platforms and intermediaries may have the resources to comply with the Proposed Regulations, and smaller market participants may be potentially driven out for lack of tax compliance resources.

As amended in 2021, Sections 6045 and 6045A impose mandatory tax reporting requirements for brokers of certain digital asset transactions. Generally speaking, Section 6045 requires brokers to report certain information about taxpayers, including names and addresses, as well as certain information about the property underlying the transaction, including the sale date and gross proceeds of a sale (and for so-called covered securities, the adjusted basis of the property sold and the character of any gain or loss) as well as to furnish payee statements to

customers. The Proposed Regulations expand upon these reporting obligations for digital asset brokers and, in many ways, are quite broad in scope.

Some key takeaways from the Proposed Regulations include:

- **Broker is defined broadly.** The Proposed Regulations do not separately define broker for digital assets but utilize the existing definition of broker in the Treasury Regulations (e., a person that in the ordinary course of business stands ready to effect sales to be made to others). However, the Proposed Regulations modify the word “effect.” Under this expanded definition, any person that provides facilitative services that effectuate sales of digital assets by customers will be considered a broker, provided that the person is in a position to know the identity of the party that makes the sale and the nature of the transaction, potentially giving rise to gross proceeds. The Proposed Regulations refer to this person as a Digital Asset Middleman. The implications of this broader definition of broker are that virtually anyone facilitating sales of crypto assets may be subject to these broker reporting rules (e.g., online trading platforms, hosted wallets, decentralized autonomous organizations (“DAOs”)). Additionally, the definition of broker includes so-called digital asset payment processors (i.e., persons that facilitate payments from one party to a second party by receiving digital assets from the first party, exchanging them into different digital assets or cash, and then paying the resulting property over to the second party).
- **Importantly, some persons are excluded from the broker definition.** As previously mentioned [here](#), the Act’s broad definition of broker created practical concerns that various actors who facilitate digital assets generally could be subject to the broker reporting rules irrespective of whether these persons would be in a position to obtain the necessary information from end users. The Proposed Regulations effectively exclude the following persons from broker status: persons providing validation services (e.g., miners and stakers), sellers of hardware or licensing, retailers accepting digital assets as a form of payment, and certain NFT creators.
- **Digital assets include more than crypto.** As defined in the Proposed Regulations, digital assets broadly include any digital representation of value that is not cash and is recorded on a cryptographically secured distributed ledger (or any similar technology), without regard to whether each individual transaction involving that digital asset is actually recorded on that ledger. Further, the Preamble to the Proposed Regulations clarifies that digital assets also include non-fungible tokens and stablecoins. Thus, transactions in various asset classes may be subject to the broker reporting rules.
- **Specific rules are provided for determining amount realized and allocating basis for digital asset transactions, as well as special realization rules.** The Proposed Regulations provide that when calculating gain or loss on digital asset transactions, amount realized is calculated as cash received, plus fair market value of property received, plus the fair market value of services received, less any transaction costs incurred at the time of the subsequent sale or exchange. Adjusted basis is generally cost basis, plus any share of transaction costs incurred at the time of acquisition. For reporting purposes, gross proceeds are also calculated in the same manner as amount realized. The Proposed Regulations provide specific rules for allocating these

transaction costs (e.g., fees charged by trading platforms to exchange one digital asset for a different digital asset).

- **The timeline may be administratively burdensome.** At 282 pages in total, the Proposed Regulations, together with the Preamble, provide a significant amount of information that market participants need to absorb (and which potential digital asset brokers need to update their internal compliance systems to address). The Proposed Regulations are generally effective in two stages: brokers (i) would be required to report gross proceeds of digital asset sales, in addition to taxpayer information, after January 1, 2025; and (ii) subsequently would be required to report tax basis and character for digital asset sales after January 1, 2026. It remains to be seen, however, whether market participants can enact systems to manage this compliance within that timeframe.
- **The reporting requirements include a new form.** IRS Form 1099-DA is set to be published in 2024 to handle crypto broker reporting requirements in lieu of existing IRS Form 1099-B. This new, yet to be released form will add further complexity and pressure to update compliance systems in a timely manner to satisfy the broker reporting requirements. Information required to be obtained and reported under the Proposed Regulations would include the following: a customer's name and address, name and number of units of the digital asset sold, date of the sale, and gross proceeds of the sale. Additionally, the Proposed Regulations would require digital asset verification information: transaction IDs, digital asset address, and an indication of the type of consideration received.

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