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IRS Floats First-Ever Broker Rules For Digital Asset Sales

By **Kat Lucero**

Law360 (August 25, 2023, 4:04 PM EDT) -- Brokers of digital assets would face tax reporting requirements similar to those for brokers of securities and other financial instruments under the first-ever proposed rules governing assets such as cryptocurrency and nonfungible tokens, released Friday by the Internal Revenue Service.

The IRS released its first-ever rules governing assets such as cryptocurrency and nonfungible tokens. (AP Photo/Patrick Semansky)

Digital asset brokers would need to file information returns and payee statements on the sale of the assets for customers in certain transactions under Internal Revenue Code Section 6045, according to the **proposed rules**. These brokers include trading platforms, payment processors, wallet providers and individuals who offer to redeem assets that were created or issued by that individual. The rules would begin applying in 2026 for transactions from the previous year.

By completing a new form called Form 1099-DA, brokers can assist taxpayers in assessing their tax obligations and avoiding complicated calculations or pay digital asset tax preparation services to file tax returns, according to the IRS. The 282-page proposal also recommended that brokers in certain circumstances include gain or loss and basis information for sales that take place on or after Jan. 1, 2026, so that customers have the information they need to prepare their tax returns.

The proposed rules are in line with tax reporting regulations on other types of assets to avoid preferential treatment, and they are part of broader enforcement on wealthy taxpayers seeking to circumvent tax rules and payments, Internal Revenue Commissioner Daniel Werfel said in a statement.

"We need to make sure digital assets are not used to hide taxable income, and the proposed regulations are designed to provide a clearer line of sight into activities by high-income people as well as others using them," Werfel said. "We want to make sure everyone pays what they owe under the tax laws, and our research and experience demonstrate that third-party reporting improves compliance."

The rules implement a provision of the Infrastructure Investment and Jobs Act, enacted in 2021, that called for **increased reporting** on digital asset brokers. In a July **revenue ruling**, the IRS clarified that a cryptocurrency holder who earned additional tokens or coins from validating transactions in a blockchain or crypto exchange — a process called staking — should report the value of those rewards as part of gross income. The guidance speaks to a pending **lawsuit** in the Sixth Circuit against the agency's treatment of a couple's income earned from staking activities.

Much of the digital asset reporting provision in the 2021 law is drawn from the Organization for Economic Cooperation and Development's crypto-asset reporting **framework** that members approved in 2022 to address the rapid adoption of such assets that can be transferred and held without banks and other traditional financial intermediaries.

The IRS and other tax authorities will need to prepare for the influx of information generated by broker reporting, according to Garrett L. Brodeur of Kostelanetz LLP.

"Whether and how authorities need to make material adjustments to best utilize new third-party information will be a topic of intriguing discussion, both within the government and in private circles," Brodeur told Law360.

Real estate brokers, mortgage lenders, title companies and closing attorneys would also need to disclose in their tax returns transactions that use digital assets to purchase real estate, as well as supply payee statements on the assets' fair market value from the sellers, according to the proposal.

Although the U.S. Department of the Treasury acknowledged that nonfungible tokens are different from other digital assets such as cryptocurrencies, the proposal ultimately deemed that transactions that use NFTs are subject to the additional reporting requirements. Back in March, the IRS **announced** that it plans to float guidance treating NFTs as collectibles under IRC Section 408(m).

NFTs, which may represent artwork, antiques, music, films, fashion design and other entertainment memorabilia, are bought, sold and traded on digital asset trading platforms similar to other digital assets, and such transactions will trigger a gain or loss, the proposal said.

"The reporting of gross proceeds and basis information is equally useful to taxpayers and the IRS as reporting on other digital assets," the proposal said.

Treasury was careful in the proposed regulations to differentiate between the types of digital assets that are reportable and the "actual characterization of different types of digital assets as a matter of substantive law," Travis W. Thompson of Sideman & Bancroft LLP told Law360.

The inclusion of NFTs in the proposed rules may be concerning for stakeholders because there has not been a lot of IRS guidance on the matter, according to Joshua Smeltzer, partner at Gray Reed.

"There will need to be a real discussion in comments provided to the IRS about making that a workable reporting regime and potentially carving out specific NFTs from the requirements at all," Smeltzer told Law360.

"This will be true of many industries now subject to these rules as the IRS tries to balance obtaining the information it needs without creating duplicative reporting obligations or unnecessary compliance expenses for assets that do not actually require informational reporting," Smeltzer said.

"I expect to see a lot of comments from both tax advisers and industry professionals to make sure that the lines are not drawn too broadly," he said.

--Editing by Neil Cohen.