Broker Crypto Tax Information Reporting Is Here, But It May Not Be Just for Brokers Anymore

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Nelson Suit, Cyrus E. Daftary, and Phil Garlett consider the cryptocurrency information reporting provisions in the Senate Infrastructure Bill and the broader implications of tax information reporting for crypto transactions. The proposed legislation would require "brokers" to provide Code Sec. 6045 cost basis reporting for sales of digital assets and Code Sec. 6045A transfer reporting on transfers of such assets.

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A. Introduction

Who would have thought that something as arcane as tax information reporting would be in the thick of debate over the $1.2 trillion Infrastructure Bill passed by the U.S. Senate in August?

The Infrastructure Bill,[1] formally known as the Infrastructure Investment and Jobs Act, prescribes expanded broker tax information reporting for cryptocurrencies and other digital assets. Largely due to a broadly worded definition of what a "broker" might be, the tax information reporting provisions that were intended to offset the bill's costs by $28 billion raised a firestorm of criticism from participants in an increasingly diverse digital asset ecosystem.

The ensuing debate placed the niche world of tax information reporting in the limelight. And, with the exponential growth of crypto-related products and services, the government's concern over a large cache of unreported income, and an industry adamant that misguided regulation would stifle innovation, this is likely to remain so.

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Oddly, tax information reporting returns—that lowly medley of Forms 1099-B, 1099-MISC, 1099-NEC, 1099-K, 1099-DIV, 1099-INT as well as Form 1042-S and Foreign Account Tax Compliance Act ("FATCA") reporting—lie at the intersection of these warring forces.

This article provides an overview of the crypto tax reporting amendments contained in the Infrastructure Bill, including new definitions of broker, digital assets and covered securities subject to both cost basis and transfer reporting. It also considers the broader implications of these provisions and existing tax information reporting rules to increasingly diverse crypto products, services and platforms.

B. Crypto Tax Provisions in the Infrastructure Bill

The Infrastructure Bill includes five significant proposed amendments (referred to below for simplicity as "amendments") to existing tax information reporting rules:

1. Broker Definition Expanded

Code Sec. 6045(c) would be amended to define a broker as including "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."

Without the amendment, Code Sec. 6045(c) defines a broker simply as a dealer, a barter exchange and "any other person who (for a consideration) regularly acts as a middleman with respect to property or services." In the tax reporting context, a "middleman" is generally thought of as a broker, nominee or another person that acts as an intermediary between payor and payee.[2]

Code Sec. 6045(a) authorizes the IRS through regulations to require a broker to file tax information returns reporting the name and address of each customer, with details of gross proceeds and such other information as provided in regulations. Such returns and the associated statements for customers are to be filed or furnished in the manner as directed by Treasury regulations.

Reg. §1.6045-1 and IRS form guidance currently provide rules requiring brokers to issue information returns on Form 1099-B, *Proceeds from Broker and Barter Exchange Transactions*, to report sales of securities and commodities for cash. In the case of certain securities classified as "covered securities," brokers are also required to maintain cost basis information and report cost basis on the disposition of such securities. The same information is provided in a recipient statement to customers.[3]

Interestingly, the Treasury has included tax information reporting for virtual currencies under Code Sec. 6045 as a regulatory project on its Priority Guidance Plan for the last couple of years. Industry and advisors had been expecting the issuance of those regulations as applied to digital assets even prior to the inclusion of the tax reporting provisions in the Infrastructure Bill. And there were expectations that those regulations would have brought centralized crypto exchanges within the scope of broker reporting.

What drew the ire of industry participants and at least a handful of Senators when it came to the tax reporting provisions of the Infrastructure Bill, however, was the sheer broadness of the definition of broker in the Code Sec. 6045 amendments. Industry participants voiced their concern that the definition of "broker" in the Infrastructure Bill would bring into scope certain non-custodial actors within the crypto ecosystem such as blockchain validators, sellers of hardware and software wallets, and software protocol developers.[4]

A person that regularly provides "any service effectuating transfers of digital assets on behalf of another person" could have a broad reach in a blockchain ecosystem that has significantly expanded beyond trading of bitcoin and ether.[5]

Several proposed amendments to limit the scope of the definition of broker never made it into the final Senate bill; in part, it appeared due to procedural hurdles. Those amendments, however, would have potentially only carved out blockchain validators such as miners and stakers and sellers of hardware and software wallets that provide no other service to purchasers.

The broadness of the broker definition allows Treasury to define the parameters of reporting persons in the digital asset space. It would be able to include centralized exchanges certainly. But this language also left room for the Treasury to bring within the broker reporting framework other crypto platforms that increasingly raise tax gap concerns for the government such as decentralized exchanges and peer-to-peer marketplaces. That is, if Treasury can figure out who could be made responsible for such reporting. But more on that later.

2. Digital Assets Defined

Amended Code Sec. 6045 would also define digital assets as "any digital representation of value that is recorded on a

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cryptographically secured distributed ledger or any similar technology as specified by the Secretary." This definition includes common cryptocurrencies but could have broader application to other digital assets such as non-fungible tokens or NFTs, or perhaps other crypto tokens that are being developed.

Under the existing Code Sec. 6045 regulations, institutions facilitating crypto asset transactions (not to mention tax practitioners) have been faced with a multitude of questions when it came to the applicability of broker reporting regulations to digital assets. Existing regulations require reporting by brokers of sales of certain securities and commodities for cash, but that is just where the questions begin when it comes to digital assets.

For example, assuming virtual currencies were generally not securities,[6] could they be characterized as commodities? Commodities for purposes of the broker reporting regulations include any "type of personal property or an interest therein (other than securities …) the trading of regulated futures contracts in which has been approved by the Commodity Futures Trading Commission." Aren't there bitcoin and ether futures contracts traded on the CME? But then would cryptocurrencies only be reported if there were corresponding futures contracts? That would provide an odd result from a practical standpoint, if a customer trades bitcoin and say dogecoin but is only reported on bitcoin trades.[7]

The new definition of digital assets in the Infrastructure Bill and the requirement that brokers report on digital assets skirt some of these more existential questions of whether a digital asset may be a security or commodity by simply defining digital assets and requiring their reporting. Presumably, the IRS would be able to further delineate the applicability of the reporting rules to different categories of digital assets.

3. Covered Securities and Basis Reporting

Beyond simply including digital assets within the fold of broker reporting, the new tax reporting amendments also specifically classify digital assets as "covered securities" if acquired on or after January 1, 2023.

The import of this change is that covered securities under Code Sec. 6045 are subject to cost basis reporting by the broker. For covered securities, brokers need to identify initial acquisition cost at the tax lot level, monitor changes to basis during the holding period and report adjusted tax basis on disposition.[8] Cost basis traditionally required adjustment for such events as wash sales, corporate action events, gifts and inheritance and accretion and amortization with respect to debt instruments. Brokers also need to manage customer lot relief elections (*e.g.,* FIFO or specific identification of lots), as well as elections relating to accounting for premiums and discounts on debt.

Moreover, cost basis reporting means reporting gains or losses with respect to a sale and determining whether the gain or loss is long-term or short-term.

Cost basis reporting for crypto assets may be different than that for traditional securities, but the cost basis requirement in the Infrastructure Bill significantly increases the complexity of reporting digital asset sales. For example, instead of adjusting the basis of a stock subject to a corporate spin-off, the tax operations team may be accounting for basis in a legacy coin and a new coin that result from a crypto hard fork.

4. Transfer Reporting

The amendments don't end there. With digital assets classified as covered securities if acquired on or after January 1, 2023, they fall within the transfer statement provisions of Code Sec. 6045A.

Code Sec. 6045A currently governs the production of transfer statements when accounts are transferred between brokers. When a customer moves securities from an account with one broker (the sending broker) to an account at another broker (the receiving broker), the sending broker is required to provide a transfer statement to the receiving broker essentially containing cost basis information on covered securities being transferred. While the required information to be included in a transfer statement is identified in Treasury regulations, there is no defined format except that it needs to be in writing unless the parties agree otherwise.[9] As a practical matter, such transfer statements are often furnished electronically.

As covered securities, digital assets would be subject to this transfer statement requirement. But the nature of digital asset transmission and the possibility that a customer could at any time initiate a transfer of part or all of its holding in one or more digital assets from one exchange to another may create a range of issues for systems that will need to handle transfer of basis information for disparate lots of crypto assets. Systems, for example, may need to recognize addresses for brokers and allow customers to select which tax lots are being transferred where the transfer covers only partial holdings. Parties will also need to agree on the format of these transfer statements.

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If that were not enough, the Infrastructure Bill includes new Code Sec. 6045A(d), which would require a broker to report transfers of digital assets to an account or address *not* maintained by a broker—for example, private wallets.[10]

5. Receipt of Digital Assets

Outside the realm of broker reporting, the Infrastructure Bill would also amend Code Sec. 6050I. Code Sec. 6050I requires reporting of certain receipts of cash in excess of $10,000. The provision applies to any person engaged in a trade or business and who, in the course of such trade or business, receives more than $10,000 in cash in one transaction or two or more related transactions, though there is an exception for certain financial institutions already subject to similar Title 31 currency transaction reporting rules.

For purposes of Code Sec. 6050I, the Infrastructure Bill treats digital assets as cash.

C. Implications for Exchanges

1. Form 1099-B Reporting

Even as some of the parameters for being a "broker" under the new crypto tax reporting provisions are being debated, what seems evident is that the Infrastructure Bill would require centralized crypto exchanges to report trades of digital assets. What is also clear is that such brokers would need to maintain and report cost basis with respect to digital assets, at least on a go-forward basis for digital assets acquired on or after January 1, 2023.

Since broker reporting currently utilizes a Form 1099-B format, it is expected that reporting of crypto asset trades would occur in a similar manner. In contrast, some crypto exchanges have reported sales to certain customers in prior years on a Form 1099-K. Form 1099-K, in part, is used by third-party payment processors to report payments to vendors or service providers generally in some sort of multi-vendor platform (*e.g.*, PayPal in the context of eBay sales). While Form 1099-K reporting for crypto trades provided some information to the IRS even as it limited customer filings due to historic Form 1099-K filing thresholds, the filings have also resulted in confusion both at the IRS and at the customer level since Forms 1099-K were not designed for transactions that trigger capital gains and losses as investor crypto trades do.

Some centralized exchanges, thus, would be transitioning from a Form 1099-K to a Form 1099-B reporting format. Besides inclusion of cost basis information, Form 1099-B has no minimum filing threshold and, at least for traditional brokerage accounts, brokers are required to have customers not only provide a taxpayer identification number ("TIN") but certify, under penalties of perjury, that it is correct on a Form W-9. In contrast, Form 1099-K for a third-party payment processor historically needed only to be filed for customers with more than 200 transactions *and* more than $20,000 in transactional value for the year. A TIN also did not require certification for a payment subject to 1099-K reporting. It is to be noted though that the American Rescue Plan Act of 2021 modifies the Form 1099-K filing threshold to payments of $600 or more beginning in 2022, and there are proposals in the works for certified TINs to be provided to payors of most types of income payments.

Other exchanges may not be currently reporting crypto trades. They may be at different stages of preparedness for Form 1099-B reporting. Some, as a matter of customer service, provide tools for customers to obtain tax reports detailing sales transactions with dates of acquisition and disposition, cost basis, and realized gains and losses. While there may still be a lift to map such data points to a format necessary for Form 1099-B reporting to the IRS, some of the core cost basis functionality and sales and gain or loss data points would already be residing in the exchange's transactional database. Still, for tax return filing with the IRS, such data points will need to be translated into the required format for the IRS's Filing Information Returns Electronically ("FIRE") platform.

Other exchanges that do not currently report crypto trades may be less prepared. They may need to begin an assessment of their readiness to report sales proceeds and manage basis data points to generate the requisite IRS information return reports and applicable client statements.

Given IRS enforcement efforts from the perspective of individual crypto investors (*e.g.,* everything from IRS information letters sent to crypto account holders[11] to the crypto tax question on the front page of Form 1040), there has been increasing demand by customers for tax-relevant information that they can use in completing their individual tax returns. One approach firms may be taking in preparing for IRS tax reporting readiness is actually to satisfy this demand through customer-oriented tax utility tools.

These tools often allow customers to track basis and realized and unrealized gains and losses on crypto trades. The tools may also provide customers transparency as to which tax lots may have a loss that can be harvested prior to realizing a gain on another lot. The thinking is that this basic customer-oriented system, if aligned with expectations of what will be required eventually for Form 1099-B reporting, would create the foundation for future tax information reporting compliance.

And this work can proceed even while the IRS prepares tax regulations for crypto tax reporting.

Finally, a few exchanges have been reporting crypto trades for customers on a Form 1099-B. They may be sitting in the catbird seat. In such cases, they may have been reporting proceeds of sale to the IRS and have worked through some of the rigors of IRS tax information reporting. Such exchanges may also be providing cost basis and short-term or long-term gain or loss data to customers for informational purposes. Thus, the transition to full Form 1099-B cost basis reporting may not be as burdensome.

Even for these firms, however, there may still be a need to vet existing core cost basis functionality to determine whether existing processes and policies are working as required as cost basis reporting becomes a mandatory requirement.

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2. Is Cost Basis for Crypto Really a Big Bad Wolf?

Cost basis reporting for securities is complex. In addition to managing basis determinations for such varied transactions as short sales, wash sales, gifts and inheritances, sales under different lot relief methodologies, and mutual fund holdings, brokers must also adjust basis for myriad corporate action events, from stock splits and reverse stock splits to corporate mergers and spin-offs.

In addition, where debt securities are involved, there is a whole additional layer of complexity since brokers need to address accretion and amortization issues and various customer-level debt elections in maintaining cost basis. Brokers track OID, market discount, bond premium, acquisition premium and for complex debt such as contingent payment debt instruments such items as negative adjustment carryforwards.

With digital assets, some of the complications of corporate actions and debt adjustments may not be relevant. More, under current law, wash sales rules may not be applicable at least for cryptocurrencies since they may not be securities.[12]

So how difficult will cost basis reporting be for digital assets?

There are at least three areas where there could be challenges to broker systems.

First, while there may not be the traditional corporate actions events *per se*, there are crypto-related events to contend with. Hard forks come to mind. In a crypto hard fork, a change to the software protocol underlying a cryptocurrency's blockchain may result in the creation of a new "coin" that now exists alongside the legacy coin. From the IRS's perspective as set forth in Rev. Rul. 2019-24, such hard forks are generally taxable events, with the fair market value of the new coin includible in income at the time the coin holder obtains dominion and control.[13]

Presumably, this means that cost basis from the legacy coin is not allocated between the legacy and new coin. Instead, the broker may need to determine cost basis in the new coin in U.S. dollars based on the fair market value of the new coin when "dominion and control" occurs. This can be tricky at times. There may be delay from the time of the hard fork and the time that a broker determines it can support the new coin. There may be pricing uncertainties immediately before and after hard forks. The amount reported as cost basis would presumably also need to be reported as income to the recipient on a Form 1099-MISC for the year of receipt. Thus, the timing and amount of receipt can potentially impact multiple Forms 1099.

There are also events such as airdrops, rewards from staking coins or "inflation rewards" received by holders of certain other tokens.

This brings us perhaps to a second area where brokers may see challenges in cost basis reporting. There are likely other services and products that an exchange offers that allow account holders to receive new tokens (as discussed below in more detail). Tokens may also be received as part of crypto lending transactions or as rebates from crypto-linked payment cards or simply as incentive rewards, whether for recommending new customers or for spending time learning about a new cryptocurrency. Brokers would need to track basis for these coins acquired through multiple channels and not simply trading.

Lastly, given the requirements in the Infrastructure Bill for brokers to comply with transfer information reporting, the entire process of transmitting and receiving cost basis information at the tax lot level will require not only systems builds but likely industry consensus on such transmissions—in particular with respect to broker-to-broker transmissions.

These transmissions will require a robust core cost basis functionality that monitors cost basis at the tax lot level since the transfer requirement is in effect a requirement for transmitting cost basis information maintained by the sending broker. Brokers will still need to monitor such activities as intra-day trades, basis adjustments for gifts and inheritances, taxpayer elections on lot relief methodology, long-term vs short-term gains or losses, *etc*. They will also need to address the impact of network transaction fees that are paid in cryptocurrency to the network as part of a transfer from one blockchain address to another. Moreover, the landscape is ever evolving, and brokers may need to address such issues as wash sales if new legislation closes that perceived loophole with respect to digital asset trading,[14] or perhaps short sales or options trades on digital assets. There is currently a proposal to amend wash sales rules to apply to digital assets.

Thus, while cost basis for crypto may not be as complex as accounting for complex debt in cost basis calculations, it likely will not be a sheep in wolf's clothing either.

3. Decentralized Exchanges

Perhaps the big unknown on the reach of the new broker crypto tax reporting provisions is in the arena of decentralized exchanges or DEXes. The Treasury appears concerned that taxpayers may avoid tax by trading on these exchanges, which theoretically are designed to match buyers and sellers on a peer-to-peer level. DEXes are by nature non-custodial. This is unlike centralized exchanges where private keys for cryptocurrency to be traded by a customer are generally controlled by the centralized exchange.

We understand that prior to the issuance of the Senate Infrastructure Bill, a version of the crypto tax reporting provisions was circulated to industry participants for comment. That version apparently included language in the broker definition that specifically includes decentralized exchanges and peer-to-peer marketplaces as brokers.

The challenge with imposing tax information reporting on decentralized exchanges is that these platforms may not have a single "person" on whom such obligations can be imposed. Governance of the protocol may be controlled through voting by widely held holders of the DEX's own crypto governance token, which creates a decentralized governance structure. Commissions from trading may be channeled not to a central party but to persons who provide liquidity to the marketplace.

But there are likely varying degrees of decentralization with respect to such platforms and further study of the legal and operational aspects of such DEXes may be needed to reframe tax information reporting rules that traditionally have relied on central intermediaries. Perhaps in certain cases, if governance of a DEX is concentrated with certain related token holders, such token holders may be held responsible for designating a responsible reporting party? Or could a DEX be otherwise required or incentivized to build into its protocol a requirement to obtain tax information from participants on the exchange as well as have capacity to designate a vendor to conduct required tax reporting?[15]

D. Beyond Crypto Trading

1. Brave New World

The uproar by the crypto industry on the scope of the Infrastructure Bill's "broker" definition is indicative of how broad and diverse crypto-related products, services and platforms have become. Projects with respect to blockchain technology especially in the decentralized finance ("DeFi") space have grown exponentially, from DEXes to creation of stablecoins to crypto lending to a multitude of payment protocols.

These projects all raise tax and tax information reporting issues given the IRS's classification of virtual currency as property. Anytime there is a transfer, there is a potential sale event. Moreover, payment goes to the heart of many tax information reporting regimes, from broker reporting to miscellaneous income reporting to payment card and third-party payment processing.

Even in the world of centralized exchanges, crypto-related product and service offerings are expanding.

2. Crypto Lending

For example, some firms are allowing customers to lend their digital assets and earn rewards in crypto as a return. Crypto lending raises a number of substantive tax questions and by extension tax reporting issues, since correct tax reporting is often dependent on the substantive tax treatment.

For crypto lending, other authors have considered whether the act of lending digital assets itself gives rise to a sale of the lent assets, generally arguing for the position that such lending may not give rise to a taxable event.[16] But likely this would be dependent on an analysis of the actual legal agreements in place for the lending relationship and the specific terms

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and conditions of such arrangements, including terms affecting the respective rights of the parties to the lent property, the party bearing the risk of loss and having the opportunity for gain, and whether what is received in return in the transaction is materially different than what was lent.

In the case where there is a taxable sale, the broker crypto tax provisions may come into play. Even assuming the lending itself is not a reportable sale, a firm facilitating crypto lending would still need to address the reporting with respect to lending rewards.

Lending rewards are sometimes stylized in marketing materials as "interest" earned in lending cryptocurrencies. But as crypto assets are generally property and not money, such lending generally does not give rise to a debt obligation. Thus, no interest.

However, the case is not as clear with respect to the lending of stablecoins that may be pegged to U.S. dollars. Such coins may be backed by a deposit of actual U.S. dollars at a designated custodian. Could rewards associated with certain stablecoin lending be classified as interest for tax purposes?

From a tax information standpoint, institutions are generally tracking such lending rewards and reporting them to customers on a Form 1099-MISC. If the lending reward (*e.g.,* for stablecoin lending) were interest, however, the correct reporting form would be Form 1099-INT. Though both forms report the income to both the IRS and recipient, the filing threshold for a Form 1099-MISC is $600 compared to a $10 filing threshold for Form 1099-INT.

Characterization of lending rewards as interest or other income also has broader cross-border withholding and reporting implications where a customer receiving such income is not a U.S. person. Certain interest payments may be exempt from withholding if the recipient is documented as a non-U.S. person on a Form W-8, but if the rewards were "other income" and determined to be from U.S. sources, they may instead be subject to 30% withholding absent reduction under an eligible tax treaty claim.

In either case, Form 1042-S reporting would be required. Characterization and sourcing of such payments, as discussed below, become more and more critical as crypto transactions move away from mere trading.

3. Staking

Certain cryptocurrencies utilize what is called a Proof of Stake ("PoS") consensus protocol. A consensus protocol is a mechanism for decentralized computer nodes to agree to the validity of each new transaction block to be added to the chain. It is a fundamental concept in the blockchain technology that underlies crypto assets. Under a PoS protocol, coin holders can "stake" their coins for a chance at validating transactions on the blockchain.

Unlike miners in the more often discussed Proof of Work ("PoW") consensus model, holders who stake do not need to solve complicated equations to validate a transaction, but they are validators nonetheless. Both miners and stakers receive rewards for validating transactions.

> *If one were to look for a message in the Infrastructure Bill tax debate, one of them is that tax reporting for digital assets is here. And the challenges are numerous.*

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The IRS in Notice 2014-21 states that miners realize income when they receive the mining rewards in cryptocurrency based on the fair market value of that reward on the date of receipt.[17] In addition, the notice noted that this could constitute self-employment income, subject to employment taxes in addition to income taxes. In arguments supporting a John Doe summons issued to the Kraken exchange in early 2021, the IRS indicated that it viewed staking rewards also as income.[18]

Firms facilitating staking and crediting customers with staking rewards may be filing Form 1099-MISC reporting the staking rewards as miscellaneous income. But if the income is in some respects in the nature of services income, could Form 1099-NEC be appropriate?

The characterization of staking income likely again matters more from a cross-border perspective. Generally, withholding agents are required to withhold on certain U.S. sourced income payments to non-U.S. recipients. Sourcing rules, however, differ depending on the nature of income.[19]

Cross-border withholding and Form 1042-S reporting are here again dependent on the unclear characterization of the payment.

4. Incentives/Rewards

Exchanges and other crypto facilitators may also provide incentive awards in the form of digital assets to customers. This may be given as part of a referral bonus for a customer to refer another customer or merely for learning about a new token on the platform.

What seems clear as crypto transactions expand from crypto trading to that wider range of crypto activities—from crypto lending to staking to crypto-linked payment cards to minting and selling NFTs—is that there are increasingly broader issues to be addressed from a tax information reporting perspective.

There is less uncertainty about these transactions. Under the long-held tax principle that "pennies from heaven" are includible in income, these rewards should generally be reported on a Form 1099-MISC to U.S. customers.

5. Form 1042-S Reporting

Again, in each of these transactions, as we look beyond mere trading of cryptocurrencies, firms will need to address cross-border withholding and Form 1042-S reporting obligations if they have customers that are not U.S. persons. This also brings forth the critical issue that firms will need to properly document their customers for tax purposes to determine U.S. vs non-U.S. status, as that drives both withholding and tax information reporting regimes.

E. Payments

Along the same vein, the rapidly transforming world of payments can either be described as a tax information reporting specialist's nirvana or nightmare, depending on the specialist's outlook on a singular reporting challenge.

Take crypto-linked payment cards, for example. Debit cards in particular would traditionally lie in the realm of merchant card reporting where merchant card acquirers would be obligated to report on Form 1099-K to vendors. But in the crypto-linked world, crypto assets are often sold in order to make fiat payment through the payment network. This may become a reportable sale under the broker tax reporting provisions.

Moreover, certain cards provide a rebate on purchases. This may be a rebate in U.S. dollars that is then converted into cryptocurrency in the customer's account. Rebates on credit cards are generally thought of as an adjustment to the purchase price and not a taxable event, but this creates a cost basis tracking issue where the rebate is converted into cryptocurrency.

A number of potential tax information regimes also collide in one of the more explosive areas where the public is engaging with crypto assets: marketplaces for non-fungible tokens or NFTs. Do broker tax reporting rules apply to transfers in these marketplaces so that Form 1099-B is required? Is there a central payment processor that will bring in the third-party payment processor reporting requirements for Form 1099-K reporting?[20] Could the NFT marketplace constitute a barter exchange for which again Form 1099-B reporting would be required?[21]

Answers to these questions likely require an in-depth look at underlying legal relationships and payment flows for a particular NFT platform. Are purchasers and sellers interacting peer-to-peer only? Is the platform standing in between as an intermediary from a payment processing standpoint?

More, the mere fact that a business accepts crypto in payment for a service or product creates tax information reporting issues, especially in the context of the broad broker definition in the Infrastructure Bill. Are they effectuating transfers of digital assets for customers?

What about businesses that pay vendors in cryptocurrency? Is the invoice in U.S. dollars? Will the translation rate used by the firm reporting on Form 1099-MISC or Form 1099-NEC be different than what the vendor expects? Having transparency and standards as to crypto pricing based on date and time of payment may become important aspects of vendor tax information reporting compliance.

Thus, even accounts payable or vendor payment functions in a business may not be spared from the clutches of crypto tax information reporting.

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F. Conclusion

If one were to look for a message in the Infrastructure Bill tax debate, one of them is that tax reporting for digital assets is here. And the challenges are numerous.

Centralized crypto exchanges will need to be prepared for tax reporting on sales of digital assets by customers and address cost basis functionality. But participants in decentralized exchanges and peer-to-peer marketplaces remain in the crosshairs of Treasury and will need to stay engaged as Treasury seeks to implement tax reporting regulations in this area.[22]

What seems clear as crypto transactions expand from crypto trading to that wider range of crypto activities—from crypto lending to staking to crypto-linked payment cards to minting and selling NFTs—is that there are increasingly broader issues to be addressed from a tax information reporting perspective. Brokers may need to report on transactions such as crypto lending and staking. Various firms engaged in payments streams that involve crypto may have new tax information reporting concerns.

Also, as we move away from payments that are simply sales proceeds to the myriad of other payment types, attention needs to be paid to potential cross-border withholding and Form 1042-S reporting considerations. Information on digital asset holdings and transactions will likely also become part of government-to-government exchanges of tax information, much as occur currently for financial accounts and assets under the FATCA and common reporting standards ("CRS") reporting regimes.

Tax information reporting for businesses engaged with digital assets is here to stay. IRS tax gap analysis indicates that tax information reporting processes increase taxpayer compliance rates from 37% to 93%, and close to 99% if tax information reporting is complemented with a backup withholding regime.[23] Part of the reason may be the deterrent effect of a taxpayer knowing that the IRS would be aware of unreported income, but partly it may also be because tax information reporting provides taxpayers with readily accessible tax data for tax return filing. In effect, the suite of IRS Forms 1099 and Form 1042 may be the IRS's best tool to reduce the perceived taxpayer noncompliance with respect to digital asset transactions.

Not to say this will be easy. Beyond the exponential growth in number and type of blockchain-related products, services and platforms, the IRS's efforts toward having industry identify and report on beneficial owners transacting in digital assets go against the grain of a technology founded on a principle of decentralized systems that are designed to work without intermediaries that would traditionally be tasked with tax reporting.

Like other platforms such as bearer bonds or offshore accounts that may in the past have provided some anonymity to the holder, however, tax authorities may still have the last word. The crypto tax reporting provisions in the Infrastructure Bill certainly hint in that direction.

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ENDNOTES

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[1] As of this writing, the Infrastructure Bill has been passed by the U.S. Senate as of August 10, 2021 and was due to be considered and voted on by the House of Representatives. References to the Infrastructure Bill in this article refer to the text of the Bill as passed by the Senate on August 10, 2021.

[2] *See* Reg. §1.6049-4(f)(4)(i).

[3] *See* Reg. §1.6045-1(k).

[4] However, Senator Rob Portman (R-Ohio) who was a primary drafter of the provision stated during discussion of the Bill in the Senate that the intent of the provision was narrower. The crypto tax reporting provision was intended to apply to "cryptobrokers" that are regularly effectuating transfers of digital assets, which, he noted, "for tax purposes means a sale on behalf of someone else." In response to industry concerns, Senator Portman's floor speech also noted that "we want to be sure miners and stakers and others now or in the future who play a key role by validating transactions, or sellers of hardware or software for digital wallets, or node operators, or others who are not brokers are clearly exempted." *See* Press Release from Senator Portman's Office, *On Senate Floor, Portman Discusses Cryptocurrency Provision in*

Infrastructure Investment & Jobs Act, August 8, 2021.

[5] In part, the scope of this broker definition may depend on how "effectuating" is interpreted. Dictionary definitions include "put into force or operation," which is broad. But could the wording be interpreted more narrowly as requiring action by a principal or agent in an actual sale? Reg. §1.6045-1(a)(10) defines "effect" to mean, with respect to a sale, to act as "(i) An agent for a party in the sale wherein the nature of the agency is such that the agent ordinarily would know the gross proceeds from the sale; or (ii) A principal in such sale." "Effectuate" could potentially be more circumscribed if it takes on the meaning of "effect" in the broker reporting regulations.

[6] For a discussion of whether cryptocurrencies or tokens may be treated as securities, *see, e.g.,* Stevie D. Conlon, Anna Vayser, and Robert Schwaba, *If a Crypto-Tree Falls in a Digital Forest, Can It Give Rise to Tax Evasion?* Tax Notes (Special Report), November 5, 2018, at 710; Joshua S. Tompkins and Paul Kunkel, *Cryptocurrencies and the Definition of a Security for Code Sec. 1091*, J. Tax'n Fin'l Products, 2021. ("There is a strong argument that cryptocurrencies are not stock or securities for purposes of Code Sec. 1091 ....")

[7] Under existing broker reporting regulations, reportable sales are sales of securities or commodities for cash. Thus, even if the rules applied, crypto-to-crypto trades (*e.g.*, bitcoin or ether traded for another coin) would not be in-scope. It will be interesting to see if the Treasury changes this cash rule for crypto trades as it issues new regulations covering crypto tax reporting. Under existing regulations, also, reporting of commodity sales is not covered by cost basis reporting rules.

[8] *See* Reg. §1.6045-1(d)(6) for rules on determining and adjusting tax basis for Form 1099-B reporting purposes.

[9] Reg. §1.6045A-1(a)(2) and (b).

[10] This raises a host of questions as to how cost basis information can be retained if digital assets leave a broker to a private wallet and later returns to the same or another broker account. Will there be a mechanism or need to track intermediate movements of digital assets?

[11] IRS News Release, IR-219-132 (July 26, 2019), "IRS has begun sending letters to virtual currency owners advising them to pay back taxes, file amended returns; part of agency's larger efforts."

[12] *See, generally*, Tompkins and Kunkel, *supra* note 6.

[13] *See also* IRS Office of Chief Counsel Memorandum 202114020 (Mar. 22, 2021).

[14] *See* Katelyn E. Towe, *Washing Losses Away: Why Cryptocurrencies Need a Wash Sale Rule*, 169 Tax Notes Federal (Oct. 5, 2020) (arguing wash sales mechanisms should be expanded to cover cryptocurrency trading).

[15] The government has been able to limit tax anonymity in the past through regulations in such areas as bearer bonds or offshore accounts (*e.g.*, through withholding and reporting requirements under the Foreign Account Tax Compliance Act).

[16] *See* Joshua Tompkins and Hubert Raglan, *Cryptocurrency Loans—Taxable or Not?* 17 J. Tax'n Fin'l Products 1 (2020).

[17] There are alternate views, however, on the timing of when staking rewards might be taxed. *See* discussion, *e.g.*, in Brian Hamano, *Staking Out New Territory: Taxation of Proof-of-Stake Protocols*, Tax Notes, January 28, 2019 (considering arguments why staking rewards may not be taxable at the time of receipt); *Joshua Jarrett et ux.*, DC-TN, No. 3:21-cv-00419 (2021) (May 26, 2021) (pending case where taxpayers argue that their staking activity is like a baker baking a cake and Tezos coins received in such enterprise should not be taxable until disposition).

[18] Second Declaration of Karen Cincotta in Support of Ex Parte Petition for Leave to Serve "John Doe" Summons, Civil No. 3:21-cv-02201-JCS, U.S. District Court for the Northern District of California (Feb. 14, 2021), Par. 105, stating: "The IRS needs records relating to other taxable events that may have occurred within the account. This includes the receipt of additional units of cryptocurrency as the result of a chainsplitting hard fork, which represents taxable income, staking, or other situations where a user may receive units of cryptocurrency gratuitously through promotional events."

[19] There may also be some uncertainty as to whether staking income could be treated as income effectively connected with a U.S. trade or business, perhaps due to a staker delegating such activity to a U.S. firm that facilitates the staking.

[20] Form 1099-K filing requirements, in part, apply to third-party settlement organizations that have the contractual obligation to make payments to participating payees of third-party network transactions. Per Reg. §1.6050W-1(c)(2), a central organization is a third-party settlement organization if it provides a third-party payment network that "enables purchasers to transfer funds to providers of goods and services." A "third party payment network" in turn is defined as any agreement or arrangement that "(A) Involves the establishment of accounts with a central organization by a substantial number of providers of goods or services who are unrelated to the organization and who have agreed to settle transactions for the provision of the goods or services to purchasers according to the terms of the agreement or arrangement; (B) Provides standards and mechanisms for settling the transactions; and (C) Guarantees payment to the persons providing goods or services in settlement of transactions with purchasers pursuant to the agreement or arrangement." Reg. §1.6050W-1(c)(3)(i).

[21] Reg. §1.6045-1(a)(4) defines a barter exchange as "any person with members or clients that contract either with each other or with such person to trade or barter property or services either directly or through such person." The term "barter exchange" does not include arrangements that provide solely for the informal exchange of similar services on a noncommercial basis (*e.g.*, noncommercial carpooling).

[22] Concurrently, news articles also indicate that the Securities Exchange Commission is increasing its scrutiny of products in the DeFi space. *See, e.g.,* Jonathan Ponciano, *SEC Charges Crypto Execs for Allegedly Fraudulent $30 Million Offerings in First Case Against This Booming $100 Billion Space*, Forbes, August 6, 2021.

[23] Treasury Inspector General for Tax Administration, Report Titled, "Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance," February 14, 2019, at 3.

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