

Background

On August 10, 2021, the United States Senate passed the \$1.2 trillion Infrastructure Investment and Jobs Act, a bill that included, as a revenue-raising measure, tax information reporting provisions that apply to “digital assets.”¹ The legislation modifies the current definition in the tax law of a “broker” responsible for information reporting on IRS Form 1099-B² to cover transactions in cryptocurrency. If it becomes law, the legislation would treat transactions in cryptocurrency the same as transactions in stocks, bonds and other traditional investments for purposes of reporting “proceeds” and “basis,” which are the primary inputs for determining taxable gain or loss.

The legislation is significant:

- It will be the first time that Congress has specifically addressed transactions in cryptocurrency in the Internal Revenue Code (Code).
- The legislation is, however, several steps removed from an actual Form 1099-B reporting requirement and work remains to be done by the Treasury Department and the Internal Revenue Service (IRS) both to activate that requirement and to define its scope.

The Senate-passed legislation builds on existing section 6045(a) of the Code, which authorizes reporting only “when required by the Secretary [of the Treasury]. . . in accordance with such regulations as the Secretary may prescribe.”³ Work to implement a cryptocurrency reporting requirement has been under way at the Treasury Department and the IRS for nearly two years, independent of the recent infrastructure legislation.⁴ Accordingly, a change to the Code was not necessary for cryptocurrency information reporting, nor does a new statute, by itself, trigger a reporting requirement. Other important considerations must first come into play.

¹ Infrastructure Investment and Jobs Act, H.R. 3684, 117th Cong. § 80603 (2021).

² IRS Form 1099-B is currently used to report gains or losses from the sale of stocks, bonds, derivatives or other securities through a broker, and is supplied by the broker to the taxpayer for whose account such gains or losses were recognized in January of the year following the transaction that gave rise to such gains or losses. *See* INTERNAL REVENUE SERV., FORM 1099-B (2021), <https://www.irs.gov/pub/irs-pdf/f1099b.pdf>.

³ By providing for information reporting only “when required” by Treasury under “such regulations as the Secretary may prescribe,” the promulgation of regulations (along with forms and instructions) is a precondition to any Form 1099-B information reporting requirement under section 6045. *See Estate of Neumann v. Comm’r*, 106 T.C. 216, 222 (1996) (distinguishing between self-executing and non-self-executing tax statutes).

⁴ INTERNAL REVENUE SERV., 2019-2020 PRIORITY GUIDANCE PLAN (2019) at 20 (identifying as a priority project “[g]uidance regarding [IRS Form 1099-B] information reporting on virtual currency under [Code] § 6045”), https://www.irs.gov/pub/irs-utl/2019-2020_pgp_initial.pdf.

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When viewed in the context of existing information reporting requirements,⁵ regulations implementing a reporting requirement for cryptocurrency should be carefully tailored to meet the common goals of improving compliance with the tax law and minimizing the burden on industry players, taxpayers and the IRS alike.⁶

As with traditional investment assets, many entities facilitate transactions in cryptocurrency, but most touch those transactions only indirectly and are not in a good position to prepare Form 1099-B information returns. To minimize burden and eliminate duplicative reporting, tax information reporting requirements have historically been imposed on those entities that are in the best position (consistent with existing industry practices) to provide the information relevant for determining tax liability. Cryptocurrency miners, software developers, internet service providers and even the power company, for example, play a critical supporting role within the digital asset ecosystem, but would be excluded from the existing reporting framework, which generally impose a reporting requirement only where (i) there is a customer relationship between the transaction participant and the entity with the reporting obligation, and (ii) the reporting entity has relevant transactional information as part of its customer relationship.⁷

While the existing statutory regime and the amendments proposed by the infrastructure legislation are expansive, in issuing regulations to implement any new or existing legislation, past experience suggests that Treasury and the IRS will consider longstanding Congressional directives to balance the burden imposed by information reporting against the benefits of compliance. And they will do this following a public comment period that will give all parties directly or indirectly connected with cryptocurrency transactions an opportunity to be heard on these points.

Once implemented by regulations, a framework for cryptocurrency reporting should look to a single entity per transaction for reporting information that is either already in hand as part of an existing customer relationship or that can be obtained while minimizing unnecessary burden and disruption to the operations of industry players.

The information reporting regime contemplated by the Senate-passed legislation corresponds with an expansion of the cryptocurrency market and Congressional and regulatory recognition of the maturity of that market. A new reporting requirement does not necessarily foretell tax compliance issues for holders of cryptocurrency or those with an information

⁵ I.R.C. § 6045; Treas. Reg. § 1.6045-1.

⁶ Press Release, Janet Yellen, Sec’y, U.S. Dep’t of the Treasury, Statement from Secretary of the Treasury Janet L. Yellen on the Cryptocurrency Compromise (Aug. 9, 2021), <https://home.treasury.gov/news/press-releases/jy0317>. Press Release, U.S. Senate Comm. on Banking, Hous. & Urb. Affs., Toomey, Warner, Lummis, Sinema, Portman Announce Agreement on Digital Asset Reporting Requirements in Infrastructure Bill (Aug. 9, 2021), <https://www.banking.senate.gov/newsroom/minority/toomey-warner-lummis-sinema-portman-announce-agreement-on-digital-asset-reporting-requirements-in-infrastructure-bill>. *See also*, Taylor Locke, *Treasury will not target non-brokers like miners even if the crypto tax provision isn’t amended*, CNBC: MAKE IT (Aug. 24, 2021, 12:01 PM), <https://www.cnbc.com/2021/08/24/treasury-will-not-target-non-brokers-even-without-crypto-tax-amendment.html>.

⁷ Treas. Reg. §§ 1.6045-1(a)(2) and (10).

reporting obligation. Instead, it signals both a maturation of the industry and an acceptance of the growing market for, and importance of, cryptocurrency in the broader economy.

Scope of the Information Reporting Requirement

Following the longstanding mandate to balance the burden of tax reporting against incremental compliance benefits, any new reporting regime for cryptocurrency should be limited to entities that, in the regular course of their operations, are paid for effecting transfers and exchanges of digital assets on behalf of third-party customers and who, as part of an existing customer relationship, have (or reasonably should be expected to have) access to relevant transactional information.

Following that mandate and lawmakers' stated intent,⁸ and to avoid duplicative (and, for taxpayers and the IRS alike, confusing) information reporting, any new reporting regime should **not** apply to:

- validators and other miners,
- developers,
- stakers,
- node operators and service providers,
- internet service providers, and
- others who do not have a direct relationship in respect of reportable digital asset transactions and would not have access to the relevant transactional information needed to complete an IRS Form 1099-B or otherwise comply with the reporting requirements.

Effective Date

Under the Senate-passed bill, the new reporting regime would apply to transactions occurring or digital assets acquired on or after January 1, 2023.⁹ To meet that timeline, Treasury and the IRS will need to work with the industry to ensure that any implementing regulations match existing data maintenance and collection practices to the maximum extent possible, recognizing that not all entities who will be subject to the new reporting requirement will have the same information or starting point for reporting.

In similar contexts, to ease the transition to a new information reporting regime, the IRS has provided penalty relief to entities that make a good faith effort to comply. A similar approach is appropriate here for reporting entities and taxpayers alike in order to avoid penalties for parties that may require a grace period to be in a position to comply with any new requirements.

⁸ Press Release, U.S. Senators Rob Portman and Mark Warner, On Senate Floor, Portman, Warner Conduct Colloquy Clarifying Cryptocurrency Provision in Infrastructure Investment & Jobs Act (Aug. 9, 2021), <https://www.portman.senate.gov/newsroom/press-releases/senate-floor-portman-warner-conduct-colloquy-clarifying-cryptocurrency>.

⁹ Infrastructure Investment and Jobs Act, *supra* note 1 at § 80603.

Compliance Considerations

In order to comply with any new reporting requirement, recordkeeping will be important. While supporting entities that only indirectly facilitate cryptocurrency transactions should not be subject to reporting requirements, those with a customer-type relationship with a participant in a cryptocurrency transaction (*i.e.*, cryptocurrency exchanges and any middlemen involved in cryptocurrency transactions) should be prepared to gather and retain customer and transactional information and complete, provide to their customers, and file with the IRS applicable Forms 1099-B after the end of each taxable year.

To the extent not already captured, those entities subject to the information reporting requirement will also be required to obtain from their customers an IRS Form W-9, Request for Taxpayer Identification Number and Certification (or, for non-U.S. residents or citizens, Form W-8) to document customer names, taxpayer identification numbers (TINs) and other relevant information for use in Form 1099-B reporting.¹⁰ Where customers fail to provide a Form W-9 or W-8, or where the reporting entity is notified of taxpayer name/TIN mismatches and other errors, “backup” withholding provisions can be triggered and procedures for implementing those provisions will also need to be in place.¹¹

Additional Considerations

- In developing rules for reporting transactions in cryptocurrency, the Treasury Department and IRS are primarily concerned with facilitating systemic compliance as transactions in cryptocurrency gain broader acceptance and utilization in the economy. This requires moving beyond “John Doe” summonses, taxpayer audits and other time-consuming manual enforcement activities. A key element of this effort is putting the necessary basis and transactional proceeds information in the hands of taxpayers and their return preparers in a uniform and usable form, which the Form 1099-B information reporting proposals are intended to do.
- Integration of transactions in cryptocurrency into the broader economy is a relatively recent development. While taxpayers, their advisors and the IRS have faced challenges in ensuring that these transactions are properly reported on tax returns, having meaningful information reporting rules in place now can help reduce the long-term compliance burden on taxpayers and the IRS alike and can also mitigate the risk of a more cumbersome legislative or regulatory response.¹²
- Capturing historical basis information is an important part of the proposed information reporting requirement, but like any new information reporting regime, can raise particular transitional challenges. Similar challenges were presented when basis reporting for stocks, bonds and other traditional investment assets was first mandated by legislation enacted in

¹⁰ See, e.g., INTERNAL REVENUE SERV., FORM W-9 (2021), <https://www.irs.gov/pub/irs-pdf/fw9.pdf>.

¹¹ See I.R.C. § 3406 and accompanying Treasury Regulations.

¹² See, e.g., I.R.C. §§ 1471-1474 (the Foreign Account Tax Compliance Act (FATCA)), a major overhaul of international tax reporting and compliance — part of the Congressional response to years of taxpayer non-compliance with reporting requirements applicable to foreign financial institutions and other foreign entities.

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2008. The transitional framework used there can serve as a model for implementing a new reporting regime for transactions in cryptocurrency.¹³

- Transactions in cryptocurrency, unlike stocks, bonds and other traditional investment assets, are often not settled in U.S. dollars or other fiat currency, adding an element of price discovery to the Form 1099-B reporting requirement, the details of which will need to be addressed in the administrative rulemaking process.¹⁴
- The information reporting provisions in the infrastructure bill include a definition of “digital assets” that is the first specific reference in the Internal Revenue Code to transactions in cryptocurrency. While limited here to an information reporting context, it is expected that the definition will be used as a base line for future legislative and regulatory action involving the tax treatment of transactions in cryptocurrency, making it particularly important for stakeholders to weigh in with comments on the proper scope and meaning of “digital assets.”

¹³ Basis reporting and related provisions were enacted as Division B of the Energy Improvement and Extension Act of 2009, Pub. L. No. 110-343, 122 Stat. 3765, 3854 (2008), codified in I.R.C. §§ 6045(g), 6045A and 6045B, and were further tailored with input from the broker industry over subsequent years.

¹⁴ See *Frequently Asked Questions on Virtual Currency Transactions*, Q&A Nos. 26, 27 (addressing determinations of value in crypto-for-crypto exchanges), available at <https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>.