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Generations Winter 2023 - IRS Postpones Digital Asset Reporting Requirements for Brokers

Despite years of rhetoric from the IRS that it plans to ramp up enforcement of digital asset reporting, the agency recently delayed the effective date of its newly introduced digital asset reporting rules. The delay is temporary and could end at a moment's notice. Here is what digital asset investors need to know:

Background

On November 15, 2021, in an effort to improve tax administration and compliance with respect to trading and investing in digital assets, the Infrastructure Investment and Jobs Act (the act) clarified that brokers are required to report or furnish certain information with respect to dispositions or transfers of digital assets. However, on December 23, 2022, the IRS issued Announcement 2023-2 (the guidance), providing that until final regulations are issued by the IRS and the U.S. Treasury Department, these additional reporting requirements do not apply. Prior to the issuance of the guidance, the new reporting rules for digital assets were set to apply to any returns or statements required to be filed or furnished after December 31, 2023.

It is important to note that the guidance applies only to returns filed by brokers. Taxpayers are still required to report income received from digital asset transactions and must answer questions regarding digital assets on IRS Form 1040 and other applicable forms.

Current Law

Most taxpayers can easily track gains earned from stocks and other customary investments because brokers who deal in such securities are required to furnish IRS Form 1099-B to their clients and the IRS. In addition to helping taxpayers track their brokerage income, Form 1099-B helps the IRS identify taxpayers who do not properly report their brokerage income on their returns.

Under current law, taxpayers who trade or sell digital assets are required to pay taxes on income earned from such trades or sales; however, cryptocurrency exchanges are not expressly required to send information returns to taxpayers or to the IRS. Prior to the act, it was not clear that the term "broker" included persons who effectuate the transfer of digital assets for others. It was also unclear whether digital assets were covered by these reporting requirements.

The lack of reporting requirements for cryptocurrency exchanges made it difficult for many taxpayers to report their earnings from the sale of digital assets accurately. Additionally, the lack of reporting obligations for cryptocurrency exchanges made it difficult for the IRS to ensure that taxpayers were properly reporting their earnings from the sale of digital assets. In response, Congress passed the act in attempt to help resolve these issues.

Changes Introduced by the Act

The act expressly clarifies that digital asset brokers are subject to additional reporting requirements and that digital assets are a type of security that is subject to such reporting requirements.

The act specifies that the definition of "broker" shall include any person who, for consideration, is responsible for regularly providing any service effectuating the transfer of digital assets on behalf of another person. In addition, the act modifies the definition of "specified securities" subject to these requirements to include digital assets. The act also clarifies that the transfer statement reporting requirement applies to transfers between brokers of covered securities such as digital assets.

Delay in Effective Date

The guidance postponed the effective date of the changes related to digital asset reporting requirements made in the act. In the guidance, the IRS clarifies that despite the delay in the effective date for the new reporting requirements, brokers must continue to report or furnish additional information as required under existing law. However, brokers are not required to report or furnish additional information with respect to dispositions of digital assets, issue additional statements related to digital assets, or file any returns with the IRS related to transfers of digital assets until the final regulations are issued.

Effect on Digital Asset Investors

The guidance states that this delay in implementing the new reporting requirements applies only to brokers. Investors who trade in digital assets will still be impacted, as they likely will not be furnished a Form 1099 or similar information return reporting their digital asset investment activities until the act goes into effect. Many digital investors may welcome this delay, because they view decentralization and the lack of regulatory oversight as a core tenet of the philosophy of cryptocurrency and blockchain technology. However, others may not welcome the difficulty and complexity of calculating gains and losses from cryptocurrency or non-fungible token trading and would prefer to have someone else do that work for them and report it on a Form 1099. Until the act becomes fully effective, taxpayers must continue to track and report their income from digital asset transactions on their own. The White House announced that it had concluded its review of the proposed regulations under the act on February 23, which is a sign that the new reporting requirements may be implemented before next tax season.

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