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Digital Assets: From Crypto to Compliance

Documentation Rules Under the Final Digital Asset Reporting Regulations

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This article provides a general overview of the tax documentation required to be collected by U.S. digital asset brokers under the final U.S. broker digital asset reporting regulations published in the Federal Register on July 9, 2024 (the "final regulations"). The final regulations contemplate how U.S. digital asset brokers, including processors of digital asset payments (PDAPs), will document their customers for purposes information reporting or establishing an exemption from information reporting of digital asset transactions.

Who must collect the tax documentation?

The final regulations specifically apply to U.S. digital asset brokers, including processors of digital asset payments. For this purpose, a "broker" means any person that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales to be made by others. A U.S. digital asset broker is a broker that is a U.S. payor or U.S. middleman that is not foreign branch or office of the broker. A processor of digital asset payments ("PDAP") is a person who in the ordinary course of a trade or business stands ready to effect sales of digital asset by regularly facilitating payments from one party (the "first party") to a second party by receiving digital assets from the first party and paying those digital assets, other digital assets, or cash, including stored value cards, to the second party. A person is a PDAP only if it has an agreement or other arrangement with the first party for the provision of digital asset payment services that provides that the PDAP may verify the first party's identity or otherwise comply with anti-money laundering (AML) program requirements.

As noted in the preamble to the final regulations, the final regulations reserve on the requirements for non-U.S. digital asset brokers for reporting information on U.S. customers until regulations are finalized to implement the OECD's Crypto-Asset Reporting Framework ("CARF"). Because reporting by non-U.S. digital

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assets brokers is postponed until the regulations implementing CARF are published, this article focuses on the documentation requirements of U.S. digital asset brokers. Treasury and the IRS noted in the preamble that the CARF regulations will be issued with enough time to begin the exchange of information in 2028 for the 2027 tax year.

Transitional Rule

In Notice 2024-56, the IRS stated that it understood that brokers may not have sufficient time during 2025, (the first year for reporting gross proceeds from digital asset transactions) to obtain certified taxpayer identification numbers (TINs) for all customers and thus provided relief to brokers that may fail to file Forms 1099-DA correctly for 2025 and from having to conduct backup withholding on insufficiently documented customers. Penalties for failure to file correct Forms 1099-DA would not apply to transactions effectuated in 2025 as long as the U.S. digital asset broker or PDAP makes a good faith effort to comply with the reporting obligations of the final regulations. Brokers that already collect tax documentation should continue to do so.

The IRS also stated in Notice 2024-56 that it is aware that brokers subject to broker reporting for digital asset sales may experience challenges in obtaining certified TINs from all payees that are existing customers. Accordingly, for digital asset sales effected in calendar year 2026, the IRS will permit brokers to rely on TINs provided by payees that are not certified if those uncertified TINs were provided by payees that opened accounts with the broker prior to January 1, 2026, (preexisting customers) and if the broker, prior to effecting the digital asset sale transaction, submits the payee's name and TIN combination to the IRS's TIN Matching Program and receives a response that the name and TIN combination furnished by the payee matches the name and TIN combination for that payee in the IRS records.

Based on our past experience with the difficulties involved in collecting and validating Forms W-9 for preexisting accounts, U.S. digital asset brokers and PDAPs should start collecting and validating Forms W-9 from their preexisting customers as soon as practicable. Forms W-9 should be requested at account opening for new accounts.

Expansion of the Definition of U.S. Exempt Recipients

A broker may treat a customer of a digital asset transaction as exempt from information reporting if the customer is an "exempt recipient." Generally, a broker may treat a customer as an exempt recipient based on a properly completed Form W-9, the broker's actual knowledge that the customer is an exempt recipient, or under the "eyeball" test, which looks to certain indicators of exempt status described in the regulations. A broker may require an exempt recipient to provide a Form W-9 to treat a customer as an exempt recipient and may treat a customer that fails to do so as a non-exempt recipient. The list of U.S. Exempt recipients includes -- U.S. corporations (other than an S corporation), a tax-exempt organization, U.S. or foreign government entity, a foreign central bank, a securities or commodities dealer, futures commission merchant, REITs, a company registered under the Investment Company Act of 1940 (other than a registered investment advisor), a common trust fund, banks and similar institutions.

For digital asset transactions, the final regulations retain the definition of exempt recipients provided above and adds an exempt recipient status for U.S. digital asset brokers (other than a registered investment advisor). This exempt status for U.S. digital asset brokers applies where multiple brokers are involved in the sale of digital assets. If more than one broker effectuates the sale of a digital asset for a customer, the first broker crediting the customers wallet or account is required to report the sale. A broker that did not first credit the gross proceeds on the sale to the customers wallet or account is not required to report the sale if, prior to the sale, that broker obtains a Form W-9 stating the first broker crediting the gross proceeds is a U.S. digital asset broker (other than a registered investment advisor). The current Form W-9 has not yet been revised to

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include the representation that a payee is a U.S. digital asset broker. The IRS intends to amend the Form W-9 to contain the required representation. To allow a broker to represent that it is an exempt U.S. digital asset broker prior to the publication of a revised Form W-9, a broker may rely upon a written statement from another broker that the other broker is a U.S. digital asset broker exempt from reporting, if the other broker provides a written statement that is associated with the Form W-9, or a statement that is separately signed by that broker under penalties of perjury, until one-year from the end of the month shown as the revision date on the Form W-9 that it is revised to include the certification.

Documentation of Non-U.S. Exempt Recipients

Exempt foreign persons are not subject to digital asset reporting. The final regulations provide a transition rule allowing for a U.S digital asset broker to treat a customer as an exempt foreign person for sales effectuated prior to January 1, 2027, if three criteria are met. First, the digital assets must be held in an account established before January 1, 2026. Second, the digital asset broker has not previously classified the customer as a U.S person. And, finally, the information the broker has for the customer includes a residence address that is not a U.S. address.

Generally, a U.S. digital asset broker may rely on a beneficial owner Form W-8 to treat a person as an exempt foreign person unless the broker has actual knowledge or reason to know that the Form W-8 is unreliable or incorrect, or the validity period of the Form W-8 has expired. A beneficial owner withholding certificate provided by an individual must include a certification (already contained in the existing Form W-BEN) that the beneficial owner has not been, and at the time the certificate is furnished reasonably expects not to be, present in the United States for a period aggregating 183 days or more during each calendar year to which the certificate pertains.

A broker must treat a beneficial owner Form W-8 from a customer as unreliable or incorrect if the Form W-8 or account information contains indicia of U.S. status. U.S. indicia includes a permanent residence or mailing address in the U.S., a current U.S. telephone number and no non-U.S. telephone number, the broker's classification of the customer as a U.S. customer in its records, or an unambiguous indication of a U.S. place of birth.

A broker may rely, however, on a beneficial owner withholding certificate notwithstanding the presence of any of the U.S. indicia set on the withholding certificate or in the account information for a customer if it has appropriate cure documentation. For an individual, the cure documentation includes a reasonable explanation from the customer, in writing, supporting the claim of foreign status plus documentation that the broker has in its possession or obtains that includes a permanent residence address or country of citizenship and:

- A certificate of residence issued by an appropriate tax official of the country in which the payee claims to be a resident that indicates that the payee has filed its most recent income tax return as a resident of that country.
- Any valid identification issued by an authorized government body (for example, a government or agency thereof, or a municipality), that is typically used for identification purposes (e.g., a driver's license), or
- For an entity, any documentation that substantiates that the entity is actually organized or created under the laws of a foreign country.

The cure documentation cannot contain a U.S. address.

Notwithstanding the above, if a broker classified an individual customer as a U.S. person in its account information, the broker may treat the customer as an exempt foreign person only if it has in its possession any

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valid identification issued by an authorized government body that is typically used for identification purposes and that documentation evidences citizenship in a country other than the United States. Further, for a broker to cure an unambiguous indication of a U.S. place of birth for the customer, the broker must have any valid identification issued by an authorized government body that is typically used for identification purposes and either a copy of the customer's Certificate of Loss of Nationality of the United States or a reasonable written explanation of the customer's renunciation of U.S. citizenship or the reason the customer did not obtain U.S. citizenship at birth.

In the case of a customer that is an entity, the broker may treat the customer as an exempt foreign person if it has in its possession documentation establishing foreign status that substantiates that the entity is organized or created under the laws of a foreign country.

The final regulations contain two grace period rules. First, a broker will not be considered to have reason to know that a certificate is unreliable or incorrect based on documentation collected for an AML program until the date that is 30 days after the account is opened. Second, if a broker has not obtained valid documentation that it can reliably associate with a payment of gross proceeds to a customer to treat the customer as an exempt foreign person, or if the broker is unable to rely upon documentation under the validity rules, the broker may treat as an exempt foreign person for 90 days under certain circumstances as set forth in Treas. Reg. § 1.6049-5(d)(ii).

Joint Account holders

Generally, for joint accounts if one or more account holders provide a Form W-9 the relevant account holder for reporting is the first named Form W-9 account holder. If all account holders have provided valid Forms W-8, then account is not reportable on Form 1099-DA. If one or more account holders is undocumented or has provided unreliable or incorrect documentation, then backup withholding and reporting apply to the first named account holder that has not provided documentation or provided incorrect documentation.

Presumption Rules

The presumptions rules under the final regulations that apply where documentation is absent or unreliable refer to the presumption rules that apply for purposes of non-resident alien withholding on U.S. source income under section 1441 of the Code. However, the final regulations specifically state that where a U.S. digital asset broker has classified a customer as an individual, the U.S. digital asset broker must treat the customer as a U.S. person.

Generally, the rules relating to documentation validity period and the period during which brokers must retain documentation are the same as currently apply under chapter 3 of the Code.

Concluding Thoughts

U.S digital asset brokers must have valid documentation in place beginning January 1, 2027. Considering how long it has taken brokers to document customers for prior information reporting regimes, U.S digital asset brokers should begin creating and putting into pace procedures and systems for obtaining, validating, and curing documentation now. Brokers should consider how documentation responsibilities will be allocated among front-, middle-, and back-office functions. They also should be considering whether validation will be done manually or through a self-created or third-party automated system, how and what documentation will be stored. Moreover, the IRS will expect a broker to have written procedures related to documentation requirements.

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