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## Cost Basis Reporting for U.S. Digital Asset Brokers

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This article covers the requirements for U.S. digital asset brokers to report cost basis on the sale of digital assets under the final broker digital asset reporting regulations published in the Federal Register on July 9, 2024 (the “final regulations”).

### Cost Basis Reporting for Digital Assets

Broker reporting on gross proceeds from sales of relevant digital assets by customers begins for reportable sales occurring on or after January 1, 2025. For sales of digital assets that are considered “covered securities,” the final regulations also require brokers to report information relating to the customer’s tax basis in the digital assets that are sold if the sale occurs on or after January 1, 2026.

“Covered securities,” for this purpose, include a digital asset “that is acquired in a customer’s account by a broker providing custodial services for such specified security on or after January 1, 2026, in exchange for cash, stored-value cards, different digital assets, or any other property or services” as described in the final regulations. Certain options on digital assets and forward contracts requiring delivery of a digital asset are also included in the definition of covered securities.

Thus, digital assets acquired by the broker for the customer in the customer’s account on or after January 1, 2026, are generally covered securities, but unlike traditional stock and securities, such assets may be acquired by cash or by exchange for stored-value cards, different digital assets or even other property.

The regulations require the following cost basis-related information to be reported on Form 1099-DA for covered security sales occurring on or after January 1, 2026:

- The adjusted basis of the covered security sold calculated in accordance with the final regulations; and
- The date such covered security was purchased, and whether any gain or loss with respect to the covered security sold is long-term or short-term.

The determination of these cost basis items can be complicated. Initial basis needs to account for the fact that a digital asset may be acquired not only for cash but in an exchange for other property. Adjusted basis and acquisition date and gain/loss information also need to account for specific rules that may adjust basis or holding period. For example, brokers would need to follow rules relating to options for options on digital assets, and certain digital assets may also be classified as securities that could require basis and holding period adjustments under wash sales provisions.

Until guidance is provided on transfer statements relating to transfers of digital assets from other brokers, digital assets that were transferred into the account, and not acquired by the broker for the customer in the account, would presumably fall outside “covered security” status and the requirement for cost basis reporting.

There are also optional broker reporting rules for sales of specified nonfungible tokens (“NFTs”) and qualifying stablecoins (these digital assets must meet specified criteria under the final regulations). These optional reporting methods generally allow for aggregate proceeds reporting instead of transaction-by-transaction reporting. The final regulations do not specify cost basis reporting for brokers utilizing the optional reporting methods for reporting sales of qualifying stablecoins and specified NFTs. The final Form 1099-DA should be reviewed to confirm that the form instructions do not require basis reporting in these cases.

Cost basis reporting is also not applicable in certain cases where brokers are required under the final regulations to report sales of digital assets to a foreign intermediary, flow-through entity, or U.S. branch (where such reporting is required generally because the broker has actual knowledge that the intermediary is acting for a U.S. person that is not exempt from reporting).

For digital assets that are not considered “covered securities,” cost basis information is not required. If a broker chooses to report cost basis information for noncovered securities, the final regulations provide that the broker is not subject to reporting penalties for failure to report this information correctly if the return identifies the sale as a sale of a noncovered security.

## **Determining Adjusted Basis for Digital Assets**

The calculation of adjusted basis begins with the concept of initial basis, which can be adjusted based on subsequent tax events (e.g., wash sales events for digital assets that are also classified as securities). Initial basis for digital assets purchased by cash is generally the cash paid, increased by any commissions, transfer taxes and digital asset transaction costs associated with the acquisition.

For digital assets received through the exchange of property that is not a digital asset, the initial basis of the digital asset is generally the fair market value of the digital asset received at the time of the exchange, increased by any digital asset transaction costs allocable to the acquisition of the digital asset. The final regulations state that the “fair market value of the digital asset received must be determined using a reasonable valuation method as of the date and time the exchange transaction was effected.” Brokers may perform its own valuation for this purpose or rely on valuations performed by a third-party digital asset data aggregator. If the value of the digital asset received cannot be determined with reasonable accuracy, the final regulations then allow the broker to look to the value of the property transferred for the digital asset. If the broker or digital asset data aggregator determines that the value of neither the digital asset nor the property transferred can be determined with reasonable accuracy, the broker must treat the value as zero. Special rules apply where the property transferred involves certain debt instruments.

Finally, where the digital asset received is exchanged for another digital asset, the final regulations provide that the costs incurred by the customer on the exchange are allocated 100 percent to the transferred assets. Thus, unlike the provisions of the proposed regulations which would have allocated 50 percent of the costs to the transferred assets and 50 percent to the digital assets received, transaction costs on such exchanges are not allocated to the digital assets received and only to the assets transferred. Thus, initial basis of the digital

assets received in such exchanges is generally the fair market value of the received asset at the time of the exchange.

As an example, assume Individual A has an account with a custodial digital asset broker (Broker). On January 5, 2026, Individual A instructs Broker to acquire on A's behalf ten units of digital asset AB at a price of \$2/unit and pays in cash. Broker charges Individual A \$5 as transaction costs for the acquisition of the ten units of digital asset AB. Individual A now has a \$25 initial basis in the ten units of digital asset AB.

On October 5, 2027, Individual A directs Broker to exchange ten units of digital asset AB for another digital asset different in kind, digital asset CD. At the time of the exchange, Broker determines that the fair market value of a unit of digital asset AB is equal to \$100, and a unit of digital asset CD is equal to \$50. Thus, Broker exchanges for Individual A their ten units of digital asset AB for 20 units of digital asset CD. Broker also charges \$20 as transaction costs for the exchange, which Individual A pays in cash. In the reporting for the 2027 sale, Broker reports a sale of 10 units of digital asset AB with gross proceeds equal to \$980 (fair market value of 20 units CD received x \$50/unit = \$1,000 less \$20 transaction costs) with adjusted basis of \$25 (as noted above). The initial basis of the 20 units of digital asset CD that is received by Individual A is \$1,000, since all the transaction costs are allocated to the transferred asset (digital asset AB) in the exchange.

Brokers should be aware that where transaction costs are paid through a deduction by the broker of a portion of the transferred or received digital asset in a digital asset for digital asset exchange, the reporting of the sale and associated costs becomes more complicated. Where transaction costs are paid through deduction from a portion of the digital asset received and treated as sold for broker services, for example, the costs of that sale to pay for the transaction costs are generally allocated to the original sale transaction to the assets transferred. Systems will need to be able to accommodate scenarios involving transaction costs paid in digital assets, whether they are digital assets of a different kind or part of the digital assets transferred or received.

## Lot Relief Methodologies

Where a customer has acquired a digital asset on different dates and/or different prices (each such acquisition generally forming a separate "tax lot") but sells only a portion of their holdings in a sale, an important aspect of cost basis reporting is that the broker be able to determine which tax lot is treated as being sold. The final regulations allow a broker to take into account a customer's "adequate identification" of the tax lot to be sold in a transaction. Absent such adequate identification by a customer, the broker must generally treat tax lots that were not acquired by the broker for the customer and for which there is no transfer date information as sold first. Then, tax lots are generally treated as sold on a FIFO basis.

For this purpose, "an adequate identification occurs if, no later than the date and time of the sale, disposition, or transfer, the customer specifies to the broker the particular units of the digital asset to be sold, disposed of, or transferred by reference to any identifier that the broker designates as sufficiently specific to determine the units sold, disposed of, or transferred." An example of a customer's adequate identification of a tax lot to be sold may be a customer's reference to the purchase date and time of the units of a particular digital asset to be sold if no other unidentified units were purchased at that same purchase date and time or purchase price.

For digital assets that are transferred into the customer's account and not acquired by the broker for the customer in that account, the final regulations permit the broker to rely on customer-provided information for the transferred-in assets, such as acquisition date, when determining which assets should be sold first. Absent such customer-provided information, transferred-in assets are generally treated as acquired on the transfer date for purposes of lot selection.

The final regulations also allow for standing instructions relating to lots to be sold as a form of adequate identification.

## Transfer Statements

The final regulations do not provide guidance with respect to transfer statements that are expected to be required when digital assets are transferred from one broker to another or when a broker transfers digital assets to a non-broker wallet. In the world of traditional securities, when a customer transfers covered securities from one broker account to an account at another broker, the sending broker is generally required to provide the receiving broker a transfer statement that contains tax lot and cost basis information for the securities transferred. Separate regulations under Section 6045A of the Internal Revenue Code are expected to address these situations. Guidance with respect to transfer statements will form a critical component of cost basis reporting as digital assets will often be transferred from broker to broker or between broker and non-broker wallets with relative frequency.

## Concluding Thoughts

The introduction of costs basis reporting for digital assets acquired and sold on or after January 1, 2026, will create a significant increase in the complexity for broker digital asset reporting. A system's ability to create and maintain tax lots for digital assets and identify the tax lot that is being sold by a customer will be critical. Brokers may need to work with business teams to determine what tax lot relief methodologies may be selected by a customer and how a customer would notify broker of a specific lot selection.

In addition, among the many complexities for cost basis reporting that may not be present with traditional stocks and securities is the fact that digital assets may be acquired not only by cash but by other property, including other digital assets. Tracking and allocating transaction costs create additional layers of complexity. Moreover, certain digital assets that may be classified as securities (e.g., certain tokenized securities) may also be subject to existing wash sales rules, which would impact both basis and holding period of the digital assets, often with retroactive effect.

Beyond these factors, it will be important to design systems that will be able to accept and process cost basis or other information relating to securities being transferred into or out of a customer account. Because rules relating to transfer statements are expected to come into play and the frequency of transfers of digital assets in and out of customer accounts are likely to be much higher than the case of traditional stocks and securities, the ability to manage cost basis information from external sources should be a factor in cost basis systems design and functionality.

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