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Proposed Crypto Reporting Regulations & CARF Requirements

June 10, 2024

Ahead of the wave

2024 U.S. Cross-Border Tax Conference

Notices

The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

With you today

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Agenda

Crypto Developments	• Government response • Regulatory activity
Crypto Basics	• Introduction to blockchains, decentralized organizations, and DAOs • Types of coins and crypto custody
Proposed digital asset regulations	• Overview of the new U.S. broker digital asset reporting rules • Industries and transactions in and out of scope
Information reporting and withholding (IRW) challenges	• Open questions related to the proposed regulations • IRW transactions
OECD and Crypto Asset Reporting Framework (CARF)	• CARF developments • Overview of CARF rules
Tax issues beyond IRW	• Guidance related to tax issues beyond IRW • Discussion of IRS guidance

01

Crypto Developments

Crypto developments

Government response

Astronomical pace of development with blockchain technology has triggered governmental responses

- Nine agencies respond with a “plan.” White House releases “Comprehensive Framework for Responsible Development of Digital Assets” – (September 16, 2022)
  - SEC, CFTC, CFPB, FTC, Treasury
  - Specifically calls out AML/KYC/CFT (combatting financing of terrorism)
  - White House states that it will “consider a federal framework to regulate non-bank payment providers.” This would eliminate the need for multi-state money transfer licenses
  - DOJ establishes Digital Asset Coordinators (DACs) – 150 federal prosecutors across the nation that specialize in crypto crimes
  - FATF (financial action task force) – focusing on regulation of VASPs (virtual asset service providers) and AML/KYC
  - OECD CARF (Crypto-asset Reporting Framework, with consultation document issued March 22, 2022, and final report issued October 10, 2022). It was announced in 2023 that the U.S. intended to participate in CARF
- Proposed Digital Asset Regulations published in the Federal Register (August 29, 2023)
  - Likely to be updated to incorporate U.S. participation in CARF

Crypto developments

Government response

- Treasury Inspector General for Tax Administration (TIGTA) Report (December 18, 2023)
  - The IRS is developing a digital asset monitoring and compliance strategy
  - Unable to complete development of the forms, instructions, and guidance until after the final digital asset regulations have been issued
  - Final regulations related to sections 6045 and 6050I are not complete and remain under development
  - IRS has announced that the application of sections 6045 and 6050I are delayed until guidance is issued
  - Working towards operationalizing digital asset work under a cohesive strategy across the IRS in late 2024
- SEC approved the listing and trading of a number of spot bitcoin exchange-traded products (January 10, 2024)
  - The ETFs appear to be structured as grantor trusts
  - Potentially triggers application of the widely held fixed investment trust (WHFIT) reporting rules

Crypto developments

Regulatory activity

Agencies looking to regulate certain transactions and activity

- Treasury (DOJ) has issued John Doe summonses to multiple crypto exchanges this year (SFOX – Aug. 15, 2022). Earlier summons were served on Coinbase, Kraken and others
- Coinbase insider trading case (July 2022)
  - DOJ brings wire fraud case against Coinbase employees for using inside information to trade ahead of coin listings
  - DOJ stuck to wire fraud charges (as opposed to insider trading) similar to the DOJ case against employee of OpenSea in NFT case (no securities present but still fraud)
  - In Coinbase, SEC brings separate civil case charging insider trading (need to prove securities exist)
  - SEC calls out 9 cryptocurrencies as "securities"
  - The 9 tokens are all different. Why were the other tokens involved NOT securities?
  - SEC subsequently alleged that Coinbase is operating an unregistered securities exchange

Crypto developments

Regulatory activity

Agencies looking to regulate certain transactions and activity

- Jarrett Refund Case –
  - Sought a refund of federal income taxes associated with receipt of token rewards for staking – rationale was that there should be no income event for tax purposes when tokens are self-created property
  - Jarrett argued that the token rewards are not subject to tax unless and until sold or exchanged which triggers a realization event
  - The IRS authorized a full refund on the Jarrett claims in December 2020
  - Jarret rejected the IRS refund offer in January 2021 because there was no assurance on the future treatment of crypto staking awards
  - Appeals Court recently concluded case was moot since IRS had issued the refund for the particular tax year
  - The IRS position that staking rewards constitute ordinary income upon receipt remains unchanged. See Rev. Rul. 2023-14

02

Crypto Basics

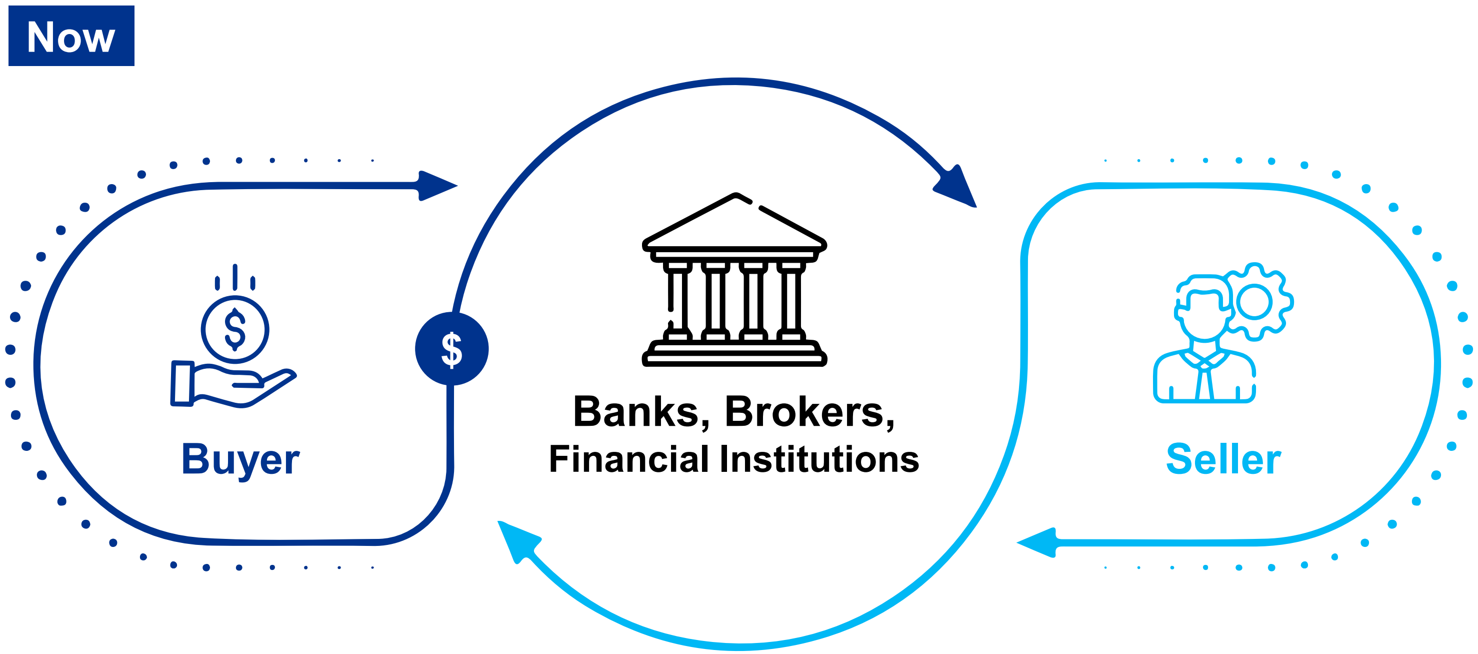
Crypto basics

Blockchain introduction

Blockchain: A system in which a record of transactions is maintained across multiple computers (nodes) that are linked in a peer-to-peer network…

…Enabling digital trust…

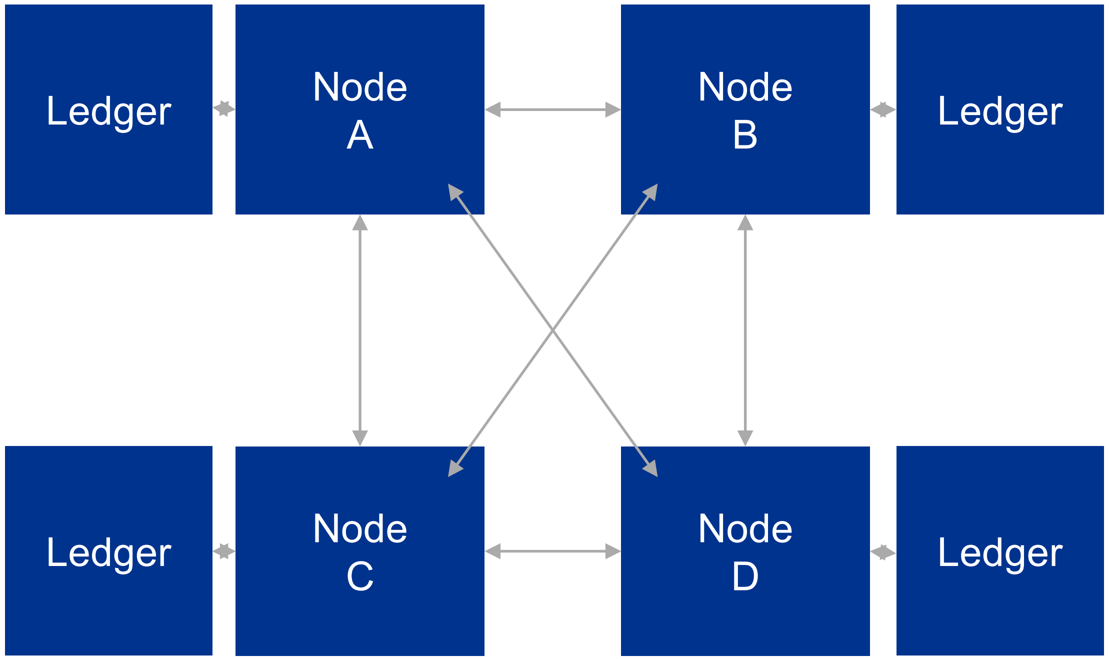
Removes the need for trusted intermediaries such as banks or brokers to serve as a trusted third-party. Each block references the transaction data from the prior block in an effort to link them together



Crypto basics

Distributed ledger technology (DLT)

- Blockchains are a form of Decentralized Ledger Technology (DLT)
- Unlike centralized ledgers kept by a traditional financial institution such as a bank, “accounts” are not kept in one intermediary’s ledger
- DLT allows copies of a ledger to be kept on a wide network of computers run by unrelated parties, without the need for a trusted intermediary
  - Transactions on the network are validated by certain participants (validators) utilizing an agreed-upon protocol
  - The protocol allows the ledgers at the different computer nodes to be synchronized
  - Generally, using blockchain DLT, transactions once validated on the network/ledger become essentially immutable

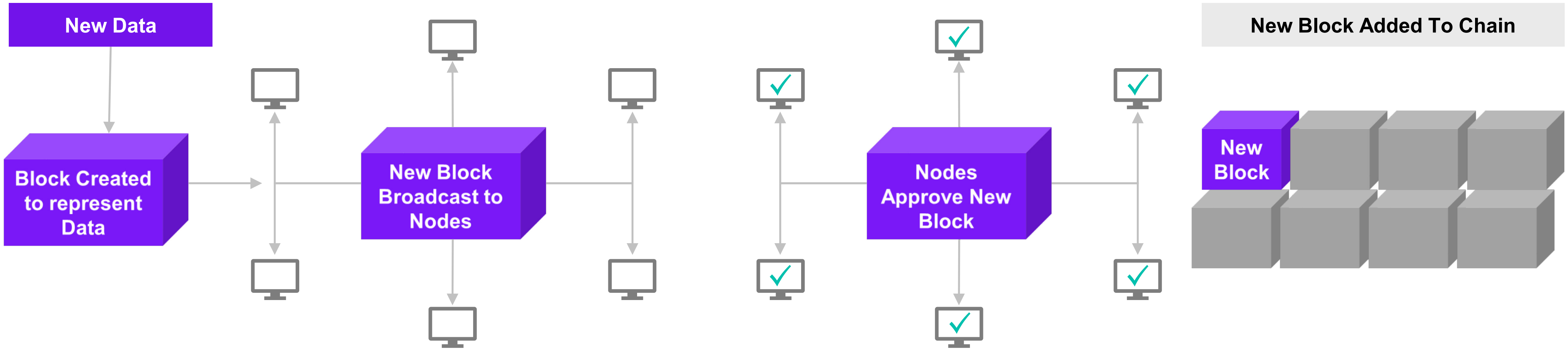


Crypto basics

Blockchain technology

New transactions are sent to all nodes which then get validated and grouped; this process is called **mining** or **consensus**

- Consensus ensures that peers on the network agree upon a consistent global state
- Once consensus is reached, the new block is posted on every node's blockchain
- Nodes will reject blocks whose data violates the protocol's rules or appears to have been tampered
- Common consensus mechanisms include Proof of Work (PoW) and Proof of Stake (PoS)



Crypto basics

Mining and Staking

Decentralized nodes maintaining the distributed ledger/blockchain utilize a consensus protocol to validate transactions

- Proof of Work
  - One of the most popular consensus protocols that requires persons “validating” the transactions to solve complicated computational puzzles to obtain the right to add a block of transactions to the blockchain
  - This activity is called mining and miners may receive both a transaction fee and rewards for their validation work if they are successful in adding the block to the blockchain
  - The mining process ensures that all transactions are genuine and protects the integrity of the blockchain
- Staking
  - Certain cryptocurrencies utilize a proof of stake consensus protocol. Under a PoS protocol, coin holders can “stake” their coins for a chance at validating transactions on the blockchain
  - Holders who stake do not need to solve complicated puzzles to validate a transaction, but are still validators

Crypto basics

Decentralized Autonomous Organizations (DAOs)

- Decentralized -- operate on a blockchain and is governed collectively by its members (via governance tokens)
- Autonomous -- its operating rules are pre-programed (via smart contracts) and automatically applied/executed on the blockchain (e.g., Ethereum) when specified conditions are met (i.e., no human intervention)
- Organizations – organized by real people, with a common goal, purpose or function, who pool resources or money to achieve that goal, purpose or function
- Examples
  - “DeFi” DAOs
  - “Collector” DAOs
  - “Social” DAOs

Crypto basics

Summary of blockchain components

Cryptography

- A blockchain is a chain of blocks which contain transaction information
- Each block of data contains a **unique hash key**, which is like a fingerprint, used to identify a block and its contents
- Each block contains transactions, a hash, and a copy of the hash of the previous block (with the exception of the **genesis block** which has no previous block hash). This concept makes the blockchain immutable. If data from a previous block changes, its hash changes, disconnecting it from the proceeding chain of blocks

Distributed ledger

- Instead of relying on a central authority to manage the ledger, blockchains use a distributed **peer-to-peer network**
- When someone joins the network, they download a full copy of the blockchain. Each new user, or computer, to the network is called a **node**
- Distributed peer-to-peer architecture provides benefits of higher **availability** than traditional client-server based networks

Consensus

- New transactions are sent to all nodes which then get validated and grouped; this process is called **consensus**
- Consensus ensures that peers on the network agree upon a consistent global state
- Once consensus is reached, the new block is posted on every node's blockchain
- Nodes will reject blocks whose data violates the protocol's rules or appears to have been tampered
- Common consensus mechanisms include Proof of Work (PoW) and Proof of Stake (PoS)

Smart contracts

- The main difference between a traditional contract and a smart contract is that smart contracts are automated
- A contract is created between parties
- Parties can choose to remain anonymous
- Predefined triggers are initiated
- The contract self executes as defined by the source code
- A participant can analyze all activities and make informed decisions
- The data captured can be used for analytics and reporting

Crypto basics

Types of crypto assets

Cryptoassets

Assets transacted using public blockchain protocols. Used to create network incentives, process transactions, and ensure completeness and accuracy

Bitcoin

Ethereum

Stablecoins

Tokens issued on public and private blockchains and which value is pegged to a physical asset's value, e.g., fiat currency, precious metals

USD coin

CBDCs

Digital currency issued by a central bank, most often utilizing a permissioned blockchain or distributed ledger technology (DLT) instead of public blockchains

SandDollar (Central Bank of The Bahamas)

Security tokens

Tokens issued on public and private blockchains, and which represent ownership interest in an underlying security instrument

The Aspen digital security token

Utility tokens

Tokens issued on public blockchains which are used for governance and to access features within middleware and decentralized applications

Maker

Uniswap

Crypto basics

A blockchain may undergo a change in software protocol (e.g., to increase size of a block)

- Soft forks generally retain the same “coin”
- Hard folks may result in a split chain and a new “coin”
- Raises significant tax reporting questions (discussed later)

Crypto basics

Understanding the types of crypto custody (commercial perspective)

Key considerations for custody & mitigation solutions

Next-gen Security & Resilience

- Layered security and operational defenses
- Balance key security and availability

Comprehensive Compliance

- Regulation-compliant processes
- Adaptable systems to react to regulatory changes

Third Party Trust

- Proof of Reserve reporting
- Independent auditor attestation

Value-adding and Scalable Systems

- Integrate into existing infrastructure
- Support participation in network activities

Custody solutions map

Qualified Custodians | Crypto Exchanges | Self Custody

Technology enablement

	HOT	WARM	COLD
Wallet Type	HOT	WARM	COLD
Storage Mechanism	Software	Software/Hardware	Hardware
Network Connectivity	Internet Connected	Network Segmented	Air Gapped Offline
Cryptographic Protection	Multi-Sig	HSM (Multi-Sig)	Multiple HSMs

Self Custody:

- Software Browser | Mobile | Desktop
- Hardware
- Physical Back-up

Commercial Crime Insurance

Crypto basics

Crypto payments is a critical use case for digital assets. There are many types of potential payments

Vendor payments

- What happens from a tax reporting perspective when vendors are paid in digital assets?
- What happens when you agree to receive digital assets for payments?
- Digital assets would generally need to translated to USD for Form 1099 reporting, likely based on date and time of payment
  - Is invoice in cryptocurrency or USD?
  - Will the translation rate used by the firm reporting on Form 1099-MISC or Form 1099-NEC be different than that the vendor expected?
  - Given the volatility of many cryptocurrencies, a system’s ability to monitor date and time of payment would be critical

Crypto basics

Types of crypto payments

Merchant payments

- Consumers are using crypto to shop and pay for items merchants
- The wider adoption of digital wallets has made it more convenient for cryptocurrency to be used as an acceptable form payment for retailers
- Can have lower transaction fees than credit card payment processes
- Appeals to merchants as once a customer completes a transaction with crypto currency it is difficult to reverse if the merchant doesn’t consent
- Notable cryptocurrency payment processors include the likes of BitPay, CoinPayments, Coinbase, etc.

Crypto basics

Types of crypto payments

Crypto-linked payment cards

- Some institutions are providing payment cards, such as debit cards, linked to accounts holding crypto assets
- Institutions will need to review their payment flows and legal documentation
- These platforms can generate multiple reporting events
- A payment may involve the sale of digital assets in the account in order to facilitate fiat payment on the card purchase such as would require broker reporting
- Rebate rewards may be translated back to cryptocurrency
- There may be no reporting on the rebate but the cost basis of cryptocurrency obtained from the rebate amount would need to be tracked
- The rebate would not itself be taxable under the IRS guidance that credit card rewards reduce the cost basis of the item being purchased (which essentially means they are never taxed if it is a personal expenditure)
- Actual payments in crypto assets may be a transfer that is a taxable sale
- In these scenarios, what appears to be transactions in the realm of payment processing also results in sales of crypto assets that could be subject to new broker tax reporting rules

03

Proposed Digital Asset Regulations

Proposed digital asset regulations

Treasury and IRS published proposed regulations on August 29, 2023, in the Federal Register

Issued principally under the authority of amendments made to existing broker reporting provisions enacted as part of the Infrastructure Investment and Jobs Act of 2021 (Infrastructure Act)

- Section 6045 of the Internal Revenue Code (Code)
- Also contains rules under sections 6050W, 1001, and 1012
- Rules intended to increase tax compliance by:
  - Allowing the IRS to verify a taxpayer's income from digital asset transactions
  - Providing taxpayers tax-relevant information for filing their tax returns
- The package of proposed regulations is expansive in its coverage
  - Reporting on gross proceeds relating to the sales of digital assets would be effective for sales occurring on or after January 1, 2025
  - Reporting cost basis for the sale of certain sales of digital assets that are classified as "covered securities" would be required for sales occurring on or after January 1, 2026
  - Under the proposed regulations, cost basis reporting would cover assets acquired on or after January 1, 2023

Proposed digital asset regulations

Not straightforward and includes a relatively broad definition of “broker” and “digital assets”

Series of interconnected definitions such as “sale,” “effect,” and new definitional categories such as “Digital Asset Middleman” and “Digital Asset Payment Processor”

- In scope
  - Custodial brokers
    - Act in the role of traditional brokers
    - Digital assets generally held in the custody of the broker
      - Broker has control over private keys to the wallets holding the digital assets
      - Broker acts as agent for the customer on trades
  - Issuers of digital assets that regularly redeem such assets (e.g., certain issuers of new coins/stablecoins)
  - Certain decentralized exchanges that fall within the new category of Digital Asset Middleman
  - Digital Asset Payment Processors
  - Real Estate Reporting Persons

Proposed digital asset regulations

Participants excluded from the broker reporting requirements

Blockchain transaction validators whose sole activity is the validation of transactions on a blockchain

- Miners on proof of work blockchains and validators on proof of stake blockchains
- Sellers of hardware and software wallets the sole function of which is to allow users to control private keys for accessing their digital assets
  - If the wallet platform provides users with direct access to trading platforms, the providers remain in-scope under the regulations
- Merchants that accept digital assets directly on a sale of their own goods or services and NFT creators who mint and sell their own NFTs

Decentralized Platforms that are NOT treated as a Digital Asset Middleman

- Analysis revolves around platforms and smart contracts that automatically execute transactions
- Person or group of persons maintaining sufficient control over the contract and deemed able to collect customer information and report on sales transactions

Proposed digital asset regulations

Digital asset middleman

Provides a service that directly or indirectly effectuates a sale of digital assets. Additionally, where the person knows or is in a position to know the:

- Identity of the party making the sale; and
  - Retaining sufficient control or influence to be able to set or change the terms under which the services are provided to request that the party making the sale provide the party's name, address, and taxpayer identification number (TIN)
- Nature of the transaction giving rise to gross proceeds from the sale
  - Maintaining sufficient control or influence over provided services to be able to determine whether and the extent to which the transfer of digital assets involved in a transaction gives rise to gross proceeds
  - A person with the ability to change the fees charged for the service is a person that maintains such sufficient control and influence

Proposed digital asset regulations

Digital asset payment processors are in scope

Persons who in the ordinary course of a trade or business stand ready to effect sales of digital assets by:

- Regularly facilitating payments from one party (buyer) to a second party (vendor or seller) by receiving digital assets from the first party and exchanging those digital assets into cash or different digital assets paid to the second party;
- Acting as a third-party settlement organization (a TPSO under section 6050W) that facilitates payments, either by making or submitting instructions to make payments using one or more digital assets in settlement of a reportable payment transaction under section 6050W without regard to whether the TPSO contracts with an agent to make, or to submit the instructions to make, such payments; or
- Acting as a payment card issuer that facilitates payments, either by making or submitting the instruction to make payments, in one or more digital assets to a merchant acquiring entity in a transaction that is associated with a payment made by the merchant acquiring entity, or its agent, in settlement of a reportable payment transaction under the merchant payment card rules of section 6050W

Proposed digital asset regulations

Reportable information on sales

Customer Information	Transaction Information	Transfer Information (for hosted wallets)
Customer Name	Digital Asset (DA) Name	Transfer Date and Time
Customer Address	Digital Asset Quantity (units)	Transfer Transaction ID
Customer TIN	Sale Date and Time	Transfer from Wallet Address(es)
	Gross Proceeds	Transfer Quantity (units)
	Transaction ID	
	Wallet Address(es)	
	Sale For Info (cash, cards, services, property)	

Proposed digital asset regulations

DRAFT 2025 Form 1099-DA, Digital Asset Proceeds from Broker Transactions

7A7A ☐ VOID ☐ CORRECTED

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

Applicable checkbox on Form 8949

OMB No. 1545-XXXX

2025

Form 1099-DA

Digital Asset Proceeds From Broker Transactions

Broker type involved in transaction:
- ☐ Kiosk Operator
- ☐ Digital Asset Payment Processor
- ☐ Hosted Wallet Provider
- ☐ Unhosted Wallet Provider
- ☐ Other

Copy A

For Internal Revenue Service Center

File with Form 1096.

FILER'S TIN

RECIPIENT'S TIN

Explanation if no recipient TIN

1a Code for digital asset

1b If 1a coded 999999, name of digital asset

RECIPIENT'S name

1c Number of units

Street address (including apt. no.)

1d Date and time acquired

1e Date and time sold or disposed

City or town, state or province, country, and ZIP or foreign postal code

1f Proceeds $

1g Cost or other basis $

1h Accrued market discount $

1i Wash sales loss disallowed $

2 Check if basis reported to IRS

3a Reported to IRS:

For Privacy Act and Paperwork Reduction Act Notice, see the **2025 General Instructions for Certain Information Returns.**

Proposed digital asset regulations

DRAFT 2025 Form 1099-DA, Digital Asset Proceeds from Broker Transactions

DO NOT FILE

CUSIP number

3b

4 Federal income tax withheld
$

5 Check if loss is not allowed based on amount in 1f

6 Gross gain or loss:
- Short-term
- Long-term
- Ordinary

7a Check if 1f includes cash proceeds

7b Check if 1f includes non-cash proceeds

8 If 7b checked, type of non-cash proceeds

9 If 8 coded OTH, name and/or explanation of non-cash proceeds

10a Check if digital asset is a noncovered security

10b Digital asset is a noncovered security because:
- Broker did not provide hosted wallet services for it
- It was transferred in to broker
- It was acquired prior to 2023

11a Sale transaction ID (TxID)

11b Digital asset address

11c Number of units

11d Check if sale is not recorded on the distributed ledger

12a Transfer-in TxID number

12b Transfer-in digital asset address

12c Number of units transferred

12d If transfer-in not recorded on the distributed ledger, provide transfer-in date and time

13

14 State name

15 State identification no.

16 State tax withheld
$
$

Form **1099-DA** Cat. No. 73567I www.irs.gov/Form1099DA Department of the Treasury - Internal Revenue Service

Proposed digital asset regulations

Reportable information on sales

- Cost basis reporting, including reporting of whether any gain or loss is long-term or short-term and the acquisition date, would be required for digital assets that are “covered securities” for sales occurring on or after January 1, 2026
- With respect to digital assets, covered securities currently means only digital assets acquired on or after January 1, 2023, for cash, stored value cards, broker services or other property and maintained in a broker custodial account for the entire period of time from acquisition date to sale
- Options on digital assets (or derivatives of digital assets) that are not themselves digital assets may be treated as covered securities if granted or acquired on or after January 1, 2023, if they otherwise meet the requirements relating to broker reporting of options generally. Certain forward contracts on digital assets (where the contracts themselves are not digital assets) that are disposed of before delivery acquired on or after January 1, 2023, would be treated as covered securities
- The requirement for cost basis reporting is currently limited to the situations above, pending additional guidance from the Treasury and the IRS under section 6045A and section 6045B, that relate to transfer reporting and organizational actions reporting
- It is important also to note that a sale of a covered security on or after January 1, 2026 may be with respect to digital assets acquired as early as January 1, 2023, requiring an ability of the system to trace back the original acquisition cost information

FATCA and the CRS

For accounts outside the U.S., it is still uncertain whether crypto accounts are reportable for FATCA and CRS

- In one case, exchange Bitfinex (BVI) included a notice of FATCA/CRS documentation requests in its terms of service
- The OECD has released a document that provides a new Crypto-Asset Reporting Framework (CARF) and amendments to CRS to cover crypto assets

04

IRW Challenges

IRW challenges

Questions related to the proposed digital asset regulations

- What are the information withholding and reporting compliance obligations of the digital wallet owner, node, exchange, miner, etc.?
- Who collects Forms W-8s and W-9s and validates them?
- Who should issue a Form 1042-S, Form 1099-K, or Form 1099-MISC?
- Who should receive a Form 1042-S, Form 1099-K, or Form 1099-MISC?
- Are there other Form 1099 reporting regimes applicable to a digital asset business outside of broker reporting?
- Who is the broker? Would a decentralized autonomous organization (DAO) be a broker?
- Should the broker reporting regulations apply to initial coin offerings, simple agreements for future tokens, and similar contracts?
- Should the definition of sale address transactions such as the transfer of digital assets to and from a liquidity pool by a liquidity pool provider, or the wrapping and unwrapping of digital assets?
- How to avoid duplicative multiple broker reporting for sale transactions involving digital asset brokers without sacrificing the certainty that at least one of the multiple brokers will report?
- Should the current rules for transfer statements remain applicable for securities that are also digital assets?
- Who would be the responsible party required to provide basis reporting for securities that are digital assets?

IRW challenges

Crypto events that may have IRW and tax consequences

Miners and stakers receive rewards for validating transactions

- IRS in Notice 2014-21 states that miners realize income when they receive the mining rewards in cryptocurrency based on the fair market value on the date of receipt; in addition, this could also be self-employment income
- In documents supporting a John Does summons served earlier in 2021 the IRS also indicated that staking rewards are income. A similar position was taken in Rev. Rul. 2023-14
- The Jarret case is interesting. Jarrett originally reporting the creation of reward tokens on his tax on Line 8 of his schedule C. Later Jarrett filed an amended return for a tax refund claiming that the reward token didn’t create taxable income. Jarrett essentially argued there should be no income even for tax purposes when tokens are first created thru staking. The IRS offered a full refund (~$4k) but Jarrett rejected the refund as Jarrett believes that reward token itself (property) shouldn’t be taxable until it is sold or exchanged which causes an income realization event
- Exchanges and other firms may allow a customer to stake proof of stake assets and receive a portion of the staking reward
  - They may file a Form 1099-MISC for this. What about 1099-NEC?

IRW challenges

Crypto events that may have IRW and tax consequences (continued)

Crypto forks

- A blockchain may undergo a change in software protocol (e.g., to increase size of a block)
  - Soft forks generally retain the same “coin”
  - Hard folks may result in a split chain and a new “coin”
- How is a crypto fork to be treated?
  - Taxable event with basis for the new coin equal to FMV?
  - Nontaxable event – but what about basis for the new and old coins?
    - Allocate between old coin and new coin?
    - Zero basis for new?
  - IRS takes the position that soft forks are not taxable events (see CCA 202316008)
  - IRS takes the position that hard forks are taxable events – receipt of new coins in the hard fork is treated as ordinary income equal to the FMV of the new coin (see Rev. Rul. 2019-24; CCA 202114020)
    - One of the biggest issues with the IRS position is how to determine the new currency and the old currency. For example, in the ETH-ETC hard fork, ETH was technically the "new" currency in that it resulted from the protocol change, but it also comprised the vast majority of value (ETC was supposed to be a "ghost" chain)

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IRW challenges

Crypto events that may have IRW and tax consequences (continued)

Operational issues

- Fair market values
- Timing of recognition – sometimes a user may not have access to coin – e.g., exchange may not support new coin or there may be a time lag (Rev. Rul. 2019-24 indicates that recognition occurs when taxpayer has dominion and control over the new coins)

Brokers that need to maintain basis information and other custodians that hold digital assets on behalf of customers will need to monitor crypto events for impact on basis and reporting

- For example, in the hard fork mentioned before, a software protocol change for a cryptocurrency may result in a new coin created in addition to the continuance of the legacy coin
- In Rev. Rul. 2019-24 and CCA 202114020 the IRS took the position that a hard fork is a taxable event
- How do you report?
  - FMV of new coin on a Form 1099-MISC and FMV becomes basis of new coin?

IRW challenges

Crypto events that may have IRW and tax consequences (continued)

A customer may receive cryptocurrency as part of an "airdrop"

- May be a promotion of a new cryptocurrency given to holders of certain other tokens
- Likely will need to report on a Form 1099-MISC and possibly in the future maintain new cost basis

Crypto lending

- Some exchanges and crypto firms are allowing customer to lend their digital assets
  - Crypto lending raises a number of substantive tax and tax reporting issues
    - Does the act of lending itself give rise to a reportable sale?
    - What about the timing and nature of the "earnings" received in crypto lending?

While crypto lending rewards are sometimes called "interest earnings" they often are not interest for tax purposes

- Crypto assets are property (not money) and generally do not give rise to a debt obligation when lent
  - However, what about stable coins that are pegged to USD and backed by U.S. dollars?
- From a reporting standpoint, this is the difference between a Form 1099-MISC vs. a Form 1099-INT
  - This may have cross-border withholding and reporting impact and other implications (e.g., limitations applicable to "interest" such as section 163(j))

IRW challenges

Crypto events that may have IRW and tax consequences (continued)

Incentives/Rewards

- Prizes, rewards, “pennies from heaven” are generally includible in gross income for U.S. tax purposes
- Exchanges may provide such rewards to customers, for example, simply for learning about a new cryptocurrency
  - They generally report these rewards on a Form 1099-MISC
- But under the broker reporting regime, they may now also need to record the FMV of the reward as part of the cost basis of the units of crypto currency now in the customer’s account

IRW challenges

Crypto events that may have IRW and tax consequences (continued)

Nonfungible Tokens (NFTs)

- Digital assets that may represent certain rights to digital art or other digital media (e.g., virtual trading cards, digital artwork, virtual land)
- Creators mint new NFTs and sell them in a marketplace, but a marketplace may allow users to trade NFTs with one another
- For these marketplaces, it is useful to understand the underlying legal relationships and the flow of funds
  - Are purchasers and sellers interacting peer-to-peer only?
  - Is the platform standing in between from a payment processing standpoint?
  - Who is the purchaser buying the NFT from?

IRW challenges

Crypto events that may have IRW and tax consequences (continued)

Nonfungible Tokens (NFTs)

- Under the proposed broker digital asset tax reporting rules, certain NFT marketplace platforms can be considered brokers subject to reporting
- Special considerations for NFTs include:
  - NFTs are often purchased using cryptocurrency. So the purchase of an NFT may trigger several sales events:
    - Sale of cryptocurrency to pay for NFT;
    - Sale of cryptocurrency to pay for “gas” needed to execute the transaction on the blockchain;
    - Sale of the NFT
  - Since, unlike payment tokens, NFTs are generally nonfungible, what happens if an NFT is the proceeds received from the exchange of cryptocurrency and if information reporting rules require you to backup withhold on these proceeds?

05

OECD Crypto Asset Reporting Framework (CARF)

OECD Crypto Asset Reporting Framework (CARF)

April 2021, the G20 mandated the OECD develop a framework providing for the automatic exchange of tax-relevant information on Crypto-Assets

Response to the rapid development and growth of the Crypto-Asset market and effort to ensure that recent gains in global tax transparency will not be gradually eroded

- OECD approved CARF which provides for the reporting of tax information on transactions in Crypto-Assets in a standardized manner (August 2022)
  - Three distinct components:
    - Rules and related Commentary
    - Multilateral Competent Authority Agreement on Automatic Exchange of Information and related Commentary
    - Electronic format (XML schema)
  - Defines: Relevant Crypto-Assets in scope and intermediaries and other service providers that will be subject to reporting
  - Incorporates recent developments in the global anti-money laundering (AML) standards of the Financial Action Task Force (FATF)

OECD Crypto Asset Reporting Framework (CARF)

August 2022, the OECD also approved amendments to the CRS to bring certain electric money products and Central Bank Digital Currencies in scope

In light of the CARF, the OECD made changes to ensure that indirect investments in Crypto-Assets through derivatives and investment vehicles are now covered by the CRS

- Amendments strengthen the due diligence and reporting requirements
  - Includes a requirement to report the role of each Controlling Person and a carve-out for genuine non-profit organizations

November 2023, the United States is included in the Joint Statement for collective engagement to implement CARF

- Work towards swiftly transposing the CARF into domestic law and activating exchange agreements in time for information exchanges to commence in 2027 (subject to national legislative procedures)

OECD Crypto Asset Reporting Framework (CARF)

Key components of the CARF

Crypto-Asset Service Providers required to report include any individual or Entity that, as a business, provides a service effectuating Exchange Transactions for or on behalf of customers, including by acting as counterparty, or as an intermediary, to such Exchange Transactions, or *by making available a trading platform*

- This will generally cover centralized crypto exchanges and brokers
- The rules may also mean that certain "decentralized" trading platforms would be in scope to the extent an individual or entity "exercises control or sufficient influence" over the platform, allowing it to comply with due diligence and reporting obligations of CARF

CARF provides guidance on the following:

- Crypto-Assets in scope
- Individuals and Entities subject to due diligence and reporting obligations
- Transactions subject to reporting
- Information required to be reported for each transaction
- Due diligence procedures to identify Crypto-Asset Users and Controlling Persons
- Determining tax jurisdictions for automatic exchange of information

OECD Crypto Asset Reporting Framework (CARF)

Crypto-Assets in scope

Relevant Crypto-Assets

- Crypto-Asset is a digital representation of value that relies on a cryptographically secured distributed ledger or similar technology to validate and secure transactions
- A Relevant Crypto Asset is any Crypto-Asset that is not a:
  - Central Bank Digital Currency (any digital Fiat Currency issued by a Central Bank)
  - Specified Electronic Money Product
    - A digital representation of a single Fiat Currency
    - Issued on receipt of funds for the purpose of making payment transactions
    - Accepted in payment by a natural or legal person other than the issuer
    - By virtue of regulatory requirements to which the issuer is subject, redeemable at any time and at par value for the same Fiat Currency upon request of the holder of the product
  - Any Crypto-Asset for which the Reporting Crypto Asset Service Provider has adequately determined that it cannot be used for payment or investment

OECD Crypto Asset Reporting Framework (CARF)

Reportable transactions

- Reportable transactions will generally include:
  - Exchange of crypto assets for fiat;
  - Exchange of crypto asset for other crypto assets; and
  - Transfers of crypto assets, including break-out of incoming and outgoing transfers, transfers with respect to certain retail transactions exceeding USD $50,000, transfers to private wallet addresses, among others
  - Transfers to a user account due to an airdrop are in-scope for reporting
- Reporting is generally broken down by each crypto-asset type
- The CARF provisions would also require reporting Crypto-Asset Service Providers to conduct tax due diligence on crypto asset users, including obtaining certification of a relevant user's tax residence (similar to CRS)
- It will be interesting to see how much of the CARF principles end up being incorporated in U.S. broker crypto reporting regulations and how they may be impacted if the U.S. participates in CARF

OECD Crypto Asset Reporting Framework (CARF)

Obligations of Crypto-Asset Service Providers

A Reporting Crypto-Asset Service Provider is subject to the reporting and due diligence requirements, if it is:

- An Entity or individual resident for tax purposes in a participating jurisdiction
- An Entity that:
  - Is incorporated or organized under the laws of a participating jurisdiction and
  - Either has legal personality in a participating jurisdiction or has an obligation to file tax returns or tax information returns to the tax authorities in a participating jurisdiction with respect to the income of the Entity;
  - An Entity managed from a participating jurisdiction; or
  - An Entity or individual that has a regular place of business in a participating jurisdiction
- A Reporting Crypto-Asset Service Provider is subject to reporting and due diligence requirements with respect to Relevant Transactions effectuated through a Branch based in a participating jurisdiction

OECD Crypto Asset Reporting Framework (CARF)

Reporting obligations of Crypto-Asset Service Providers

An entity or individual resident for tax purposes in a participating jurisdiction must, for each relevant calendar year or other appropriate reporting period, report the following information with respect to its Crypto-Asset Service Providers:

- Name
- Address
- Jurisdiction(s) of residence
- Taxpayer identifying number(s) (TINs)
- Date of birth (in the case of an individual)
- Place of birth (in the case of an individual)
- Controlling Persons that are Reportable Persons of Entities
  - Same information as above and
  - The role(s) by virtue of where each Reportable Person is a Controlling Person of the Entity
- Name, address, and identifying number (if any) of the Reporting Crypto-Asset Provider

OECD Crypto Asset Reporting Framework (CARF)

Reporting obligations of Crypto-Asset Service Providers (continued)

For each type of Relevant Crypto-Asset with respect to which it has effectuated Relevant Transactions during the relevant calendar year or other appropriate reporting period:

- Name of the type of Relevant Crypto-Asset
- Aggregate gross amount paid, aggregate number of units, and number of Relevant Transactions in respect of:
  - Acquisitions against Fiat Currency
  - Disposals against Fiat Currency
  - Acquisitions against other Relevant Crypto-Assets
  - Disposals against other Relevant Crypto-Assets
- Aggregate FMV, the aggregate number of units, and the number of Reportable Retail Payment Transactions
- Similar details related to transfers

OECD Crypto Asset Reporting Framework (CARF)

Due diligence obligations of Crypto-Asset Service Providers

Individual Crypto-Asset Users:

- When establishing a relationship with the Individual Crypto-Asset User, or with respect to Preexisting Individual Crypto-Asset Users:
  - By 12 months after the effective date of CARF reporting Crypto-Asset Service Providers must:
    - Obtain a self-certification that helps the Crypto-Asset Service Provider determine the Individual's residence(s) for tax purposes
    - Confirm the reasonableness of such self-certification based on the information obtained by the Reporting Crypto-Asset Service Provider
      - Including any documentation collected pursuant to AML/KYC Procedures
- If there is a change of circumstances that causes the Reporting Crypto-Asset Service Provider to know, or have reason to know, that the original self-certification is incorrect or unreliable, the Reporting Crypto-Asset Service Provider cannot rely on the original self-certification
  - Must obtain a valid self-certification, or a reasonable explanation and, where appropriate, documentation supporting the validity of the original self-certification

OECD Crypto Asset Reporting Framework (CARF)

Due diligence obligations of Crypto-Asset Service Providers (continued)

Entity Crypto-Asset Users:

- When establishing a relationship with the Entity Crypto-Asset User, or with respect to Preexisting Individual Crypto-Asset Users by 12 months after the effective date of CARF a Reporting Crypto-Asset Service Provider must:
  - Obtain a self-certification that helps the Crypto-Asset Service Provider determine the Entity's residence(s) for tax purposes
  - Confirm the reasonableness of such self-certification based on the information obtained by the Reporting Crypto-Asset Service Provider
    - Including any documentation collected pursuant to AML/KYC Procedures
  - If the Entity certifies that it has no residence for tax purposes, the Reporting Crypto-Asset Service Provider may rely on the place of effective management or on the address of the principal office to determine the residence of the Entity
- If the self-certification indicates that the Entity is a resident in a Reportable Jurisdiction, the Reporting Crypto-Asset Service Provider must treat the Entity as a Reportable User, unless it reasonably determines based on the self-certification or other information in its possession or that is publicly available, that the Entity is an Excluded Person

OECD Crypto asset reporting framework (CARF)

Due diligence obligations of Crypto-Asset Service Providers (continued)

Determine whether the Entity has one or more Controlling Persons who are Reportable Persons

- Applies to Entities other than Excluded Persons and Active Entities (based on self-certification)
- Reporting Crypto-Asset Service Provider may rely on information collected and maintained pursuant to AML/KYC Procedures, so long as they are consistent with the 2012 FATF Recommendations (as updated in June 2019 pertaining to virtual asset service providers)
  - If the Reporting Crypto-Asset Service Provider is not legally required to apply AML/KYC procedures, it must apply substantially similar procedures for purposes of determining the Controlling Persons
- Must rely on a self-certification from the Entity or such Controlling Person that allows the Reporting Crypto-Asset Service Provider to determine the Controlling Person(s) residence(s) for tax purposes and confirm the reasonableness of such self-certification based on information obtained by the Reporting Crypto-Asset Service Provider, including any documentation collected pursuant to AML/KYC Procedures
- Same change of circumstances as Individuals applies to Entities and Controlling Persons

OECD Crypto asset reporting framework (CARF)

Due diligence obligations of Crypto-Asset Service Providers (continued)

Validation Procedures for Individuals and Controlling Persons

- Self-certification is valid only if it is:
  - Signed or otherwise positively affirmed by the Individual or Controlling Person
  - Dated at the latest at the date of receipt
  - Contains the following information:
    - First and last name
    - Residence address
    - Jurisdiction(s) of residence for tax purposes
    - The TIN for each Reportable Person with respect to each Reportable Jurisdiction
    - Date of birth
- For both Individuals and Entities, the TIN is not required to be collected if the jurisdiction of residence of the Reportable Person does not issue a TIN or domestic law of the Reportable Jurisdiction does not require the collection of a TIN

OECD Crypto asset reporting framework (CARF)

Due diligence obligations of Crypto-Asset Service Providers (continued)

Validation Procedures for Entities

- Self-certification is valid only if it is:
  - Signed or otherwise positively affirmed by the Individual or Controlling Person
  - Dated at the latest at the date of receipt
  - Contains the following information:
    - Legal name
    - Address
    - Jurisdiction(s) of residence for tax purposes
    - The TIN for each Reportable Person with respect to each Reportable Jurisdiction
    - Entities other than Active Entities or Excluded Persons
      - Information required for Individuals related to each Controlling Persons
      - The role(s) by virtue of which each Reportable Person is a Controlling Person, if not determined by AML/KYC Procedures
    - If applicable, information as to the criteria it meets to be treated as an Active Entity or Excluded Person

06

Tax Issues Beyond IRW

Tax issues beyond IRW

Notice 2014-21

- IRS announced that “virtual currencies” (as defined) are treated as property and not currency for tax purposes
- As a general rule, the taxation of a given financial instrument depends on its tax classification (i.e., as debt, equity, a derivative, etc.)
- Virtual currency is not treated as currency that can generate foreign currency gain or loss

IRS FAQs

- Expand upon Notice 2014-21 and apply the principles set forth therein to additional situations
- As with Notice 2014-21, the IRS FAQs provide that virtual currency is to be treated as “property” (and not currency)
- “In some environments, [virtual currency] operates like “real” currency (i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance), but it does not have legal tender status in the US.”

Tax issues beyond IRW

Timing issues

- Sales/Exchanges: The sale or exchange of a virtual currency for property or cash is a taxable transaction that can result in gain or loss equal to the difference between FMV and basis
- Spending: Any payment for goods or services with a virtual currency likewise is a taxable transaction that can result in gain or loss
- Earning: Virtual currency received as a payment for goods or services (including "mining" per Notice 2014-21) must be included in income (in US dollars) at its FMV; tax basis then equals FMV
- Hard Forks: "Airdrops," on account of hard forks, once one has dominion and control, with "new" cryptocurrency likely ordinary income as there is no "sale or exchange" (Rev. Rul. 2019-24 and CCA 202114020)

Tax issues beyond IRW

Character of income – Mining and staking

- Notice 2014-21 states that mining awards must be included in gross income
- The IRS position is that staking rewards constitute ordinary income upon receipt. See Rev. Rul. 2023-14
  - There is an alternative “self created property” position under which staking rewards would not be taxed until sold, there have also been legislative proposals that would provide for this result
- If a miner or staker has ordinary income upon receipt of a cryptocurrency award, can a later sale or other disposition of such cryptocurrency produce capital gain?

Trade or business – Mining and staking

- Notice 2014-21 does suggest that mining can be a trade or business, but does not conclude that it always is
- Both mining and staking are largely passive activities in that computers do most of the work; however, most tax advisors believe that mining and staking can be construed as “active” income from services
  - There are also different forms of staking, from taxpayer running a node themselves to delegated staking which may have implications as to whether there is a trade or business
- How to determine where the trade or business or service takes place
- Relevant to determine if non-US persons are engaged in a US trade or business or sourcing for withholding purposes

Tax issues beyond IRW

Wash sale rules

- Market participants have asked whether cryptocurrencies are “stock or securities” subject to the wash sale rules
- Foreign currencies are not securities for purposes of the wash sale rules. Cryptocurrencies might be sufficiently similar to foreign currency to apply this authority by analogy
- Cryptocurrencies are economically similar to commodities and have been classified as commodities by the CFTC. Commodities are not securities for purposes of the wash sale rules
- Gantner, the most recent court decision considering the meaning of the term “security” in the wash sale context, narrowly interpreted the term to include only instruments that Congress had knowledge of when first enacting the statute. This would not include cryptocurrencies
- There has been legislation proposed that would expand the wash sale rules to “digital assets” (among other asset classes)
- Note – the wash sale rules do not apply to positions that are marked to market

Tax issues beyond IRW

Legal entity status of DAOs

- Most are not formed as legal entities - amorphous organizations built on computer code that exist on a blockchain
- If not a legal entity, operational issues exist (opening bank accounts, transacting with third parties, protecting intellectual property, limiting liability of the members, etc.)
- Possible solution – “wrapping” a DAO with a legal entity (Cayman foundation, Wyoming, etc.) or general partnership status

Tax status of DAOs

- No definitive tax guidance to date on the tax classification of DAOs
- Lummis-Gillibrand Responsible Financial Innovation Act (June 7, 2022)
- Section 204 specifies that “DAOs” are business entities for purposes of the Code . . . but, then defines “DAOs” as organizations “incorporated or organized” under the laws of a state or foreign jurisdiction, such that most DAOs likely not covered by the provision
- Even though not formed as legal entities, DAOs could be tax entities
- Broad definition of “partnership” in section 761 and under case law (Culberston and Luna)

Tax issues beyond IRW

Tax status of DAOs (continued)

- If a DAO issues governance tokens only, perhaps no sharing of profits, and therefore no entity?
- Default classification, or affirmative election (if an eligible entity)?
- Is the DAO a domestic or foreign entity?
- Could a DAO be a “publicly traded partnership” within the meaning of section 7704?
- Consequences of Tax Entity Status?
  - Taxation of owners/members (under Sub K or Sub C regime)
  - Filing of tax and information returns (entity tax returns as well as information returns, such as K-1s, 1099s, etc.)
  - If foreign, USTB/ECI, CFC, PFIC, etc.
  - Tax withholding obligations
  - Tax elections and audit rules

04

Q&A

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