

Alert | Tax/Blockchain & Digital Assets



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UPDATED: Infrastructure Bill Contains New Cryptocurrency Reporting Requirements

The U.S. Senate passed its infrastructure bill (the “Bill”) that includes additional cryptocurrency reporting requirements, which are expected to generate \$28 billion in revenue. The Bill currently does not provide the IRS with any additional funding to increase tax enforcement, as contemplated earlier. However, the Bill includes a provision on information reporting for cryptocurrency transactions and brokers of cryptocurrency and provides for non-compliance penalties.

Specifically, Section 80604 of the Bill would require businesses that transmit digital assets to file tax information reports similar to the Form 1099 requirements for securities brokers. The definition of a person responsible for filing such reports is broad: “*any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets.*” This is intended to require information reporting for cryptocurrency exchanges but could be interpreted to cast a wider net to require other segments of the blockchain industry, such as cryptocurrency payment service providers, to file information reports.

Further, as tax-free Section 1031 like-kind exchange rules do not apply to the conversion of one cryptocurrency for another cryptocurrency, the Bill could be interpreted to include information reporting on all exchanges of digital assets, regardless of whether the exchange involves U.S. -dollar or any other fiat currency. Similarly, the Bill may also require reporting any involuntary receipt of cryptocurrencies in hard forks, airdrops, or other rewards. Generally, airdrops occur when a new blockchain project distributes free tokens to existing holders of specific cryptocurrencies such as Bitcoin and Ethereum. A hard fork is a

material change to a blockchain-system protocol that generally (but not always) results in a split of the existing blockchain protocol under which a holder of a pre-split cryptocurrency typically receives additional cryptocurrencies generated by the newly created blockchain. Some cryptocurrencies may also be issued as rewards for using an app, purchasing merchandise, referring customers, watching advertisements, etc. Information reporting related to hard forks, airdrops, or other rewards could be onerous because not all holders of an existing cryptocurrency may have immediate dominion and control over the newly created cryptocurrency.

The term “digital asset” is likewise broad, defined as “...*any digital representation of value which is recorded on a cryptographically secured distributed ledger or similar technology...*” This would apply not only to cryptocurrency transactions but also to an interest in a company represented by a blockchain token, utility tokens, visual and audio works in the medium of non-fungible tokens (NFTs) or any other cryptographic representation of value that may unfold in the future. Since an art dealer selling NFTs is doing so for consideration, the IRS might require dealers who sell NFTs to file tax information reports on the sale of such digital assets, even if the dealer is using a third-party platform to sell NFTs rather than its own platform to execute its sales.

The Bill would allow the IRS to trace the transfer of digital assets when there is no sale or exchange that would otherwise trigger an IRS reporting requirement. The proposed amendment to Section 6045A would require a broker to file tax information returns to report transfers of digital assets not part of a sale, or exchanges from an account maintained by brokers to an account that is not maintained by, or an address not associated with, a person that the broker knows or has reason to know is a broker. This intends to cover a transaction where a holder of cryptocurrency on an exchange transfers the cryptocurrency to a personal wallet or a wallet maintained on another exchange.

In addition, the Bill would treat digital assets as cash for purposes of Internal Revenue Code Section 6050I and require that businesses that receive digital assets in excess of \$10,000 in a single transaction file an information return with the IRS.

There was opposition in the Senate on the broad scope of the information reporting provision. Several amendments were filed that would have narrowed the scope of the reporting requirements in connection with persons solely engaged in validating distributed ledger transactions (such as mining and staking), selling hardware or software, or those developing digital assets or their corresponding protocols for use by persons that are not customers of the developer. However, none of the amendments were adopted, so the original broad language of the information reporting requirements remained in the final Bill. It is now up to the House to determine whether to keep, narrow the scope of, or drop these reporting obligations.

If the Bill is enacted in its current form, the proposed changes would affect digital assets acquired on or after Jan. 1, 2023, and apply to returns required to be filed, and statements required to be furnished, after Dec. 31, 2023. However, this bill is a fast-moving work in process, so we anticipate that changes may be made to the Bill.

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