

Taxing Digital Assets: What's at Stake?¹

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Introduction and Executive Summary

The Responsible Financial Innovation Act (RFIA), introduced by Senators Lummis and Gillibrand, proposes to give digital assets special tax advantages over most other types of property. Income tax law ordinarily treats income as taxable when received, but the RFIA would exempt much income from digital assets from this general approach, and instead tax it later, or, in some cases, not at all. This amounts to a tax subsidy for digital assets. The RFIA would also weaken the authority of Treasury and the Internal Revenue Service (IRS) to establish information reporting rules, undermining attempts to ensure that income taxes owed are paid on income flowing from digital assets. This report analyzes three major tax provisions of the RFIA:²

First, the RFIA would allow digital asset validators to defer income from *mining* and *staking*, two methods of validating transactions on the blockchain in exchange for digital asset rewards. This would give income from mining and staking more favorable tax treatment than income from work, or income generated from other assets. Essentially, the proposal would provide a tax subsidy for mining and staking, which may encourage financial resources, computing power, and energy to flow to these activities rather than other industries and uses. It would also encourage “lock-in” (taxpayers holding onto digital assets for longer periods due to tax benefits than they would otherwise). The proposal also creates tax traps for the unwary, who are likely to be those with smaller holdings of digital assets, while delivering the bulk of the tax benefits to those who hold the largest amounts of digital assets and are likely to be most sophisticated.

¹ We thank Omri Marian, Ryan Gurule, Alex Thornton, as well as a number of other academics and practitioners for their helpful conversations, comments, and suggestions.

² We do not discuss the other tax provisions in the RFIA. Section 203 of RFIA “[e]xtends the current safe harbors for securities and commodities trading activity made by non-United States persons who use a United States financial institution to conduct digital asset trading activities under specified conditions, including that the non-United States person does not have an office in the United States.” [Lummis-Gillibrand Responsible Financial Innovation Act Section-by-Section Overview](#) 1 (2022). Section 204 “[s]pecifies that certain decentralized autonomous organizations (DAOs) are business entities for the purposes of the tax code.” *Id.* Section 205 “[e]stablishes that digital asset lending agreements are not generally taxable events, in the same way that securities lending transactions are not today” under section 1058. *Id.* Section 206 mandates that the IRS publish guidance on a number of tax questions related to digital assets. *Id.* Section 207 requires the Comptroller General to write a report on retirement investing in digital assets. *Id.*

While we focus on the provisions as drafted in the RFIA, other bills, including the Virtual Currency Tax Fairness Act from Senators Toomey and Sinema, include proposals that are conceptually similar to certain provisions in the RFIA. See section 2 of this report, titled, *Income Exclusion for Personal Transactions*, for a more detailed analysis of proposals to exclude gain on digital assets in certain personal transactions.

Second, the bill would exclude from gross income up to \$200 of gain or loss per personal transaction when individuals pay for goods or services using virtual currency. This exclusion would also be a tax preference for virtual currency, and effectively subsidize it relative to other assets or cash. Individuals would be able to realize income by paying for goods and services with appreciated virtual currency, but would not be taxed on any gain up to \$200. Some argue that such an exclusion is necessary because virtual currency is like foreign currency, which already has a *de minimis* gain exclusion under section 988(e).³ This argument ignores important differences between virtual currency and foreign currency. The exclusion would also create administrative and enforcement burdens.

Third, the RFIA would modify the broker reporting regime, narrowing who qualifies as a “broker” under section 6045 and what information can be shared under section 6045A. Broker reporting helps the IRS confirm that taxpayers are accurately reporting their gain (or loss), and in so doing encourages voluntary compliance with tax laws by those dealing in digital assets. It also plays an important role in ensuring individuals have the information they need to include the gain (or loss) they realize on the sale or disposition of appreciated (or depreciated) assets on their tax returns. Broker reporting under section 6045 already applies to brokers of many other types of assets, and a provision of the Infrastructure Investment and Jobs Act (IIJA) confirmed that this reporting also applies to digital assets. However, the RFIA’s changes would narrow Treasury’s authority to create a broker reporting regime that covers as many relevant transactions as possible while minimizing burden. As a result, the RFIA would likely hinder the broker reporting regime’s aim of ensuring taxpayers with digital assets include all their realized income on their tax return.

Tax subsidies for digital assets like those proposed in the RFIA would come at a federal budget cost and lawmakers should consider and explain whether such subsidies are justified. This requires assessing the potential social costs and benefits of encouraging resources to flow towards digital assets and away from other investments and activities. There is extensive debate about these costs and benefits,⁴ and we do not evaluate them all. However, in undertaking this evaluation, lawmakers should consider that administering these tax subsidies and encouraging the use of digital assets more broadly would likely have significant negative impacts on the tax system and tax compliance, given the role of digital assets in facilitating tax evasion and other illicit activity more broadly.⁵

1 Mining and Staking Rewards

The RFIA would allow digital asset miners and stakers to defer income from mining and staking activities until they choose to sell the digital assets received. This is inconsistent with basic tax

³ Unless otherwise noted, all references to “section” are to sections of the Internal Revenue Code of 1986, as amended, and all references to “Treas. Reg. §” are to Treasury regulations issued thereunder.

⁴ For an example of an overview, see David Perkins, Cong. Rsch. Serv., R45427, [Cryptocurrency: The Economics of Money and Selected Policy Issues](#) (2020).

⁵ See, e.g., US Dep’t of Just., [How To Strengthen International Law Enforcement Cooperation For Detecting, Investigating, And Prosecuting Criminal Activity Related To Digital Assets](#) 21-24 (2022).

principles and treats mining and staking activity more favorably than other work. It also creates tax incentives to hold a digital asset rather than sell it, inappropriate planning opportunities, and traps for unwary miners and stakers.

1.1 Current Law – Block Rewards Are Taxable When Received

There are two primary ways to obtain digital assets: 1) buy them in exchange for cash or other property, or 2) acquire block rewards through mining or staking.

Mining and staking are, broadly speaking, the two ways of adding a transaction to the blockchain, which is the ledger (usually public) that provides a recorded history of transactions.

Miners race to solve a randomly generated cryptographic problem using computing power.⁶ The first to do so updates the blockchain with the latest validated transactions and receives a certain amount of digital assets in exchange. Bitcoin is an example of a digital asset that is mined.

Stakers “stake” (or put up) a certain amount of their own digital assets and place them in a digital wallet, where they are frozen and cannot be used in transactions.⁷ The network randomly picks which of the stakers gets to validate a transaction. The likelihood of being picked varies with the amount of digital assets staked. Validators receive a reward in the native cryptocurrency of the blockchain in proportion to their stake. Ethereum is an example of a digital asset that is staked.⁸

Rewards for mining or staking activity are taxable income. This is not controversial.⁹ Under the Internal Revenue Code and the Supreme Court precedent in *Glenshaw Glass*, all “undeniable accessions to wealth, clearly realized, . . . over which [a] taxpayer[] has complete dominion” are included in gross income.¹⁰ For example, when an employee receives a paycheck from work, that is income to them. The employee has total control over how they spend the paycheck, and their total wealth has gone up. Now consider a miner who receives a block reward in the form of a unit of a digital asset in exchange for validating a transaction. The miner completely controls the digital asset. They can directly purchase goods and services using the digital asset, sell it, or hold it as an investment. This is an “undeniable accession to wealth.”

IRS guidance affirms that reward income for mining activities is taxable when received.¹¹ While the IRS has not yet released official guidance on staking rewards, even some proponents of

⁶ For a brief and accessible explanation, see John Huang et al., [Bitcoin Uses More Electricity Than Many Countries. How Is That Possible?](#), New York Times (September 3, 2021).

⁷ See Jake Frankenfield, [Proof-of-Stake](#), Investopedia (last updated June 9, 2022).

⁸ Ethereum also currently uses mining and is transitioning to exclusively staking this year. See Ethereum, [The Merge](#) (last updated July 14, 2022).

⁹ Reuven Avi-Yonah & Mohanad Salaimi, [A New Framework for Taxing Cryptocurrencies](#) 19-24 (2022) (noting that mining income is already taxable under IRS Notice 2014-21 and that staking income is taxable under section 61 and the *Glenshaw Glass* test).

¹⁰ *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

¹¹ Notice 2014-21, 2014-16 I.R.B. 938 (April 14, 2014).

income deferral for staking rewards recognize that, under current law, “[s]taking [r]ewards should give rise to income for federal income tax purposes, when received.”¹²

1.2 Proposal – Block Rewards Are Taxable When Rewards Are Sold

Section 208 of the RFIA would change the timing of income earned from mining or staking, so that rather than being taxable when it is received (as under current law) it would be taxable only when the rewards are sold:

In the case of a taxpayer who conducts digital asset mining or staking activities, the amount of income relating to such activities shall not be included in the gross income of the taxpayer until the taxable year of the disposition of the assets produced or received in connection with the mining or staking activities.

The policy rationale for this departure from the basic principles of income tax is unclear. Some advocates have argued that it will ease administrative burden. Yet the burdens of complying with normal income tax rules are not necessarily higher for staking and mining income than for other types of income. In the case of mining and staking income, the timing and value of rewards are readily knowable. As Professor Omri Marian of University of California, Irvine School of Law put it, “[t]here is no serious compliance burden in reporting block rewards when received — certainly none that is more burdensome than those for other transactions that are clearly taxable and for which no one seriously considers administrative relief.”¹³

1.3 Deferral of Income on Block Rewards Is a Tax Subsidy

The ability to delay tax on mining and staking income is a financial benefit, because of the time value of money (in most cases, as discussed more below), and the possibility for additional tax planning that can further reduce or eliminate income from deferred asset gain. Moreover, it is, in economic terms, a subsidy. It is a tax preference for earning income from mining and staking over other forms of income that would be subject to the usual rules (and one that is not justified on pure administrative grounds). Economists call this a “tax expenditure,” because although this subsidy is delivered through the tax system, the loss of revenue would have the same impact on the budget as if the government wrote miners and stakers a check.¹⁴

Tax subsidies for certain income or activities are not inherently bad or good policy. Tax expenditures can be worthwhile, or not, depending on their aims, outcomes, and the alternatives. But assessments of this proposal to defer recognition of income from mining and staking should be clear about the fact that it *is* a subsidy for digital asset mining and staking, over other forms of generating income. Evaluating whether this subsidy is worthwhile then requires considering not

¹² See, e.g., Avi-Yonah & Salaimi, *supra* note 9, at 24. Professor Omri Marian also discusses how some proponents of treating staking rewards as only taxable when sold have relied on a misinterpretation of a single case and incorrect legal reasoning. See Omri Marian, [Law, Policy, and the Taxation of Block Rewards](#), Tax Notes Federal (June 6, 2022).

¹³ Marian, *supra* note 12.

¹⁴ See Ctr. on Budget and Policy Priorities, [Policy Basics: Federal Tax Expenditures](#) (last updated December 8, 2020).

only the fiscal cost, but also whether it is desirable to create a tax incentive for resources – including financial resources, computing power, and energy – to flow away from other industries and activities towards digital asset mining and staking.

The policy rationale and goals of this subsidy are not clear. Proponents of the bill have generally argued that digital asset use is a positive thing. But they have not explained why they believe the benefits of staking and mining for society at large (beyond the direct benefits for miners and stakers) are so great that that such activity should be rewarded or incentivized by the US government in the form of a tax preference.

We will not here attempt to identify and weigh all of the potential social costs and benefits of encouraging resources to flow towards digital assets and away from other activity.¹⁵ However, as lawmakers assess the implications of providing a tax subsidy for mining and staking, we encourage them to consider a potential negative externality the subsidy could impose on the tax system specifically. Digital assets have become a locus of illegal activity broadly, including tax evasion.¹⁶ Consequently, the IRS Criminal Investigation division has been integral in identifying and seizing billions of dollars in digital assets in cases involving tax evasion, fraud, money laundering, and other financial crimes.¹⁷ Because digital assets are a significant source of tax noncompliance in the US,¹⁸ the Government Accountability Office and Treasury Inspector General for Tax Administration have recommended that the IRS improve its tax compliance efforts related to digital assets.¹⁹ A subsidy for digital asset income therefore requires an especially compelling justification to offset the externality that digital asset use imposes on the tax system as an avenue for tax evasion and other forms of illicit activity.

Lawmakers should consider this negative impact on the tax system, as well as other costs and benefits, before they seek to create a subsidy for digital asset income.

1.4 The Subsidy Creates Questionable Incentives and Traps

¹⁵ For an example of an overview, *see* Perkins, *supra* note 4.

¹⁶ *See* US Dep't of Just., *supra* note 5. Financial crimes like money-laundering and fraud are often connected with tax evasion. *See* Jean-Pierre Brun et al., World Bank Group, [Taxing Crime: A Whole-of-Government Approach to Fighting Corruption, Money Laundering, and Tax Crimes](#) xiii (2022).

¹⁷ In fiscal year 2021, the IRS “was responsible for the seizure of cryptocurrency valued at more than \$3.5B,” and surpassed that amount in fiscal year 2022. Internal Revenue Serv., FS-2022-19, [IRS-CI Highlights](#) (2022).

¹⁸ *See, e.g.*, Alan Rappoport, [Tax Cheats Cost the U.S. \\$1 Trillion Per Year, I.R.S. Chief Says](#), New York Times (April 13, 2021) (“Mr. Rettig attributed the growing tax gap to the rise of the \$2 trillion cryptocurrency sector, which remains lightly regulated and has been an avenue for tax avoidance. He also pointed to foreign-source income and the abuse of pass-through provisions in the tax code by companies.”); US Dep't, of Treas., [General Explanation of the Administration's Fiscal Year 2023 Revenue Proposals](#) 98 (2022) (“[T]ax evasion using digital assets is a rapidly growing problem.”)

¹⁹ There are not sound estimates of the size of tax noncompliance related to digital assets, in part because of how little information the IRS currently has on digital assets. *See* US Gov't Accountability Office, GAO-20-188, [Virtual Currencies: Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance](#) (2020); Treas. Inspector Gen. for Tax Admin., No. 2016-30-083, [As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance](#) (2016).

Furthermore, even if there were a sound policy argument for subsidizing mining and staking income, allowing deferral of that income until the digital asset is sold is an odd way to do so: it creates strange lock-in effects and traps for the unwary, which could leave many validators worse off than under current law if they do not receive good advice (or are not wealthy). The following examples illustrate some of these issues:

- Base example: A validator receives a block reward in 2022 worth \$100. The validator holds the reward digital asset as a capital asset and sells it for \$150 in 2024. The validator has a 32% marginal federal tax rate for ordinary income and a 15% marginal federal tax rate for long-term capital income.
 - Current law: The validator would pay \$39.50 in federal income tax, split between \$32 (ordinary income) in 2022, and \$7.50 (long-term capital gain) in 2024. There is some value to the deferral of the \$7.50, meaning that the present value/cost of the tax is slightly less than \$39.50.
 - Proposed law: The validator would pay \$48 in federal ordinary income taxes in 2024. There is a small deferral benefit, but not enough to offset the \$8.50 in additional tax liability.
- Sophisticated validator example: Now suppose, instead, that the validator never sells the reward digital asset. The validator either has sufficient liquid assets to cover life expenses without selling the reward digital asset or can borrow against it (or other assets) to fund life expenses.²⁰
 - Current law: \$32 in ordinary income in 2022.
 - Proposed law: The validator would not pay any income tax on the digital asset.

As these examples show, the deferral of block reward income encourages “lock-in”: validators would be better off if they hold their investment in block rewards, even when selling them and using the proceeds to invest elsewhere would be more economically efficient. Validators who are wealthy enough to either hold the reward tokens indefinitely or borrow against them would reap the greatest tax benefit. Borrowing against assets at preferred rates to fund lifestyle expenses without triggering tax has long been a favored tax planning tool for high-wealth filers.²¹ If mining and staking income can be deferred until disposition, then the miner or staker can simply hold onto the block rewards forever, borrowing against them to cover expenses.²² If the block

²⁰ See Jesse Eisinger, Jeff Ernsthause & Paul Kiel, [The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax](#), ProPublica (June 8, 2021) (detailing how wealthy individuals borrow against their assets to pay living expenses, which allows them to avoid income taxes).

²¹ See, e.g., Devon Pendleton and Benjamin Stupples, [Banks Are Giving the Ultra-Rich Cheap Loans to Fund Their Lifestyle](#), Bloomberg (July 23, 2021); [How rich people are using cheap loans to cash out without taking a big tax hit](#), Business Insider (November 29, 2021)

²² See Chanell Alexander, [Should you borrow against crypto? Here are the risks](#) NerdWallet (October 25, 2021) (“A crypto loan may make sense if someone holds a substantial amount of crypto and wants to liquidate it without having to sell and possibly pay taxes on it.”); Ben Knaus, [Why Would Anyone Borrow Against Their Crypto?](#), Meld

rewards are never disposed, then the heirs will also receive a basis step-up, ensuring that no tax is ever paid on the income from staking or mining.

Deferral also creates traps for the unwary individual validator. Validators who sell their appreciated rewards could end up worse off, paying more in taxes at high ordinary income tax rates than they would have if their block rewards were treated as ordinary income upon receipt.²³

We are not aware of any estimate of the revenue impacts of the proposals in the RFIA. On net, we anticipate that this provision reduces revenue. Those with the largest digital asset holdings are likely to have access to good tax advice. They will therefore likely use the subsidy to never pay taxes on their digital assets, while those with smaller holdings and lower wealth are less likely to do so. Given the distribution of digital assets,²⁴ we expect the revenue loss from and subsidy of sophisticated investors to outweigh the revenue gain from unsophisticated investors who pay taxes on their digital asset rewards at a later time and at ordinary rates.

Some commentary has argued that providing deferred income treatment for staking rewards (but not mining rewards) would encourage development of staking technologies,²⁵ which tend to be less energy intensive than mining.²⁶ However, the RFIA would change the tax treatment for mining and staking equally with the same convoluted deferral mechanism.

2 Income Exclusion for Personal Transactions²⁷

Another provision of the RFIA would exclude up to \$200 of gain or loss per personal transaction from gross income when an individual pays for goods or services using virtual currency. (“Virtual currency” would be a subset of “digital assets” under the RFIA.²⁸) This rule is also not justified by administrative burden or other rationales and treats virtual currency more favorably than almost any other asset or investment: it is another proposed tax subsidy for a class of digital

(December 13, 2021) (noting that loans secured by digital assets can allow “users to access liquidity without enacting a taxable event . . .”).

²³ The proposal would also allow for elective treatment of gains. A well-advised taxpayer would be able to deliberately trigger ordinary income on staking rewards by selling the reward right when they receive it, and then benefit from long-term capital gains treatment going forward. This type of electivity is undesirable and may lead to wasteful planning.

²⁴ See, e.g., Igor Makarov and Antoinette Schoar, [Blockchain Analysis of the Bitcoin Market](#) 29 (National Bureau of Economic Research, Working Paper No. 29396, 2021) (finding that the top 0.01% of bitcoin investors held about a quarter of all outstanding bitcoins).

²⁵ See, e.g., Avi-Yonah & Salaimi, *supra* note 9, at 27-29.

²⁶ This justification is questionable. Staking uses significantly less energy and has a lower price of entry than mining. See Marian, *supra* note 12. As a result, there is already a “market subsidy” to encourage development of staking technologies. See *id.* It is not clear why the government should further subsidize staking on top of the existing “market subsidy.”

²⁷ This section focuses its analysis on provisions in the RFIA. However, the analysis applies similarly to similar provisions in other bills. See, e.g., the Virtual Currency Tax Fairness bills in the [House](#) (exempting up to \$200 of gain) and [Senate](#) (exempting up to \$50 of gain).

²⁸ See RFIA § 101(a).

assets. Moreover, it would create an avenue for tax avoidance and new administrative and compliance burdens for the IRS.

2.1 Current Law – Virtual Currency Gain Is Taxable

Under IRS guidance, virtual currency is treated as property for federal tax purposes.²⁹ Accordingly, when a taxpayer sells or exchanges virtual currency for other property or services, they will normally have taxable gain or loss if the value of the virtual currency has changed since it was acquired. The character of the gain or loss depends on whether the taxpayer holds the virtual currency as a capital asset.

For example, a taxpayer, “B,” holds a unit of virtual currency as a capital asset and has a basis of \$100 in the virtual currency. If B exchanges their virtual currency for a \$250 good, they have realized a \$150 capital gain and must pay income tax on that gain. The tax results would be the same whether B held a stock as a capital asset or a unit of virtual currency.

2.2 Proposal – Virtual Currency Gain Is Excluded for Certain Personal Transactions

Section 201 of RFIA would exclude from gross income up to \$200 of gain or loss from the disposition of virtual currency in “personal transactions” (i.e., non-business transactions) for goods or services. This exclusion applies per transaction. In the example above, if B paid for the good using virtual currency, they would not have to pay taxes on their \$150 gain.

Excluding gain from virtual currency is an exception to normal income tax treatment that realized income is subject to tax and means that virtual currency would be treated more favorably than almost any other asset or investment. Let’s return to the example above of B buying a \$250 good and imagine that B can pay with the appreciated virtual currency (basis of \$100), appreciated stock (basis of \$100), or cash. If B paid with appreciated virtual currency, they would realize the gain on the virtual currency, but the proposed exclusion would mean B would pay no taxes on the income from the realized gain. If B paid with appreciated stock, however, B would realize the gain on the stock and would be required to pay taxes on that \$150 realized gain. It is tax advantageous for B to pay with virtual currency over stock (and, by extension, over other property).

B would also prefer to pay with virtual currency over cash. Paying in cash would yield no taxable event for B. But paying with cryptocurrency means B can realize a gain – and thus take full advantage of the asset’s appreciation – without paying any taxes on it.

2.3 The Proposal Subsidizes Investments in Virtual Currency

There is no compelling administrative justification for an income exclusion.

One theory is that this is a *de minimis* exclusion that is warranted because virtual currency is like foreign currency and requires some amount of gain to be excluded from income to reduce administrative burdens. The proposal builds off section 988(e), which allows individuals to

²⁹ Notice 2014-21, 2014-16 I.R.B. 938 (April 14, 2014).

exclude gain on personal transactions involving foreign currency if the gain on the transaction does not exceed \$200.

Congress created the section 988(e) exclusion to respond to a set of concerns specific to foreign currency that do not arise from virtual currency. According to the legislative history of section 988(e), lawmakers enacted the exclusion because “an individual who lives or travels abroad generally cannot use U.S. dollars to make all of the purchases incident to daily life. If an individual must treat foreign currency in this instance as property giving rise to U.S.-dollar income or loss every time the individual, in effect, ‘barter’ the foreign currency for goods or services, the U.S. individual living in or visiting a foreign country will have a significant administrative burden that may bear little or no relation to whether U.S.-dollar measured income has increased or decreased.”³⁰

Individuals who pay for personal transactions of goods or services using virtual currency are not in the same situation as those on vacation or living abroad. They almost certainly *can* “use U.S. dollars to make all of the purchases incident to daily life” and are choosing to pay for goods or services with virtual currency rather than cash. The rationale for the section 988(e) exclusion for foreign currency gain from gross income does not apply to virtual currency.³¹

There may come a day when the use of virtual currency is mandatory for a broad array of purchases incident to daily life. Even then, the administrative justification for the foreign currency exclusion would not necessarily carry over. Virtual currency transactions are recorded on the blockchain, and third-party reporting of virtual currency transactions will apply to transactions beginning next year.³² Therefore, unlike with foreign currency, there is a lasting public record of virtual currency transactions, combined with third-party reporting to the taxpayer and the IRS, that would lessen the burden of tracking gain and loss.

Again, a departure from usual income tax treatment with no strong administrative rationale is a subsidy.

Perhaps the proponents of the law view this subsidy as worthwhile because virtual currency use should be encouraged. Indeed, this proposal would create a strong incentive for people to make as much of their consumption as possible in purchases that would result in less than \$200 of gain from appreciated virtual currency. We will not assess here all the pros and cons of encouraging virtual currency’s use as a form of currency. But, as with the deferral proposal, any assessment of this provision should also consider the potential costs to the tax system in the way that it would encourage tax avoidance and create administrative and compliance burdens for the IRS.

2.4 The Exclusion Creates Potential Enforcement and Administrative Problems

³⁰ [H.R. Rep. No. 105-148](#), at 525 (1997).

³¹ For a thorough discussion of the differences between foreign currency and virtual currency and the arguments against treating virtual currency as a foreign currency, see Adam Chodorow, [Bitcoin and the Definition of Foreign Currency](#), 19 Fla. Tax Rev. 367 (2016).

³² See section 6045(g)(3)(C)(iii).

A dollar limit exclusion, as several experts have pointed out, could be easily used to avoid taxes on appreciated virtual currency.³³ Those holding appreciated virtual currency could separate larger transactions into many smaller ones that fall below the exclusion threshold to avoid paying taxes they would otherwise owe on virtual currency.

Acknowledging this risk, the RFIA includes language aimed at minimizing it, stating that “all dispositions which are part of the same transaction (or a series of related transactions) shall be treated as one disposition.”³⁴ However, the exclusion itself and the aggregation anti-abuse provision would likely create burdens for the IRS and for taxpayers: “[t]he taxpayer would have to establish whether they qualify for the de minimis [exception], and the IRS would have to check whether the taxpayer was correct. Then, if you aggregate the amount, which would then preclude a de minimis exception, again you’re adding a new rule with new counting and reporting.”³⁵ The anti-abuse rule would thus create new demands on the IRS, with the exclusion regime increasing administrative burden overall.³⁶

3 Broker Reporting

With bipartisan support, the IJA clarified explicitly that broker reporting requirements apply to digital assets – an important step towards increasing tax compliance for those with income from digital assets. The RFIA proposes new definitions for the digital assets broker reporting regime, limiting broker reporting to those who effect sales of digital assets at the direction of customers in the ordinary course of a trade or business.³⁷ It would also narrow the broker reporting of transfers that are not sales or exchanges to information “voluntarily provided by the customer” and “held for a legitimate business purpose.”³⁸ While these limitations may seem superficially reasonable, they would constrain Treasury’s authority to create an effective reporting system that minimizes burden. The changes would undermine the goals of the broker reporting regime and the broader aim of collecting tax on realized income.

3.1 Current law

Information reporting plays a critical role in tax compliance. The IRS can check the information that taxpayers report on their tax returns against information the agency receives from various third parties, such as employers, banks, and brokers, to verify that taxpayers accurately reported their income. This information is also sent to taxpayers, which helps them report their income

³³ See Amy Lee Rosen, [De Minimis Exception Could Hinder Crypto Tax Administration](#), Law360 (November 19, 2019).

³⁴ RFIA § 201.

³⁵ Rosen, *supra* note 33.

³⁶ See Jonathan Curry, [Rettig Warns Against New Info Reporting Rules Without Funding](#), Tax Notes (April 14, 2022).

³⁷ RFIA § 202(a).

³⁸ RFIA § 202(b)(2).

correctly. Third-party reporting improves voluntary taxpayer compliance, as taxpayers know that the IRS has a way of verifying income subject to this reporting.³⁹

Broker reporting is a specific type of third-party reporting that provides information on realized gains of certain property to the IRS and taxpayers. Broker reports include identifying information of the customer and the gross proceeds of the sale of a “specified security,” which is further defined to include, among other things, stocks, bonds, and certain commodities.⁴⁰ The reports also list the customer’s “adjusted basis” of the specified security (the value of the security used as the starting point for calculating any gain or loss), and whether any gain or loss made is long-term or short-term (which may affect the rate at which it is taxed).⁴¹ Brokers send these reports both to the IRS and to customers, giving the customers a record that can help them accurately calculate and report their taxable gains, and allowing the IRS to verify that individuals have properly reported income from these gains. Compliance rates for income subject to third-party reporting like broker reporting exceed 80%, compared with compliance rates below 50% for income without third-party reporting.⁴²

Treasury has long had the authority under section 6045 to require brokers of digital assets (e.g., cryptocurrency exchanges) to file broker reports, including basis reporting.⁴³ Treasury and the IRS started working on guidance to clarify when digital asset brokers were subject to reporting requirements, and put the project on the Priority Guidance Plan in 2019.⁴⁴ However, that guidance was not released, and prior to the IIRA, brokers of cryptocurrency remained unsure whether they needed to file broker reports.⁴⁵

While the requisite statutory authority already existed, section 80603 of the IIRA clarified the situation by explicitly applying the definition of “brokers” subject to reporting to “any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.”⁴⁶ It includes “any digital asset” in the list of “specified securities” and defines “digital asset” for the purpose of section 6045: “Except as otherwise provided by the Secretary, the term ‘digital asset’ means any digital representation of

³⁹ See US Dep’t of Treas., [The American Families Plan Tax Compliance Agenda](#) 5 (2021).

⁴⁰ Section 6045(a) & (g)(3)(B).

⁴¹ Section 6045(g)(2)(A); Treas. Reg. § 1.6045-1(d)(2).

⁴² US Dep’t of Treas., *supra* note 39, at 5-6.

⁴³ See NY State Bar Ass’n, [Report No. 1433, Report on the Taxation of Cryptocurrency](#) 30 (2020) (“It would seem that the broad authority with respect to ‘financial instruments’ set forth in Section 6045(g)(3)(B)(iv) provides Treasury and the Service authority to require basis reporting with respect to cryptocurrency.”).

⁴⁴ Dep’t of Treas., [2019-2020 Priority Guidance Plan](#) 20 (2019).

⁴⁵ Treas. Inspector Gen. for Tax Admin., [The Internal Revenue Service Can Improve Taxpayer Compliance for Virtual Currency Transactions](#) 9 (2020).

⁴⁶ [Infrastructure Investment and Jobs Act](#), Pub. L. No. 117-59, § 80603, 135 Stat. 429, 1340 (2021); section 6045(c)(1)(D).

value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.”⁴⁷

The IIJA also modifies section 6045A to require brokers to report the adjusted basis of digital assets which are not part of a sale or exchange that they transfer to non-brokers. Transfer statements must also include identifying information about the parties involved in the transfer. These reports help individuals track their basis in digital assets and provide the IRS with the requisite information to check that taxpayers report income from the disposition of digital assets.

The Joint Committee on Taxation estimated that these provisions, together with adding digital assets to the existing reporting regime for cash purchases over \$10,000,⁴⁸ would raise \$28 billion over 2024 to 2031.⁴⁹

3.2 Changes to the Broker Reporting Regime Would Limit Its Effectiveness

The RFIA would create a new definition for “digital asset” that, among other changes, would remove the flexibility the Secretary currently has to modify the definition of “digital asset” for the purposes of section 6045 and section 6045A.⁵⁰ The digital asset industry is rapidly changing. Restricting Treasury’s authority to change the definition of “digital asset” will limit Treasury’s ability to react to digital asset evolution and provide updated guidance to the industry.

Drawing from the Keep Innovation in America Act, introduced in the House in late 2021,⁵¹ the RFIA also changes the definition of a “broker” with respect to digital assets to “any person who (for consideration) stands ready in the ordinary course of a trade or business to effect sales of digital assets at the direction of their customers.”⁵²

This change reflects concerns from the digital asset industry and certain lawmakers that the IIJA definition of “broker” would apply to people involved in the digital asset industry who they believe should not have to comply with the section 6045 and section 6045A requirements.⁵³ A common argument is that miners do not have customers, and thus do not have the information needed for broker reporting. Some people have suggested that the IIJA provisions nevertheless could be interpreted by Treasury and the IRS to include all miners in the broker reporting regime.

⁴⁷ Infrastructure Investment and Jobs Act, § 80603, 135 Stat. at 1340 (2021); section 6045(g)(3)(D).

⁴⁸ Infrastructure Investment and Jobs Act, § 80603, 135 Stat. at 1341 (2021); section 6050I(d).

⁴⁹ Joint Committee on Taxation, JCX-33-21, *Estimated Revenue Effects of the Provisions in Division H of an Amendment in the Nature of a Substitute to H.R. 3684* (2021).

⁵⁰ RFIA § 202(b)(1).

⁵¹ See [Keep Innovation in America Act](#), H.R. 6006, 117th Cong. § 2 (2021).

⁵² RFIA § 202(a).

⁵³ See, e.g., Maryam Gamar, [How Two Competing Cryptocurrency Policies Began A Conversation About Digital Rights](#), Vox (August 8, 2021); Daniel Kuhn, [“Cautiously Optimistic”: Crypto Brings Lobbying Muscle to Infrastructure Debate](#), CoinDesk (August 3, 2021).

During the IIJA legislative process, lawmakers introduced various amendments to specifically exclude certain actors from the definition of “broker.”⁵⁴ More recently, a bipartisan group of Senators introduced a bill that would create similar exclusions and modify the definition of “broker.”⁵⁵

Aware of lawmaker and industry concerns, Treasury has already stated that cryptocurrency actors who cannot get access to customer information will not be subject to broker reporting.⁵⁶ In a usual guidance process, Treasury would publicly solicit feedback from all digital asset

⁵⁴ Senators Lummis, Toomey, and Wyden introduced an amendment to the IIJA and, later in 2021, a bill that would exempt from the 6045(c)(1)(D) definition of broker “any person solely engaged in the business of (A) validating distributed ledger transactions (B) selling hardware or software for which the sole function is to permit a person to control private keys which are used for accessing digital assets on a distributed ledger, or (C) developing digital assets or their corresponding protocols by other persons, provided that such other persons are not customers of the person developing such assets or protocols.” [S.3249](#), 117th Cong. (2021). Senators Warner, Portman, and Sinema introduced an amendment that would exempt proof of work miners but not stakers, and wallet developers from broker reporting. Laura Weiss, [Cryptocurrency Negotiators at ‘Impasse’ Over Tax Reporting Rules](#), Roll Call (August 6, 2021). These amendments may appear to reasonably exclude certain groups. However, just like the RFIA, they limit Treasury’s authority, which could lead to problematic holes in the reporting regime. The notice-and-comment process is the most effective way to hear input from all stakeholders and craft the most efficient, least burdensome reporting requirements.

⁵⁵ Senators Toomey, Sinema, Lummis, Warner, and Portman introduced a bill on August 3, 2022, that is modeled after the Lummis-Toomey-Wyden amendment described in footnote 54. [S. ___](#), 117th Cong. (2022). This bill takes a different approach to modifying the definition of “broker” than the RFIA. The bill would modify the definition of broker to be “any person who (for consideration) regularly effectuates transfers of digital assets on behalf of another person.” *Id.* § 1(a). This change would narrow the definition of “broker” by excluding persons who provide services effectuating transfers of digital assets but do not directly effectuate digital assets. For example, some actors in the digital asset space may write code or otherwise set up infrastructure that regularly effectuates transfers of digital assets, but do not themselves “regularly effectuate[]” transfers. The bill would also create two categories of exceptions to the definition of “broker”: any person solely engaged in “(A) validating distributed ledger transactions, without providing other functions or services, or (B) selling hardware or software for which the sole function is to permit persons to control private keys which are used for accessing digital assets on a distributed ledger” is not a “broker.” *Id.* § 1(b). The RFIA would make a more significant modification to the definition of “broker,” changing it to “any person who (for consideration) *stands ready in the ordinary course of a trade or business to effect sales of digital assets at the direction of their customers.*” RFIA § 202(a) (emphasis added). However, the RFIA would not create any exceptions to this “broker” definition.

The new bill differs from the Lummis-Toomey-Wyden amendment in three ways. First, unlike the amendment, the bill would modify the definition of “broker” in section 6045(c)(1)(D) as described above. [S. ___](#), 117th Cong. § 1(a) (2022). Second, the bill would limit the exception for validators to those who do not “provid[e] other functions or services.” *Id.* § 1(b). Third, the bill does not include the amendment language that would have excluded from the definition of broker “any person solely engaged in the business of developing digital assets or their corresponding protocols for use by other persons, provided that such other persons are not customers of the person developing such assets or protocols.” *Id.* However, the modification to the general definition of broker may lead to a similar outcome as this removed exclusion.

⁵⁶ See Alan K. Ota, [Crypto Tax Reporting Limits Gain Bipartisan Momentum](#), Law360 (February 14, 2022) (“In a Feb. 11 letter to Portman, Jonathan Davidson, a Treasury assistant secretary for legislative affairs, said the department ‘intends to propose regulations that address the concerns expressed’ by Portman and Warner. Davidson said Treasury agreed that ‘ancillary parties who cannot get access to information that is useful to the IRS are not intended to be captured’ by broker reporting requirements, including those who validate transactions, write software code or sell storage devices for private keys.”); Allyson Versprille, [Treasury Signals Crypto Miners Won’t Face IRS Reporting Rule](#), Bloomberg (February 11, 2022) (providing the first description of the letter from the Treasury Department).

stakeholders and incorporate that input into a sound reporting regime.⁵⁷ In its implementation of other reporting regimes, Treasury has crafted rules that aim to require reporting for as many relevant transactions as possible, while minimizing administrative burden and duplicative reporting.⁵⁸ Treasury's responses to lawmaker and industry concerns are consistent with this approach.

Despite these assurances and Treasury's longstanding authority to subject digital asset brokers to reporting,⁵⁹ the RFIA would supplant the guidance process. It would create blanket carveouts by limiting the definition of "broker" to those acting "in the ordinary course of a trade or business" and "at the direction of their customers." Improper statutory carveouts could create information gaps, and, in a fast-moving technology and business environment, might over time require inefficient workarounds that increase burden. In addition, blanket carveouts may create a two-tiered market that prompts transactions that aim to evade taxes to move outside of the reporting requirements.⁶⁰

As noted above, we are not aware of any cost estimate of the RFIA or its components. However, the Joint Committee on Taxation estimated⁶¹ that an amendment proposed by Senators Wyden and Lummis during the IJA negotiations, which, while not identical to the RFIA proposal, would similarly exclude certain groups from the definition of "broker," would cost \$5 billion.⁶²

⁵⁷ In discussing Treasury's development of reporting requirements for the Foreign Account Tax Compliance Act, a practitioner stated, "I think the Treasury tried very hard to listen to the input that was coming in." Sandali Handagama, [Here's How the US's Infrastructure Bill Crypto Tax Provision Might Be Implemented](#), CoinDesk (September 8, 2021); see also, Alison Bennett, [IRS Issues Guidance Granting Transition Relief for Good-Faith Efforts Under FATCA](#), Bloomberg Law News (March 5, 2014) (during the FATCA guidance development process, practitioners found that "the IRS and the Treasury Department listened to the financial industry's biggest concern" and "have been so accommodating" in working with stakeholders"); New York State Bar Association, [Re: Report on the Proposed FATCA Regulations 2](#) (May 29, 2012) ("The Proposed Regulations provide highly detailed rules on a range of issues that had only been addressed in part (or not at all) in previous guidance, and they do so in a manner that we believe is genuinely responsive to many of the legitimate concerns expressed by affected financial institutions and other stakeholders.").

⁵⁸ See, e.g., Withholding of Tax on Certain U.S. Source Income Paid to Foreign Persons, Information Reporting and Backup Withholding on Payments Made to Certain U.S. Persons, and Portfolio Interest Treatment, TD 9658, 79 Fed. Reg. 12726, 12728 (March 6, 2014) ("These temporary regulations provide guidance coordinating the requirements under chapters 3 and 61 and section 3406 with the requirements under chapter 4 in order to develop a more integrated set of rules that reduces burdens (including certain duplicative information reporting obligations) and conforms the due diligence, withholding, and reporting rules under these provisions to the extent appropriate in light of the separate objectives of each chapter or section."); Regulations Reducing Burden Under FATCA and Chapter 3, REG-132881-17, 83 Fed. Reg. 64757 (December 18, 2018).

⁵⁹ See NY State Bar Ass'n, *supra* note 43.

⁶⁰ See Ryan Gurule, Fin. Accountability and Corp. Transparency Coalition, [Congress Should Tread Cautiously with Digital Asset Reporting Exceptions](#) (August 5, 2021).

⁶¹ Allyson Versprille, [Bipartisan Crypto Change in Senate Bill Would Raise \\$23 Billion](#), Bloomberg Tax (August 5, 2021).

⁶² Part of the cost may reflect a difference in taxpayer and broker behavior compared to what is expected under the enacted statute. One commenter noted that the broker reporting changes in the IJA raised \$28 billion in part because they clarified that Treasury had the authority to extend broker reporting to brokers of digital assets and thus would

The RFIA also limits reporting on broker-to-non-broker transfers under section 6045A. It would restrict the information reported to “customer information that is voluntarily provided by the customer and held by the broker for a legitimate business purpose.” Some might interpret the restriction as saying that if a customer and a broker agree that the broker will not ask for or hold customer information, then any broker-to-non-broker transaction would not be covered by broker reporting. No other broker reporting provisions has such a carveout, in part because this sort of carveout effectively allows brokers and their customers to agree between themselves to opt out of tax compliance reporting. This change would frustrate the purpose of broker reporting, facilitate tax cheating, and encourage brokers to tout noncompliance with broker reporting as a feature of their platform and business proposition.

Digital asset industry commentators are also advocating an approach to interpreting what constitutes a “legitimate business purpose” that could significantly narrow who is subject to section 6045A reporting.⁶³ They argue that protocols that facilitate transactions using virtual currency and decentralized exchanges lack a “legitimate business purpose” in collecting and holding customer information, and therefore no party to the transaction could be subject to third-party reporting.⁶⁴ Their argument effectively assumes that collecting information to comply with federal law is not collecting information “for a legitimate business purpose.”

As digital assets transfer from one person to another to another, any break in the chain of information reporting due to improper limitations on broker reporting would result in the final person in the chain having no basis information. Without third-party reporting on their basis in the asset, the person could have a harder time accurately reporting their income. The IRS would similarly face an information gap that undermines its ability to cross-check the taxpayer’s stated income. A widespread understanding that the IRS is unable to verify gains or losses on certain digital asset transactions could in turn undermine voluntary compliance with tax law. Given how important consistent broker reporting is for every sale, exchange, or other transfer of digital assets facilitated by a broker, Congress should be skeptical of any changes to section 6045A that narrow reporting requirements.

Treasury and the IRS rely on information reporting to confirm that taxpayers are appropriately reporting their realized income. The RFIA’s proposed changes to broker reporting under section

prevent the challenges from taxpayers that might occur if Treasury had simply used its existing authority to extend broker reporting. Cara Griffith et al., [Cryptocurrency: What’s Next for Regulation and Compliance \(Transcript\)](#), Tax Notes (March 9, 2022). Part of the cost could stem from carveouts causing industry members outside of the exempted groups to incorrectly believe they do not need to comply with broker reporting. The cryptocurrency community has misunderstood agency action in the past. For example, when the government offered to settle a cryptocurrency staker’s tax refund claim instead of litigating it, some in the cryptocurrency community celebrated it as an early sign that the government had a “losing argument.” Tax experts commented that such views “might be reading too much into the Justice Department’s decision.” Nathan J. Richman and Mary Katherine Browne, [Tax Pros Burst Overeager Cryptocurrency Community Bubble](#) (February 25, 2022).

⁶³ See Peter Van Valkenburg, [Electronic Cash, Decentralized Exchange, and the Constitution](#), Coin Center (2019) (discussing what constitutes a “legitimate business purpose” in the context of regulating cryptocurrency software developers and individual users of that software under the Bank Secrecy Act).

⁶⁴ See *id.*

6045 and section 6045A would significantly limit the tools available to Treasury and the IRS to improve tax compliance for digital assets.