



Whitepaper

Navigating the new digital asset reporting rules: Key differences and potential pitfalls for brokers

Broker reporting of digital asset sales by customers under the final regulations published in the Federal Register on July 9, 2024 differ in several important respects from the existing broker cost basis information reporting rules applicable to customer sales of traditional securities. Although the new digital asset reporting rules are broadly similar to the existing rules for traditional securities, critical differences may trip up the unprepared. Failure to fully account for these differences could leave brokers exposed to substantial penalties due to incorrect information reporting for digital asset sales, particularly given the potential for high trading volume.



Key differences

1. Timing
2. Certain non-cash sales of digital assets are reportable in addition to cash sales
3. Exceptions to reporting
4. Optional simplified reporting
5. Narrower definition of covered security subject to required cost basis reporting by brokers and no transfer reporting for transfers of digital assets from one broker to another
6. Different broker reporting dates for customer sales
7. Other than Forms 8937, generally no required basis adjustments
8. No required basis and holding period adjustments related to wash sales except for tokenized securities
9. Fewer required basis adjustments for covered digital assets
10. No ability to make certain basis adjustments without greater penalty risk



Timing

Transaction time is generally granular to intra-day for digital asset sales vs. end of day for traditional securities, although the time of sale is not required to be reported on the form (see preamble discussion at 89 Fed. Reg. 56512 (July 9, 2024)), requiring time of sale prices, in addition to date; see Treas. Reg. 1.6045-1(d)(5)(ii)(A)(1).

Certain non-cash sales of digital assets are reportable in addition to cash sales

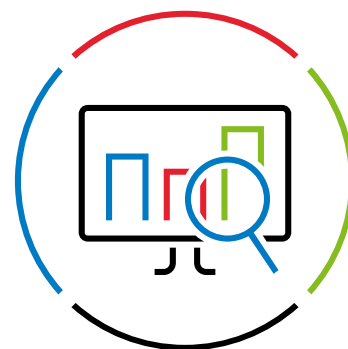
While sales of traditional securities are generally reportable only to the extent they are conducted for cash, dispositions of digital assets are also reportable when conducted in exchange for stored-value cards; for different digital assets; to settle certain forward contracts, options or regulated futures contracts; exchanges for certain broker services, and certain payments by processors of digital assets (PDAPs).

Exceptions to reporting

No return of information is required if the sale of digital assets was for payment of transaction costs via withheld digital assets received that are subsequently sold by brokers or for broker sales of withheld digital assets received to pay backup withholding on digital asset sales (provided the digital assets are sold immediately).

Optional simplified reporting

For Qualified Stablecoins (QSCs) and Specified NFTs, including *de minimis* reporting rules and no required reporting for so-called “non-designated” sales of QSCs (preamble, discussion at 89 Fed. Reg. 56505 (July 9, 2024)).





Narrower definition of covered security subject to required cost basis reporting by brokers and no transfer reporting for transfers of digital assets from one broker to another

Under the regulations, a digital asset is a covered security only if it is acquired in a customer's account by a custodial broker on or after January 1, 2026 in exchange for cash, stored-value cards, different digital assets, or certain other specified property or services. Moreover, sales are only reportable under the July 2024 regulations if the broker is a US digital asset broker as defined therein.

Different broker reporting dates for customer sales

Gross proceeds reporting begins with calendar year 2025 sales (reported in the 2026 tax reporting season). Cost basis reporting begins with calendar year 2026 sales (reported in the 2027 tax reporting season).

Other than Forms 8937, generally no required basis adjustments

For changes to the basis of digital assets, e.g. for corporate actions, including in connection with tokenized securities.

No required basis and holding period adjustments related to wash sales except for tokenized securities

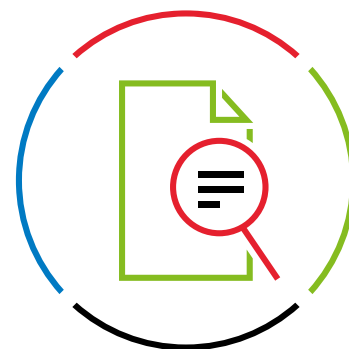
As defined in the regulations. Moreover, the regulations provide that wash sales apply and must be reported by brokers. Basis and holding period adjustments must be made between sales and purchases of the tokenized securities and the related underlying securities held in the same account.

Fewer required basis adjustments for covered digital assets

Compare the applicable adjustments for covered digital assets as compared to other covered securities under Reg. Sec. 1.6045-1(d)(6).

No ability to make certain basis adjustments without greater penalty risk.

Other than those explicitly provided for in an issuer statement provided under IRC Sec. 6045B based on customer or third-party information without penalty risks (see Reg. Sec. 1.6045-1(d)(2)(iv)(B)).





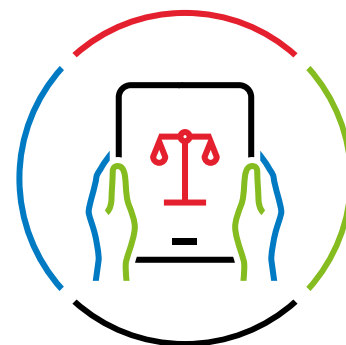
One important difference is the new regulations' broad definition of digital asset, although not all digital asset sales transactions are reportable, due to not only the *de minimis* exceptions listed above, but also certain other exemptions found in Notice 2024-57 (the release of which accompanied the new regulations.) Traditional securities are generally defined in a much more targeted way under the broker reporting regulations.

Covered securities in the context of digital assets are more narrowly defined as compared to the subset of traditional securities that are covered securities.

Also, the new regulations currently do not provide for transfer reporting for digital assets. Per the preamble, this omission is intentional, and it has been publicly stated that subsequent regulations are expected to be issued to fill this gap. From a practical standpoint, however, this means that brokers have no current obligation to generate transfer statements for digital assets. This could potentially result in fewer covered digital assets than would otherwise exist (because transferred digital assets will not constitute covered securities). It will also logically result in less reporting of basis adjustments to digital assets that are transferred as a result of inheritance or gifts (because those adjustments are addressed in the existing regulations for transfer reporting applicable to traditional securities that constitute covered securities).

And the wash sales rule (and its attendant required basis and holding period adjustments), basis averaging rules, and many option and debt related adjustments currently apply under the regulations only to the very narrow subset of digital assets considered "tokenized securities." The required application of these rules to this subset of digital assets (tokenized securities) could prove challenging to brokers, given that they are not applicable to all digital assets.

Finally, the regulations explicitly provide that potential penalty relief for good faith reliance on third party information found at Treas. Reg. 1.6045-1(d)(2)(iv)(B) is not available for digital assets or related options and forwards. This leaves brokers unable to incorporate most third party or taxpayer information without potential penalty risk. Given that many corporate action events impact the basis of securities, the possible lack of issuer statements for many digital assets in an ecosystem where these assets may be generated and maintained algorithmically can present a variety of problems.



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