



Whitepaper

New digital asset tax reporting rules: 10 key aspects for brokers

By Stevie D. Conlon, Anna Vayser, and Robert Schwaba

US tax law generally requires brokers to report cash sales of customers' securities. Required broker reporting of sales of digital assets, such as cryptocurrencies, was added by the Infrastructure Investment & Jobs Act of 2021. Final regulations implementing this required reporting were published on July 9, 2024.



Substantial penalties can apply if brokers do not correctly and timely report sales of such securities. In addition, a broker must generally obtain a properly completed and signed Form W-9 from customers or sales could be subject to backup withholding (at a current tax rate of 24 percent).

Ten important aspects of broker reporting of digital assets

(as of November 11, 2024)

1. New Form 1099-DA
2. Effective dates
3. Lots of forms expected due to the number of transactions
4. Broad definition of digital assets but narrow definition of "covered" digital assets subject to cost basis reporting
5. Narrow initial definition of a digital asset broker and planned updates to later include non-custodial middlemen and non-US brokers
6. Time for identifying lots sold
7. Limits on use of customer provided information
8. Special requirements for basis adjustments by brokers
9. Special *de minimis* rules and alternative reporting related to stablecoins and NFTs
10. Time-based backup withholding relief



New Form 1099-DA

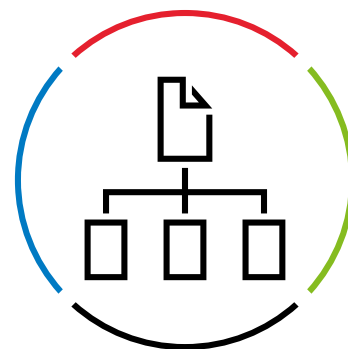
Brokers will generally be required to report sales of digital assets on a new form (IRS Form 1099-DA) starting with calendar year 2025 transactions. As of November 11, the form had not been finalized, but as of that date, a draft version of the form and the related broker instructions are on the IRS website.

Effective dates

The effective dates for broker reporting of sales and broker reporting of cost basis for digital assets are staggered. Sales occurring in calendar 2025 and later must generally be reported. However, the cost basis of certain digital asset sales are only required to be reported for those sales occurring in calendar 2026 and later.

Lots of forms expected due to the number of transactions

As discussed below, the scope of the definition of digital assets subject to broker reporting is broad. There are important exceptions from broker reporting for certain digital asset sales that can apply but there will still be lots of reportable sales. Moreover, the rules generally provide that brokers must report intra-day sales of digital assets separately. And, unlike broker reporting of sales of traditional securities, certain non-cash digital asset sales are also reportable. For these reasons, brokers should be prepared that there could be lots of Forms 1099-DA that must be filed.





Broad definition of digital assets but narrow definition of “covered” digital assets subject to cost basis reporting

Digital assets subject to broker reporting are expansively defined as “any digital representation of value that is recorded on a cryptographically secured distributed ledger (or any similar technology), without regard to whether each individual transaction involving that digital asset is actually recorded on that ledger, and that is not cash [as defined in the Final Regulations].” Notice 2024-57 provides that certain digital asset transactions including those related to digital asset lending, staking, and a few others are excluded from broker reporting. Certain digital asset sales are exempt from reporting per the Notice or various rules of the regulations.

The subset of digital assets subject to cost basis reporting are much narrower. Only digital assets custodied by a US broker are subject to cost basis reporting. Furthermore, any digital assets transferred to a broker are not currently subject to cost basis reporting (although the IRS has messaged that the regulations will be updated to include transferred-in digital assets as covered in a later phase). The regulations include other limitations on cost basis reporting.

Narrow initial definition of a digital asset broker and planned updates to later include non-custodial middlemen and non-US brokers

Currently, only digital asset brokers that are custodial brokers must file Forms 1099-DA. However, the regulations will eventually be updated to include both non-custodial brokers (such as middlemen) and non-US brokers. It is expected that these updates will occur in separate phases, in part because additional time is needed by the IRS to refine the rules for non-custodial middlemen and because the non-US broker reporting rules are expected to be harmonized with pending non-US digital asset reporting rules promulgated by the OECD (Organization for Economic Co-operation and Development).





Time for identifying lots sold

When a taxpayer sells a portion of a particular digital asset custodied by a broker, it must be determined which particular portion of the assets were sold. A taxpayer must generally provide the broker with an adequate identification of which units of a digital asset are sold by the date and time of the sale. Otherwise, the broker must generally report sales using a first-in, first-out (FIFO) method based on assets held in the specific brokerage account.

Limits on use of customer provided information

A broker is permitted, but not required, to consider certain customer provided information for the determination of when digital assets transferred to the broker were acquired by the customer. However, use of certain other information from customers and third parties could result in penalty risks to the broker.

Special requirements for basis adjustments by brokers

Brokers are not generally required to make basis adjustments to covered digital assets. As mentioned earlier, digital assets that are transferred into a broker held account are not currently covered.

Basis adjustments for securities that are inherited or gifted are contemplated to be made in connection with transfers to accounts. Because digital assets that are transferred to a broker are not covered, there are no required basis adjustments related to gifting and inheritance.

Moreover, the inability to make basis adjustments based on information from customers and third parties without penalty risks will likely also limit any related basis adjustments.

There are no required basis adjustments for wash sales related to digital assets (except for digital assets that are “tokenized securities,” a term defined in the Final Regs).

More broadly, with respect to broker reportable sales of digital assets for both sales and cost basis reporting, related transaction costs must be taken into account.

A customer is likely to incur fees and charges when digital assets are bought or sold. Such fees and charges are defined as “transaction costs.” Transaction costs related to purchases or sales of assets can reduce the taxable proceeds of a sale or increase the basis of property acquired.

There are special rules for determining how transaction costs incurred in sales of digital assets are allocated. In general, when one digital asset is sold for another, the digital asset transaction costs decrease the proceeds of the digital asset sold. Also, if digital assets are acquired and none are disposed in connection with such acquisition, the transaction costs are generally allocated to such acquisition. Finally, if in connection with the sale of one digital asset for another, the broker withholds digital assets that are sold to pay transaction costs related to such digital asset sale, the transaction costs are allocable exclusively to the original, related sale transaction. Certain sales of digital assets by a broker to pay for a customer’s sales related transaction costs and certain sales of digital assets to fund sales related backup withholding are not broker reportable.



Special *de minimis* rules and alternative reporting related to stablecoins and NFTs

In order to provide limited relief from broker reporting related to stablecoins and NFTs (non-fungible tokens), brokers can use *de minimis* thresholds (\$10,000 in sales per calendar year for qualified stablecoins and \$600 in sales per year for specified NFTs, as those terms are defined in the regulations), under which broker digital asset reporting would generally not apply. And, if broker sales exceed the specified *de minimis* thresholds, simplified reporting (or possibly no reporting) as specified in the regulations would generally be available.

Time-based backup withholding relief

IRS Notice 2024-56 provides brokers with several important exceptions from backup withholding on reportable sales of digital assets:



Reportable sales that occur in calendar 2024 are not subject to backup withholding.



Certain reportable sales that occur in calendar 2025 are not subject to backup withholding even if the broker has not obtained a certified taxpayer ID number (TIN) on a Form W-9 from the customer but only if 1) the customer opened its account before January 1, 2026 and 2) the taxpayer's name and TIN combination are submitted to the IRS TIN Matching Program for verification and the IRS responds that such combination matches IRS records.



Reportable real estate sales and reportable sales by digital asset payment processors (as could occur in connection with certain payment or credit card type transactions) are also, for now, exempt from backup withholding. Digital asset sales for NFTs are also exempt for now.



Because a broker may backup withhold as required in digital asset sales reporting — and then have inadequate cash to pay the full amount of backup withholding when the digital assets are liquidated for cash (a shortfall) — the Notice also provides a limited exception to address this possible shortfall. However, it is only available for reportable sales occurring before January 1, 2027.

There is additional backup withholding relief that may be available under the Final Regulations.

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Stevie D. Conlon is a vice president, tax and regulatory counsel for Wolters Kluwer. She oversees tax regulatory issues and development. She is a nationally recognized tax expert on the cost basis tax law, the taxation of financial products and derivatives, and she has been quoted in top-tier news publications.

[Connect with her on LinkedIn](#)



Anna Vayser is a Product Manager with Wolters Kluwer and plays a lead role in products focusing on tax compliance with IRC Secs. 305(c), 1446(f) and 871(m). She is also involved in GainsKeeper complex debt functionality development.

[Connect with her on LinkedIn](#)



Robert Schwaba is a Specialized Consulting Manager with Wolters Kluwer, assisting financial institutions with tax matters on a variety of topics including Subchapter C, 305(c) and 871(m) withholding tax matters, blockchain and cryptocurrency, and banking compliance issues.

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