November 8, 2023

The Honorable Lily Batchelder
Assistant Secretary of Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. William M. Paul
Principal Deputy Chief Counsel
Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224

Re: Comments on the Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions Proposed Regulations (REG-122793-19)

Dear Ms. Batchelder and Mr. Paul:

The American Institute of CPAs (AICPA) is submitting comments on the proposed regulations regarding gross proceeds and basis reporting by brokers and determination of amount realized and basis for digital asset transactions (REG-122793-19), "proposed regulations."

We offer these comments in addition to our previously submitted comments.[1]

Our comments address the following areas:

A. Basis Tracking Issues
B. Cost Basis in Determination of Gain or Loss and Broker Notification
C. Duplicate Reporting
D. Penalty Relief
E. Taxpayer Privacy and Need for a De Minimis Rule
F. Request for Comments #44
G. Need for Delay in Effective Date of Infrastructure Investment Jobs Act ("IIJA") Changes to Section[2] 6050I

[1] The AICPA has previously provided comments on virtual currency taxation matters including: "Comments on Notice 2014-21: Virtual Currency Guidance," June 10, 2016; "Updated Comments on Notice 2014-21: Virtual Currency Guidance," May 30, 2018; "Comments on Revenue Ruling 2019-24, the New Question on Schedule 1 (Form 1040), and the Internal Revenue Service's Frequently Asked Questions on Virtual Currency Transactions," February 28, 2020; "Comments on Virtual Currency Question on the Form 1040 and Instructions," August 29, 2022; "Comments on Virtual Currency Reporting under Internal Revenue Code Section 6045 and Section 6050I, and the Form 8300 and Instructions," October 28, 2022; and "IRS Draft Instructions to 2022 Form 1040 Pertaining to Digital Assets," December 16, 2022; "AICPA Proposed IRS Frequently Asked Questions (FAQs) Pertaining to the 2022 Form 1040 Digital Asset Question," February 17, 2023; "Guidance Needed on the Tax Treatment of Losses of Digital Assets, April 14, 2023; "Notice 2023-27 on Non-Fungible Tokens (NFTs)," June 16, 2023; and Comments on the IRS Draft 2023 Forms 1040, 1065, 1120, and 1120-S Digital Asset Question," July 28, 2023; "Digital Assets Taxation," September 8, 2023.

[2] Unless otherwise indicated, all references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), and references to a "Treas. Reg. §" are to the Treasury regulations promulgated under the Code.

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A. Basis Tracking Issues

Overview

The proposed regulations for digital assets address both section 6045, returns of brokers, as well as section 1001, determination of amount of and recognition of gain or loss, and section 1012, basis of property-cost. The proposed regulations provide ordering rules to apply when a taxpayer has multiple acquisitions of the same digital asset in an account. In such situations, brokers are to report the sale of less than the customer's entire holdings per the customer's designation. This designation must be given to the broker at the time of the disposition (Prop. Reg. § 1.1001-7, Prop. Reg. § 1.1012-1(h), and Prop. Reg. § 1.1012-1(j)). For digital assets not in the custody of a broker, the taxpayer can specifically identify the units of a digital assets disposed of "if, no later than the date and time of the sale, disposition, or transfer, the taxpayer identifies on its books and records the particular units to be sold, disposed of, or transferred by reference to any identifier such as the purchase date and time or the purchase price for the unit, that is sufficient to identify the units sold, disposed of, or transferred in order to determine the basis and holding period of such units." The proposed regulations also provide that a specific identification required adequate records for all units held in a single wallet or account (Prop. Reg. §1.1012-1(j)(2)). The proposed regulations specify that specific identification is per units in a wallet or account, thus implying that a universal or multi-wallet/account approach is not allowed by the proposed regulations.

If the customer does not provide an adequate identification of the units sold by the time of sale, the broker (or taxpayer if the units are not in the custody of a broker) is to identify the basis of the units disposed of using the first in first out (FIFO) method (Prop. Reg. § 1.6045-1(d)(2)(ii)(B) and Prop. Reg. §1.1012-1(j)). For this purpose, the broker looks at the earliest units of the particular digital asset purchased for the account or transferred into it by the broker. This is not the first time the IRS has suggested how to track basis of digital assets. The first time was in October 2019 with the release of several Frequently Asked Questions, "FAQs" on virtual currency. [3] Prop. Reg. §1.1012-1(j) and FAQs #39 to #41 on basis tracking are not identical.

Many of the IRS virtual currency FAQs released in October 2019 repeated basic elements of Notice 2014-21, while others were new information on the calculation of gains and losses on virtual currency transactions. FAQs #39, #40 and #41 explain how a taxpayer identifies which units are deemed sold, exchanged, or otherwise disposed of in a transaction. Per FAQ #39, a taxpayer "may choose which units of virtual currency are deemed to be sold, exchanged, or otherwise disposed of if you can specifically identify which unit or units of virtual currency are involved in the transaction and substantiate your basis in those units."

Details on how to identify the virtual currency unit disposed of are covered in FAQ #40 as follows:

> You may identify a specific unit of virtual currency either by documenting the specific unit's unique digital identifier such as a private key, public key, and address, or by records showing

[3] IRS, Frequently Asked Questions on Virtual Currency Transactions; https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions.

> the transaction information for all units of a specific virtual currency, such as Bitcoin, held in a single account, wallet, or address. This information must show (1) the date and time each unit was acquired, (2) your basis and the fair market value of each unit at the time it was acquired, (3) the date and time each unit was sold, exchanged, or otherwise disposed of, and (4) the fair market value of each unit when sold, exchanged, or disposed of, and the amount of money or the value of property received for each unit.

Finally, FAQ #41 provides that if a taxpayer did not use the deemed specific identification method, "the units are deemed to have been sold, exchanged, or otherwise disposed of in chronological order beginning with the earliest unit of the virtual currency the taxpayer purchased or acquired; on a first in, first out (FIFO) basis."

Recommendations

Treasury and the IRS should provide examples similar to the one offered below with Taxpayer D and clarify whether the taxpayer in such situations is required to continue to follow the FAQs for those assets and if not, what they should do to ensure that errors with respect to basis are not made in the continual reporting of gains and losses on digital asset transactions.

The instructions for Form 1099-DA,[4] Schedule D to Form 1040, Capital Gains and Losses, and Form 8949, Sales and Other Dispositions of Capital Assets, should explain how taxpayers, such as Taxpayer D (see example in analysis below) in the proposed regulations, should note on these forms why they are using a different basis number for some gain or loss calculations.

Additional guidance and examples should be included in the final regulations on what a taxpayer can do to prove what units they specifically identified when they sell, dispose of or otherwise transfer digital asset units not held in the custody of a broker (at Prop. Reg. 1.1012-1(j)).

Finally, even prior to finalization of the section 6045 broker reporting regulations, a statement should be added to the IRS virtual currency FAQ website that the final regulations will likely override FAQs #39 to #41 and that clarification will be offered at that time on how a taxpayer who followed a basis tracking treatment allowed by the FAQs that is no longer allowed by the final regulations under sections 1012 and 6045.

Analysis

The deemed specific identification approach in the FAQs published on the IRS website was not limited to application on a wallet by wallet or exchange by exchange system; instead, a universal or multi-wallet approach was allowed (or at least not prohibited). For example, assume that

[4] *See* IR-2023-153 (August 25, 2023). While the proposed regulations do not refer to Form 1099-DA, IR-2023-153 announcing the release of the regulations mentions that the reporting form brokers will use is Form 1099-DA to be issued in draft form in the future. For sales or exchanges of digital assets that take place on or after January 1, 2025, the proposed regulations would require brokers, to report gross proceeds on a newly developed Form 1099-DA and to provide payee statements to customers.

Taxpayer D acquired multiple units of digital asset XYZ (a virtual currency) over several years. Some of these units are held in Taxpayer D's personal wallet, which he alone controls, while others were acquired and held on Exchange M and the balance on Exchange N. In 2022, Taxpayer D sold 10 units of XYZ held on Exchange M. In D's digital asset records, tracked using special software designed for tracking, Taxpayer D specifically identified 10 units of XYZ held on Exchange N as the units disposed of, and Taxpayer D calculated the gain or loss accordingly (assuming these were the first units Taxpayer D acquired on Exchange N). Note that while the units were literally sold on exchange M, within the tracking software units of N were specifically identified as the ones sold (using the universal or multi-account approach allowed by the FAQs). This scenario, which would not be uncommon as the FAQs allowing a universal approach were issued in October 2019, means that either the taxpayer should be allowed to continue to use the treatment allowed by the tracking software that was in place before finalization of the section 6045 regulations or final regulations should explain what taxpayers should do to move from the universal approach of the FAQs to the per wallet or account approach specified in Prop. Reg. §1.1012-1(j). However, this example is used to illustrate the difference between wallet by wallet and universal methods.

The proposed regulations do not operate similarly to the universal or multi-wallet system of FAQs #39, #40, and #41. This change will mean that some taxpayers will receive Forms 1099-DA that do not match their tax basis records. For example, continuing with Taxpayer D, assume that in 2025, Taxpayer D asks Exchange N to sell 10 units of XYZ and makes no specific identification with Exchange N and has no other sales on Exchange N in 2025. The Form 1099-DA that Taxpayer D receives from Exchange N in 2025 will report basis of the first 10 units of XYZ that Taxpayer D acquired in the earlier years. However, this reporting results in an incorrect basis, because in 2022, Taxpayer D already reported those units as sold via the deemed identification procedure allowed by the FAQs. It appears that Taxpayer D must continue to rely on the deemed specific identification via the universal approach for digital assets acquired before the proposed regulations go into effect. For new types of digital assets acquired via brokers, Taxpayer D can apply the basis rules of the proposed regulations.

B. Cost Basis in Determination of Gain or Loss and Broker Notification

Overview

Prop. Reg § 1.1012-1 describes the method for specifically identifying units of a digital asset and the absence thereof requires either the taxpayer or broker to use the cost of the earliest units acquired, commonly referred as FIFO.

The taxpayer is required to make notations in their books and records as follows to satisfy specific identification requirements. "A specific identification of the units of a digital asset sold, disposed of, or transferred is made if, no later than the date and time of the sale, disposition, or transfer, the taxpayer identifies on its books and records the particular units to be sold, disposed of, or transferred by reference to any identifier, such as purchase date and time or the purchase price for

the unit, that is sufficient to identify the units sold, disposed of, or transferred in order to determine the basis and holding period of such units."[5]

The taxpayer is responsible for specifically identifying the units sold no later than the date and time of the sale, disposition, or transfer under two circumstances:

1. Identification of the digital asset NOT in the custody of a broker;
2. Identification of the digital asset sold at a broker.[6]

However, in the case where the taxpayer sells digital assets with a broker, the taxpayer must also notify the broker about the specific digital assets they intend to sell.

As outlined in Prop. Reg. § 1.1012-1(j)(3), the taxpayer specifies to the broker having custody of the digital assets the particular units of the digital asset to be sold, disposed of, or transferred by reference to any identifier, such as purchase date and time or purchase price that the broker designates as sufficiently specific to determine the units transferred in order to determine the basis and holding period of such units.

Recommendations

Treasury and the IRS should:

1. Provide guidance on how taxpayers should comply with broker notification of specific digital asset sales in the absence of any current notification mechanism.
2. Provide guidance on how taxpayers will comply with specific identification of digital assets when cryptocurrency tracking software generally provides neither a way to mark those digital assets nor incorporate those sales into gain and loss calculations.
3. Provide guidance on whether a support email sent by the taxpayer satisfies the requirement for the broker notification requirement of specific identification.
4. Clarify how the IRS (and the taxpayer) will handle the frequent occurrence of cost basis mismatch of information reporting on gains and losses.
5. Provide guidance on how taxpayers should know they may be subject to and resolve the myriad of reconciling issues among their Forms 1099-DA.
6. Provide guidance on reconciling the ongoing basis differences between the cryptocurrency tracking software and exchanges.
7. Remove the requirement for taxpayers to specifically identify digital assets at a date and time before the sale and instead consider allowing taxpayers who previously used an alternative cost basis other than FIFO to continue using that method if it was consistently applied.
8. Consider allowing taxpayers who consistently followed FAQ #39, #40 and #41 to track their cryptocurrency gain or loss upon disposition to elect to continue to use the method allowed by FAQ #39, #40 and #41 for all cryptocurrencies purchased prior to effective date of the Prop.

[5] Prop. Reg. §1.1012-1(j)(2).
[6] *See* Examples in Prop. Reg. §1.1012-1(j)(5)(i) and Prop. Reg. §1.1012-1(j)(5)(ii).

Regs. Consider also requiring all cryptocurrencies purchased after effective date of the Prop. Regs. to use the wallet-by-wallet method specified in the Proposed Regulations.

Analysis

IRS should allow alternative methods as a substitute for specific identification because of the significant administrative burden and the restrictive capabilities of the cryptocurrency tracking software to perform these calculations. In such situations, the basis information on Form 1099-DA will unlikely match taxpayer records, but the Form 1099-DA will still indicate that a disposition occurred, and the amount realized. We discuss below the various issues involved with the proposed regulations requirement on specific identification and reconciliations.

- Issues with Notifying Brokers about Specific Identification

Exchange J and Exchange K are digital assets brokers also known as centralized exchanges who have custody of digital assets on behalf of taxpayers. Neither centralized nor decentralized exchanges provide any notification mechanism or feature for taxpayers to specifically identify the digital assets they want to sell.

Taxpayers could send their notifications to support@exchangeJ.com, for example; however, the exchange may not reflect the information request in taxpayers' Form 1099-DA. IRS should clarify if a support email sent by the taxpayer satisfies the requirement for the broker notification requirement of specific identification.

Even if the taxpayer satisfies the broker notification by email, the exchange will still likely report digital asset sales based on the earliest units acquired, commonly referred as FIFO. Meanwhile, the taxpayer will properly notate their records for the specific digital assets sold resulting in a cost basis mismatch between the exchange and the taxpayer like the FAQ basis examples above. The broker will report on Form 1099-DA sales on a FIFO basis, and the taxpayer will report the same sales on their Form 8949 on a specific identification basis resulting in different gains and losses, thus triggering an information mismatch with the IRS.

- Reconciling Form 1099-DA and other issues

Regardless of the extent of Form 1099-DA reporting, taxpayers will still have some digital asset transactions that are not reflected on the Form 1099-DA. Furthermore, taxpayers will still likely be relegated to using cryptocurrency tracking software to manage 100% of their transactions including all amounts reported on Form 1099-DAs. Taxpayers will have to reconcile the information reported on Forms 1099-DA to make sure proceeds and especially cost basis is reported correctly. In cases where an exchange does not have cost basis information, such as "transferred in" digital assets, taxpayers must rely on the cryptocurrency tracking software to determine the cost basis related to the proceeds reported with zero basis.

Taxpayers who used universal cost basis reporting in prior years will likely have a perpetual mismatch with the basis records kept by a centralized exchange. Taxpayers who switch from universal cost basis to an address-by-address basis in 2024 will result in cost basis inventory of unsold tokens in their cryptocurrency tracking software for Exchange K, for example, that will never match Exchange K's cost basis inventory of unsold tokens for that particular customer.

Meanwhile, taxpayers who switch from universal cost basis to an address-by-address basis in their cryptocurrency tracking software back to the beginning of time will result in double counting or omitting gain and losses already reported in prior years. If taxpayers created new Forms 8949 after making this change and compared the new Forms 8949 to the ones filed in prior years, the amounts reported on the forms would not match on a year-to-year comparison. Taxpayers may not be aware of these issues arising while attempting to comply with the proposed regulations.

Finally, most cryptocurrency tracking software already has limitations on features and the address-by-address or account-by-account basis tracking may not be an option within taxpayers' existing software. If taxpayers do not have this option, they may have to migrate to another software provider, creating additional administrative burdens on the taxpayers. IRS should provide guidance on how taxpayers should know they may be subject to and resolve the myriad of reconciling issues among their Forms 1099-DA. Crypto tax management is already challenging enough, and most taxpayers will likely not be capable of resolving reporting mismatches resulting in over or underreporting by taxpayers.

- Issues with Taxpayers Documenting Specific Identification in their Records

Unhosted wallets do not provide any mechanism or feature for taxpayers to specifically identify the digital assets they want to sell at a point in time before the sale or disposal takes place. Most taxpayers use cryptocurrency tracking software to track transactions and complete crypto tax calculations that would otherwise be virtually impossible without the software. In addition, the software does not provide any features for taxpayers to specifically identify units of digital assets before the sale takes place.

Cryptocurrency tracking software is an aggregation tool for all crypto transactions for all wallets, exchanges, and tokens for a given taxpayer. The software provides current token balances, realized gain and loss calculations, and the cost basis inventory of unsold tokens in addition to unrealized gains and losses. Cryptocurrency tracking software typically offers the FIFO method and at least one other cost basis method such as highest in first out (HIFO) . Some software has as many as 15 different cost basis methods.

In practice, taxpayers do not specifically identify digital assets at a date and time before a trade happens regardless of the cost basis method used. Digital asset investing is orders of magnitude more complex than securities for several reasons. For example, most taxpayers may have 2-3 securities brokerage accounts and, therefore, they receive 2-3 Forms 1099-B, Proceeds from Broker and Barter Exchange Transactions, as a result. It is common for crypto taxpayers to have 15-30 exchanges accounts and wallets, for example, and some taxpayers have over 100 such

accounts and wallets. Taxpayers also often have a multiple number of different tokens, and multiple number of different chains, and so on, which illustrates the significant crypto tracking complexity. As result it is impractical for taxpayers to specifically identify digital assets as defined in Prop. Reg. § 1.1012-1(j)(1) and Prop. Reg. § 1.1012-1(j)(2).

- Explanation of the Administrative Burden of Specific Identification Tracking

Taxpayers' cost basis inventory of unsold tokens at any given time is typically available as a comma separated values (CSV) file download from their respective cryptocurrency tracking software. A taxpayer would have to download the CSV file, scroll through hundreds or thousands of transactions to manually notate one or several lots of tokens they intend to sell. Then, after the sale of tokens, they would have to refresh the tax software to reflect the new sale and download another CSV file to reflect the current updated cost basis inventory of unsold tokens and repeat the process over and over again. Meanwhile, the Taxpayer's notation of the sale in their previous CSV download is not reflected in the new CSV download because it was done manually in the spreadsheet and not in the software. For example, if a Taxpayer A has 837 trades, they would have to follow this process and result in 837 CSV files, where each CSV documents one trade before the date and time of the sale in question. This can be very administratively burdensome for the taxpayers to track based on specific identification. Taxpayers will need guidance on how to comply with specific identification of digital assets when the cryptocurrency tracking software generally provides neither a way to mark those digital assets nor incorporate those sales into gain and loss calculations.

- Limitations of Specific Identification with Cryptocurrency Tracking Software

Even if taxpayers go through the burden of documenting and specifically identifying digital assets before they are sold, it provides zero value because cryptocurrency tracking software is incapable and lacks the features to incorporate the digital asset lots identified by the taxpayer for gain and loss calculations. Since it is nearly impossible for taxpayers to calculate gains and losses without cryptocurrency tracking software, it will be impossible for taxpayers to comply with the requirements for specific identification.

Taxpayers who intend to calculate their crypto taxes based on specific identification can use any one of the alternative cost basis methods available in the cryptocurrency tracking software other than FIFO. Alternatives like HIFO and closest cost first out (CCFO) are a proxy for specific identification because the specific units of digital assets are identified after the fact from the calculation rather than before the date and time a trade takes place.

For example, Taxpayer B chose CCFO in 2016 because it closely matched the economics and flow of funds for their use case. They intended to specifically identify and sell digital assets for consulting services shortly after they were received from customers. The cryptocurrency tracking software is limited, so Taxpayer B used CCFO as a proxy because it closely resembled gains and losses as if the software allowed the taxpayer to specifically choose the digital assets sold.

C. Duplicate Reporting

Overview

The proposed regulations, as currently stated, create duplicate reporting concerns for taxpayers that will make it difficult for taxpayers to correctly meet their tax compliance obligations and avoid receiving a CP2000 or a similar notice from the IRS for failure to report all their information reports.[7]

Recommendations

The final regulations should provide tiebreaker or coordination rules to avoid duplicative reporting.[8]

It is also recommended that efforts be made to reduce the expected number of digital asset reporting forms taxpayers may receive, which could exceed 1,000 per year.

Analysis

For example, assume Taxpayer A uses a non-custodial wallet to store cryptocurrency DEF. The non-custodial wallet offers customers the option of using a decentralized exchange aggregator to trade their cryptocurrency. Taxpayer A decides to trade their cryptocurrency DEF for cryptocurrency MNO using this feature.

In this example, Prop. Reg. §1.6045-1(a)(21) calls for the following parties to issue Taxpayer A an information form reporting only gross proceeds:

- The non-custodial wallet.[9]
- The decentralized exchange aggregator.[10]
- The decentralized exchange where the trade was settled.[11]

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[7] The IRS explains the rationale for some duplicative reporting in the proposed regulations. *See* Preamble to REG-122793-19, 88 FR 59598, (Aug. 29, 2023). Per the IRS, part of the challenge to avoiding duplicative reporting is that in some situations, one broker might not know that another broker is reporting the same transaction.

[8] Examples of tiebreaker or coordination rules include Treas. Reg. § 1.6041-1(a)(1)(iv) on situations where a contractor might otherwise received both a Form 1099-NEC, Nonemployee Compensation, and Form 1099-K, Merchant Card and Third Party Network Payments, as well as Prop. Reg. § 1.6045-1(c)(8)(i) to avoid duplicative reporting of transactions that involve digital assets and sale of a commodity.

[9] Preamble to the proposed regulations, 88 FR 59578, (Aug. 29, 2023): "The term broker for this purpose also includes persons that are not custodians. For example, a non-custodial executing broker that acts as an agent for customers to effect sales of securities is included in this definition."

[10] The decentralized exchange aggregator is considered a "digital asset middleman" as defined in Prop. Reg. § 1.6045-1(a)(21).

[11] Preamble to the proposed regulations, 88 FR 59585, (Aug. 29, 2023): "The Treasury Department and the IRS expect that this clarified proposed definition will ultimately require operators of some platforms generally referred to as decentralized exchanges to collect customer information and report sales information about their customers, if those operators otherwise qualify as brokers."

Even with detailed records and examination of the Forms 1099-DA received, Taxpayer A may not be able to confirm whether there is duplicative reporting among the forms received. Additional questions arise such as:

- How will the IRS expect the taxpayer to report these information forms on their income tax return?
    - For example, will the IRS expect the taxpayer to report the gross proceeds three separate times on their income tax return and then back out two of the entries?
    - If the taxpayer reports only gross proceeds once on their tax return, will this trigger a matching error notice, such as CP2000?
- How will the taxpayer know and prove that the gross proceeds reported in the three different informational reports are all from the same transaction?

Duplicative reporting creates an additional administrative burden for taxpayers, and it is unclear how duplicative reporting falls within the legislative intent of the Infrastructure Investment and Jobs Act (IIJA).

In late October 2023 it was reported that the IRS expects that about 8 billion Forms 1099-DA will be filed under the broker reporting rules.[12] The preamble to the proposed regulations states that the IRS expects between 13 million and 16 million taxpayers (owners) will be affected by the new reporting rules. Assuming 16 million taxpayers, these estimates means that on average, a taxpayer might receive approximately 500 reporting forms annually. Given that many individuals may only transact in digital assets on one or more exchanges and not use digital assets to purchase goods and services, many taxpayers will receive far less than 500 reporting forms while others may receive over 1,000 forms. The ability to reconcile so many forms to one's records will be quite time-consuming and subject to error.

D. Penalty Relief

Overview

As our comments demonstrate, implementation of digital asset reporting on Form 1099-DA is likely to bring significant challenges for brokers and taxpayers with digital asset transactions. Brokers may face difficulties in obtaining property information to report, such as taxpayer identification and basis, and some taxpayers might not realize they are a considered to be a broker under the final regulations.

[12] Jonathan Curry, "IRS Prepping for at Least 8 Billion Crypto Information Returns," *Tax Notes*, Oct. 26, 2023; https://www.taxnotes.com/tax-notes-today-federal/tax-system-administration/irs-prepping-least-8-billion-crypto-information-returns/2023/10/26/7hhdp. This news story reports on a statement made by Julie Foerster, IRS Director of Digital Assets during an October 25 meeting of the Council for Electronic Revenue Communication Advancement.

Additionally, basis information may not be correct for recipients of Form 1099-DA based on the taxpayer's records for the current and prior tax years of tracking basis, as allowed under the virtual currency FAQs.

Recommendations

Treasury and the IRS should provide penalty relief to both brokers required to file Form 1099-DA and to taxpayers who receive Form 1099-DA for the first three years that the final regulations for digital assets are in effect.

- Beginning with the first reportable year, transition penalty relief should be afforded to brokers who fail to accurately complete or furnish Form 1099-DA if the filer establishes that it made a good faith effort to comply with the new reporting requirements. A good faith effort to comply should be able to be satisfied by proving the filer made changes to its systems, processes, and procedures for collecting and processing information relevant to Form 1099-DA.

- If Form 1099-DA contains inaccurate information that the taxpayer uses on their income tax return or is not aware that the basis information is incorrect per the taxpayer's past reporting, penalty relief should be extended to such a taxpayer where reliance upon the information return occurred in good faith.

Analysis

While we appreciate the postponement of reporting relevant transactions, additional penalty relief during a transition period would be helpful for those who may make inadvertent reporting mistakes. Given the broad scope of potential reporting errors, a minimum of one transition year providing relief is appropriate for those attempting to comply with the regulations in good faith.

Broker reporting also directly impacts a taxpayer who initiated the reportable sale, as the taxpayer generally relies upon Forms 1099 to complete their own income tax filings. If Form 1099-DA contains inaccurate information that the taxpayer uses on their income tax return or is not aware that the basis information is incorrect per the taxpayer's past reporting, penalty relief should be extended to such a taxpayer where reliance upon the information return occurred in good faith.

E. Taxpayer Privacy and Need for a De Minimis Rule

Overview

The proposed regulations are expected to result in taxpayers receiving, on average, a few hundred Forms 1099-DA annually. While many of these forms will be issued by brokers that are subject to FinCEN money transmitter or similar laws that require compliance with "know your customer" (KYC) rules, many brokers will not have detailed private information on the taxpayer for whom they must issue a Form 1099-DA. Thus, taxpayers will be asked by many involved with digital assets for personal information such as name, address, taxpayer identification number, and digital

account details. Individuals will rightly be concerned about transferring this information when they don't have a relationship with that party and are not convinced that the information will only be used for broker reporting and will not know if the broker can keep the data secure.

Recommendations

In the absence of a de minimis rule for reporting such merchant transactions,[13] Treasury and the IRS should provide guidance in the final regulations on how a digital asset payment processor should be collecting sensitive taxpayer information to comply with such reporting requirements.

Alternatively (or in addition to), provide a de minimis rule such that a Form 1099-DA is not required to be filed by payment processors on purchases of $500 or less with such amount adjusted annually for inflation. In instructions to Form 1040 and 1099-DA, taxpayers can be reminded that they are still required to report gains (and possibly losses) from use of digital assets to acquire goods and services even if no Form 1099-DA is received.

Analysis

The proposed regulations would require certain digital asset payment processors to report transactions on a Form 1099-DA, which raises significant concerns about privacy and security of taxpayer identification information. For example, assume that Taxpayer B wants to pay for groceries using a digital asset. In this scenario, the grocery store works with a third-party digital asset payment processor to help process transactions. Prop. Reg. § 1.6045-1(a)(1) provides that a broker means any person that in the ordinary course of a trade or business during the calendar year stands ready to effect sales to be made by others. A digital asset payment processer is defined in Prop. Reg. § 1.6045-1(a)(22)(i)(A) as a person who in the ordinary course of its business regularly stands ready to effect digital asset sales by facilitating payments from one party to a second party by receiving digital assets from the first party and exchanging them into different digital assets or cash paid to the second party, such as a merchant. This third-party payment processer is a broker under such definition therefore must issue a Form 1099-DA to Taxpayer B and report the proceeds for the transaction.

For the digital asset payment processor to collect the necessary information to be reported on Form 1099-DA, the grocery store and payment processor might have an arrangement for the grocery clerk to collect the information from Taxpayer B (name, address, and SSN). While the collecting parties might add some technique to improve the security of the information, there are significant risks in the process given the number of parties involved and the setting itself (a busy store, for example).

If Taxpayer B provides their private tax identification information to the clerk, whether verbally or digitally, there is an increased risk of disclosing this information to others.

[13] Preamble to the proposed regulations, 88 FR 59590, (Aug. 29, 2023)

For numerous reasons taxpayers will still need to maintain records to track all of their digital assets, basis, and information to match Forms 1099-DA to their records. As a result, taxpayers will have the information they need for transactions handled by payment processors without the need for a 1099-DA for all of the transactions. The importance of maintaining data security for taxpayers outweighs the need for Form1099-DA issuance every time a taxpayer uses a third-party payment processor for purchase of goods or services.

F. Request for Comments #44

Overview

The proposed regulations included a request for comments #44:

"Should the ordering rules for unhosted wallets be applied on a wallet-by-wallet basis as proposed, or should these rules be applied on a digital asset address-by-digital asset address basis or some other basis?"

Recommendation

The ordering rules should be applied on an address-by-address basis to maintain consistency of cost basis tracking among all taxpayers' hosted and unhosted wallets and accounts.

Analysis

Many unhosted wallets, such as Metamask, facilitate creation of almost an unlimited number of addresses. Ethereum addresses are also called accounts; therefore, accounts and addresses can be used interchangeably. Metamask also supports several Ethereum virtual machine (EVM) compatible blockchains that allow the user to have multiple addresses and multiple chains at the same time all within one wallet.

For example, both Taxpayer A and Taxpayer B have an inventory of 27 addresses and have an identical transaction set (i.e., the same exact trades, for the same amounts, the same tokens on the same dates). In addition, addresses cannot be associated as originating from a specific wallet. Taxpayer A has 27 wallets, and Taxpayer B has 1 wallet with everything else being equal. If the ordering rules are applied on a wallet-by-wallet basis, Taxpayer A and Taxpayer B would receive significantly different gains and losses and create significant inconsistencies among taxpayers. However, under the same scenario, ordering based on an address-by-address basis provides both taxpayers the same result, assuming both taxpayers used the same cost basis method.

G. Need for Delay in the Effective Date of IIJA Changes to Section 6050I

Overview

IRS Announcement 2023-02 released by the IRS on December 23, 2022, provides that the broker reporting rules added by the IIJA, will not be effective until final regulations are issued under section 6045 and section 6045A. Without this relief, the reporting rules for digital assets added by the IIJA would have been effective for statements required to be furnished after December 31, 2023.

While we appreciate the announcement, it did not provide relief for reports due under section 6050I for merchants who receive, in one or more related transactions, digital assets worth over $10,000. The reports required by this section, Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business, are due within 14 days of the receipt of the digital assets. Thus, transactions that occur starting in the last 13 days of 2023 are first due in 2024.

Recommendation

The effective date of the IIJA changes to section 6050I should be postponed until final regulations are issued.

Analysis

No guidance has been issued under the IIJA changes to section 605I, including the recently released proposed regulations. In October 2022, the AICPA submitted comments to the IRS with recommendations for guidance under section 6045 and section 6050I regarding changes made by the IIJA.[14] AICPA noted several issues that merchants could face in complying with the digital asset changes to section 6050I. These issues included situations, such as an airdrop or other promotional token, where the recipient does not have and cannot obtain the necessary information from the sender to file Form 8300. There are also situations where the "sender" is not a natural person, such as validators earning staking rewards. To provide adequate time for taxpayers to understand the rules and how to comply, the IRS should delay the effective date of section 6050I until final regulations are issued.

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[14] Comments on Virtual Currency Reporting under Internal Revenue Code Section 6045 and Section 6050I, and the Form 8300 and Instructions, Oct. 28, 2022.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Annette Nellen, Chair, AICPA Virtual Currency Task Force, at (408) 924-3508 or Annette.Nellen@sjsu.edu; Reema Patel, AICPA Senior Manager – Tax Policy & Advocacy, at (202) 434-9217 or Reema.Patel@aicpa-cima.com; or me at (830) 372-9692 or bvickers@alamo-group.com.

Sincerely,

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