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Global Financial Services Industry
6 January 2025

Release of final digital asset broker reporting regulations for "non-custodial industry participants"

Global Information Reporting

On December 27, 2024, the Treasury Department and the IRS released final regulations under section 6045, titled "Gross Proceeds Reporting by Brokers that Regularly Provide Services Effectuating Digital Asset Sales," addressing reporting rules for "non-custodial industry participants," the term used in the preamble for the first set of final digital asset broker reporting regulations published in the Federal Register on July 7, 2024. Contemporaneous with the release of these regulations, Notice 2025-03 was published to provide transitional relief for digital asset brokers impacted by these new rules.

In contrast to the first set of final regulations, these regulations only address section 6045, updating and finalizing the "middleman" reporting rules in the proposed regulations released in August 2023. The proposed middleman rules applied to persons providing a "facilitative service," including as brokers those that "ordinarily would know or be in a position to know the identity of the party that makes the sale and the nature of the transaction potentially giving rise to gross proceeds from the sale." In response to publicly submitted comments that this definition was overbroad, these final regulations change the term to "effectuating service," including as brokers any persons that provide a trading front-end service that ordinarily would know the nature of the transaction potentially giving rise to gross proceeds from the sale.

A trading front-end service is a service that receives and processes digital asset sale orders by providing a user interface that enables input and transmission of order details to a distributed ledger network for interaction with a digital asset trading protocol. This term is not exclusive to decentralized finance ("DeFi")—although persons providing such services are referred to in shorthand by Treasury and the IRS as "DeFi brokers"—but it does expand the broker definition from the prior final regulation package to include as brokers those that do not

necessarily custody digital assets and may use smart contracts and decentralized protocols to effect digital asset trading. As stated in the preamble of these regulations,

> trading front-end service providers typically are legal entities or individuals that can more easily be identified by taxpayers and the IRS; the software code they write is not immutable; they are best suited to obtain information from customers; and the services they provide are most analogous to the services provided by conventional securities brokers.

Distributed ledger validation services and the licensing of software or selling of hardware are excluded from the definition of "effectuating service," and persons exclusively providing such services would not be considered brokers. As outlined in the regulations, a software licensor or hardware seller that provides unhosted wallet services may provide trading front-end services with respect to some transactions and not others, in which case only the digital asset sales carried out using the trading front-end service would be considered broker activity.

An operator of a digital asset trading protocol is also excluded from treatment as a broker if it does not otherwise provide trading front-end services. Although not enumerated in the regulation language, the preamble also notes that DeFi trading applications, such as automated market maker systems, order matching services, or market making functions, generally also would fall outside of the broker scope because users tend to access these functions through trading front-end services. In acknowledging this, the preamble notes that, "[i]f the IRS learns that a significant amount of DeFi trading does not give rise to information reporting, the Treasury Department and the IRS may reconsider the scope of the definition of broker with respect to DeFi transactions."

The proposed regulations included rules for reporting by controlled foreign corporation (CFC) and non-US digital asset brokers in certain contexts, but the first set of final regulations put those rules on hold. The final regulations do not further address CFC or non-US reporting under section 6045 or the Crypto-Asset Reporting Framework (CARF), limiting the application of broker reporting rules to US digital asset brokers for now. According to the preamble to the first set of regulations, Treasury anticipates releasing guidance addressing non-US and CFC digital asset broker reporting in future regulations.

Reporting by DeFi brokers is required on transactions that they effectuate on or after January 1, 2027, two years after the first reportable transactions for other digital asset brokers. As the services generally are non-custodial, cost basis reporting is not anticipated, and Form 1099-DA reporting by DeFi brokers is expected to include only reporting of gross proceeds. Backup withholding applies to DeFi broker transactions as with other reportable broker payments, but Treasury and the IRS intend to release proposed regulations under section 3406 to "provide trading front-end service providers with greater flexibility to satisfy their backup withholding obligations with respect to these transactions."

To allow DeFi brokers more time to prepare for compliance, Notice 2025-03 provides penalty relief for tax year 2027 reporting. The relief is only available to a broker that makes a good faith effort to file and furnish required Forms 1099-DA accurately and timely. The notice cautions that a broker will not be considered to have made a good faith effort if it files or furnishes "after the later of the date that the IRS first contacts the broker concerning an examination of such broker or one year after the original due date for filing such returns."

Backup withholding also is phased in under the notice, suspending withholding on 2027 transactions and allowing for reliance on uncertified taxpayer identification numbers (TINs) for 2028 transactions. Such TINs must have been collected prior to 2028, and the broker must confirm the TIN using the IRS's TIN Matching Program. For accounts established prior to 2028 by persons not classified as US tax residents, brokers are permitted to treat such persons as exempt foreign persons for sales in 2028 without additional documentation, provided no US residence address is on file.

For sales prior to 2029, no backup withholding underpayment penalty will be imposed where a DeFi broker withholds 24% of the gross proceeds in digital assets. If the value of the withheld digital assets decreases between the time of the withholding and the time the broker liquidates the digital assets to fiat for deposit with the IRS, the amount will be deemed to satisfy the backup withholding liability provided the liquidation occurs immediately after the broker receives the withheld digital assets. As with other digital asset brokers, the relief provided under Notice 2024-56 also applies to DeFi brokers. Any suspension of withholding under the prior notice, such as suspension of withholding on proceeds in the form of specified non-fungible tokens (NFTs) or sales by processors of digital asset payments (PDAPs) in exchange for goods or services, is extended to DeFi brokers as well.

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