

**SELECTED ISSUES REGARDING THE TAXATION
OF DIGITAL ASSETS**

PREPARED BY THE STAFF
OF THE
JOINT COMMITTEE ON TAXATION



June 2023

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SELECTED ISSUES REGARDING THE TAXATION OF DIGITAL ASSETS

A. Background

Digital Assets

In the last 15 years, a new class of assets, known as digital assets, has grown from an idea into a trillion-dollar industry.¹ As described in a 2008 whitepaper by Satoshi Nakamoto, the pseudonymous inventor of the first digital asset, Bitcoin (the “Bitcoin whitepaper”), the purpose of the protocol behind Bitcoin was to create a scarce, purely digital good that allowed online payments without having to go through a central authority, such as a financial institution.² That was achieved by using a consensus mechanism to allow participants to maintain a public distributed ledger, recording transfers of units of Bitcoin (known as “BTC”). (The public distributed ledger typically consists of consecutive lists of transactions (“blocks”) that are cryptographically secured in a “blockchain.”) Though today there is a wide variety of protocols, most adhere to the core principles described in the Bitcoin whitepaper.

There are two kinds of digital assets: fungible and nonfungible. One common type of fungible digital asset is cryptocurrency (e.g., Bitcoin). Nonfungible digital assets are known as nonfungible tokens (“NFTs”). Digital assets as a set are often referred to as crypto, with units of a given digital asset often referred to as coins or tokens.

Similarly, there are two kinds of digital asset exchanges: centralized and decentralized. The largest centralized exchanges include Binance, Coinbase, and Kraken.³ Centralized exchanges serve as intermediaries that may perform functions that are provided by separate companies in (for example) the stock market: centralized exchanges may serve as the exchange, custodian, and broker, all in one.⁴ In contrast, decentralized exchanges generally consist only of a protocol that matches buyers and sellers, who retain custody of their digital assets. Decentralized exchanges, without acting as an intermediary, simply facilitate peer-to-peer transfers. The largest decentralized exchanges include dYdX and Uniswap.⁵

Whether and to what extent digital assets should be treated as securities or commodities is the subject of intense industry and regulatory interest. In recent litigation, the Commodity

¹ See, e.g., CoinMarketCap summary statistics, available at <https://coinmarketcap.com/> (reporting total market capitalization of digital assets of roughly \$1.17 trillion as of May 3, 2023).

² See Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, available at <https://bitcoin.org/bitcoin.pdf>.

³ See, e.g., CoinMarketCap ranking of top cryptocurrency spot exchanges, available at <https://coinmarketcap.com/rankings/exchanges/>.

⁴ In other words, centralized exchanges are vertically integrated.

⁵ See, e.g., CoinMarketCap ranking of top cryptocurrency decentralized exchanges, available at <https://coinmarketcap.com/rankings/exchanges/dex/>.

Futures Trading Commission (the “CFTC”) has taken the position that Bitcoin, Ether,⁶ Litecoin, and at least two stablecoins,⁷ Tether and Binance USD, are commodities that are subject to the agency’s regulatory authority.⁸ The Securities and Exchange Commission (“SEC”) has pending litigation and enforcement actions related to digital assets that the SEC has determined are securities subject to SEC regulation.⁹

Brief History of the Tax Treatment of Digital Assets

Notice 2014-21

In 2014, six years after the release of the Bitcoin whitepaper, the Internal Revenue Service (the “IRS”) issued its first guidance on digital assets (the “2014 Notice”).¹⁰ The 2014 Notice answers certain questions about “convertible virtual currency.” The use of that term follows a prior report by the Financial Crimes Enforcement Network (“FinCEN”) (a bureau of the Treasury Department).¹¹

The 2014 Notice defines virtual currency as “a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value” and convertible virtual currency as “virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency.” Bitcoin is the only example of a convertible virtual currency in the notice.¹²

⁶ Ether (known as “ETH”) is the digital asset of the Ethereum protocol. Bitcoin and Ether are by far the largest digital assets by market capitalization. In the first quarter of 2023, Bitcoin represented roughly 45 percent of the global crypto market, while Ether represented nearly 20 percent. Futures on Bitcoin and Ether trade on the Chicago Mercantile Exchange (“CME”), which is regulated by the CFTC.

⁷ A stablecoin is a digital asset the price of which is intended to track the price of some underlying asset. Often that underlying asset is the dollar or another currency.

⁸ *Commodity Futures Trading Commission v. Changpeng Zhao, Binance Holdings Limited, et al.*, Complaint for injunctive and other equitable relief and civil monetary penalties under the Commodity Exchange Act and Commission Regulations, p. 9, available at <https://s.wsj.net/public/resources/documents/cftc-cz-complaint-032723.pdf>.

⁹ See U.S. Securities and Exchange Commission, *Crypto Assets and Cyber Enforcement Actions*, available at <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>.

¹⁰ See Notice 2014-21, 2014-16 I.R.B. 938, March 25, 2014.

¹¹ See Financial Crimes Enforcement Network (FinCEN) *Guidance on the Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (FIN-2013-G001, March 18, 2013).

¹² See Notice 2014-21, sec. 2 (“Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies.”).

The 2014 Notice takes the position that for Federal tax purposes convertible virtual currency is treated as property and not as currency.¹³ The notice applies this logic to various scenarios, asking questions related to the tax treatment of convertible virtual currency and answers that, because convertible virtual currency is property, the standard tax treatment for property applies. The notice is silent, however, on whether convertible virtual currency might ever be treated as a security or commodity for Federal tax purposes.

The 2014 Notice further provides that no inference is to be drawn with respect to virtual currencies other than convertible virtual currencies.¹⁴

Revenue Ruling 2019-24

Five years after the 2014 Notice, the IRS issued additional guidance (the “2019 Ruling”).¹⁵ The 2019 Ruling addresses two situations dealing with “cryptocurrency” and with certain aspects of blockchain technology.¹⁶ In the first situation, the protocol of a digital asset (“Crypto M”) undergoes a protocol change such that a new digital asset (“Crypto N”) is created. Crypto N is not transferred to the legacy owners of Crypto M. For that reason, the ruling holds that the taxpayer (a legacy owner of Crypto M) does not have gross income with respect to Crypto N.

In the second situation, the protocol of a digital asset (“Crypto R”) undergoes a protocol change such that a new digital asset (“Crypto S”) is created. Crypto S is transferred to the legacy

¹³ Notice 2014-21, sec. 4, Q-1 and Q-2; see also Notice 2023-34 (modifying the background discussion in Notice 2014-21 but reaffirming the position that “convertible virtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes”). In particular, Notice 2014-21 states as background: “In some environments, [virtual currency] operates like ‘real’ currency—*i.e.*, the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance—but it does not have legal tender status in any jurisdiction.” (Emphasis added.) Notice 2023-34 revises that sentence, which is no longer accurate (Bitcoin now has status as legal tender in El Salvador and the Central African Republic) and “may be misinterpreted as overstating the similarity between convertible virtual currency and ‘real’ currency.” The revised sentence reads as follows: “In certain contexts, virtual currency may serve one or more of the functions of ‘real’ currency—*i.e.*, the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance—but the use of virtual currency to perform ‘real’ currency functions is limited.”

¹⁴ See Notice 2014-21, sec. 2. See also Notice 2023-27, which provides that the Treasury and IRS intend to issue guidance related to the treatment of certain NFTs as collectibles under section 408(m) of the Code. That treatment is relevant for other purposes, including the long-term capital gains rate under section 1(h). The Notice describes a “look-through analysis” to determine whether an NFT is a collectible. Under that analysis, an NFT is a section 408(m) collectible “if the NFT’s associated right or asset is a section 408(m) collectible.” The Notice requests comments on those and other issues.

¹⁵ Rev. Rul. 2019-24, 2019-14 I.R.B. 1004. The 2019 Ruling defines virtual currency with somewhat greater precision than the 2014 Notice: “Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value other than a representation of the United States dollar or a foreign currency.”

¹⁶ The 2019 Ruling defines cryptocurrency as a type of virtual currency that uses cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.

owners of Crypto R who may immediately sell or otherwise dispose of Crypto S (*i.e.*, they have “dominion and control” over Crypto S and an “accession to wealth”). For that reason, the ruling holds the taxpayer (a legacy owner of Crypto R) has gross income equal to the fair market value of the Crypto S transferred to the taxpayer.

Broker reporting of digital assets

In 2021, in the first enacted legislation dealing expressly with digital assets, Congress enacted new broker reporting requirements with respect to digital assets.¹⁷

In a letter dated February 11, 2022, to a bipartisan group of six Senators, the Treasury Assistant Secretary for Legislative Affairs stated:

[A]ncillary parties who cannot get access to information that is useful to the IRS are not intended to be captured by the reporting requirements for brokers. For example, persons who are just validating transactions through a consensus mechanism are not likely to know whether a transaction is part of a sale.

Starting in 2024, brokers of digital assets will be subject to the same information reporting requirements that currently apply to brokers of securities. For this purpose, a digital asset is any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary of the Treasury (the “Secretary”).¹⁸ This definition is broader than the definition of virtual currency found in either the 2014 Notice or the 2019 Ruling.

Remaining Uncertainty

The Internal Revenue Code of 1986, as amended (the “Code”), does not treat all property the same. In some instances, different kinds of property are subject to different tax treatment. The following section of this report describes several of those instances, especially those in which financial assets, such as securities or commodities, are subject to a specified treatment. In many instances, the status of digital assets is uncertain. For example, whether a digital asset, of any kind, is properly treated as a security or a commodity under any provision of the Code is unclear and has not been resolved by either Congress or Treasury.

The principles motivating the policy underlying certain provisions may suggest that digital assets should be eligible for, or subject to, the same tax treatment. But with respect to certain other provisions, the exclusion of digital assets under present law from the same tax treatment seems consistent with the underlying policy.

¹⁷ Public Law 117-58, sec. 80603 (Information reporting for brokers and digital assets). For this purpose, new section 6045(c)(1)(D) provides that a broker includes “any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.”

¹⁸ Sec. 6045(g)(3)(D).

B. Selected Issues

1. Election for dealers and traders to mark digital assets to market (section 475)

Background and Present Law

In general

Generally, dealers in securities are required to use the mark-to-market method of accounting for securities that are held at year end. Any security that is inventory in the hands of the dealer is included in inventory at fair market value. Also, any security that is not inventory in the hands of the dealer but is held by the dealer at the end of the calendar taxable year triggers recognition of gain or loss by the dealer for the year as if the security were sold for its fair market value on the last business day of the year.¹⁹

A dealer in securities is a taxpayer that either (1) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business, or (2) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.²⁰ A security is defined to include any (A) share of stock in a corporation; (B) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust; (C) note, bond, debenture, or other evidence of indebtedness; (D) interest rate, currency, and equity notional principal contract; (E) option, forward contract, or short position in any security described in (A), (B), (C), or (D); and (F) other position identified as a hedge with respect to a security described in (A), (B), (C), (D), or (E).²¹

Exceptions are provided for certain securities that would otherwise be subject to the application of the mark-to-market rules. Subject to proper identification by the taxpayer, these exceptions include: (1) any security held for investment; (2) any note, bond, debenture, or other evidence of indebtedness that is acquired or originated by the taxpayer in the ordinary course of the taxpayer's trade or business and is not held for sale; (3) any obligation to acquire debt described in (2) if such obligation is entered into in the ordinary course of the taxpayer's trade or business and is not held for sale; and (4) any hedge that is with respect to (a) a security to which the mark-to-market rules do not apply or (b) a position, right to income, or a liability which is not a security in the hands of the taxpayer.²²

Dealers in commodities and traders in securities or commodities may also elect to use the mark-to-market accounting method and be treated in the same manner as dealers in securities.²³

¹⁹ Sec. 475(a).

²⁰ Sec. 475(c)(1).

²¹ Sec. 475(c)(2). Section 1256 contracts generally are excluded from the definition of security.

²² Sec. 475(b).

²³ Sec. 475(e) and (f).

A commodity is defined to include “any commodity which is actively traded within the meaning of section 1092(d)(1),” but the term “commodity” is not explicitly defined.²⁴

Any gain or loss on dealer securities is generally treated as ordinary income or loss.²⁵ Any gain or loss on other assets that are marked to market pursuant to an election is also generally treated as ordinary income or loss. Limitations on the deductibility of capital losses generally do not apply to losses on assets that are marked to market.

Application to Digital Assets

Whether digital assets are within the scope of section 475 is uncertain. Certain digital assets are actively traded and may have reliable market valuations.

Congress has previously expressed an intent to allow mark-to-market accounting to facilitate tax compliance for frequently traded assets with determinable market values:

Mark-to-market accounting generally provides a clear reflection of income with respect to assets that are traded in established markets. For market-valued assets, mark-to-market accounting imposes few burdens and offers few opportunities for manipulation. Securities and exchange-traded commodities have determinable market values, and securities traders and commodities traders and dealers regularly calculate year-end values of their assets in determining their income for financial statement purposes.²⁶

2. Trading safe harbor (section 864(b)(2))

Background and Present Law

Foreign persons are subject to U.S. taxation generally on two types of income: (1) income effectively connected with the conduct of a trade or business within the United States (“effectively connected income” or “ECI”), which is generally taxed in the same manner as business income of a U.S. resident;²⁷ and (2) investment income received from sources within the United States which are “fixed or determinable annual or periodical gains, profits, and income” (referred to as “FDAP income”).²⁸ ECI is subject to net-basis income tax; FDAP

²⁴ Sec. 475(e)(2)(A). The term “commodity” also includes any notional principal contract with respect to any commodity that is actively traded, any evidence of an interest in, or derivative instrument in, any commodity that is actively traded or any notional principal contract with respect to such a commodity (such as an option, forward contract, futures contract, short position or similar instrument) and, any position that is a hedge with respect to any interest treated as a commodity under the foregoing definitions and that meets certain identification requirements. Sec. 475(e)(2)(B)-(D).

²⁵ Sec. 475(d)(3).

²⁶ H.R. Rep. No. 105-148, 105th Cong., 1st Sess. (June 24, 1997).

²⁷ Secs. 871(b) and 882.

²⁸ Secs. 871(a) and 881.

income is subject to a 30-percent gross-basis tax (generally collected through withholding, with rates often reduced by a bilateral income tax treaty).

Thus, the U.S. taxation of foreign persons depends on whether the foreign person's activities rise to the level of a trade or business. In general, to rise to that level, an activity must be considerable, continuous, and regular. Whether an activity rises to that level is, for many activities, unambiguous: most foreign persons, for example, are not importing goods for sale in the United States. For certain activities, though, the line separating a trade or business from an activity not subject to net U.S. income tax is less clear. Buying and selling stock or securities (or commodities) is one such activity. When does investing (the income from which is subject to tax as FDAP income) become trading (the income from which is subject to tax as ECI)? The test for whether an activity rises to the level of a trade or business is based on all facts and circumstances: there is no bright line.

To provide certainty to taxpayers and to attract foreign direct investment in U.S. capital markets, the Code provides a safe harbor for trading stock or securities (or commodities) (the "trading safe harbor").²⁹ Under the trading safe harbor, a foreign person trading stock or securities (or commodities) generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which the transactions are effected.³⁰ In addition, a foreign person trading stock or securities (or commodities) for the person's own account, even through an office or other fixed place of business in the United States, generally is not treated as engaged in a U.S. trade or business, if the person is not a dealer in stock or securities (or commodities).³¹

With respect to trading in commodities, the trading safe harbor applies only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.³²

Thus, a foreign person trading in stock or securities (or commodities) generally is taxed on only FDAP income (and not on capital gains).

Application to Digital Assets

Whether digital assets are within the scope of the trading safe harbor is uncertain. Notice 2014-21 states only that convertible virtual currency is treated as property for Federal income tax

²⁹ Sec. 864(b)(2).

³⁰ Sec. 864(b)(2)(A)(i), (B)(i), and (C).

³¹ Sec. 864(b)(2)(A)(ii) and (B)(ii). In other words, a foreign person that is a dealer in stock or securities (or commodities) generally is outside the scope of the trading safe harbor with respect to its dealing.

³² Sec. 864(b)(2)(B)(iii).

purposes;³³ the notice does not specify whether convertible virtual currencies might be treated as stock or securities (or commodities).

The IRS has ruled that whether an asset is regulated by the CFTC is relevant to determining whether the asset should be considered a commodity for purposes of the trading safe harbor.³⁴ Futures on Bitcoin and Ether are traded on the CME (which is regulated by the CFTC); for that reason, those futures (and the underlying digital assets) might be treated as commodities for purposes of the trading safe harbor.³⁵

The safe harbor applies to commodities “only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.” How the additional limitation on commodities eligible for the trading safe harbor might or should apply in the context of digital assets is unclear. Further, how “an organized commodity exchange” might or should be interpreted in the context of the different kinds of digital asset exchanges is also unclear.³⁶

3. Treatment of certain loans of digital assets (section 1058)

Background and Present Law

Transfer of securities under certain agreements

If a taxpayer transfers securities pursuant to an agreement which meets certain requirements, then the taxpayer recognizes no gain or loss either on the exchange of such securities for an obligation under such agreement or on the exchange of rights under such agreement for securities identical to the securities originally transferred.³⁷ For this purpose, a security means any share of stock in any corporation, certificate of stock or interest in any

³³ Notice 2014-21, sec. 4, Q-1.

³⁴ PLR 8540033 (“The fact that trading in cash settlement futures contracts is regulated by the CFTC rather than the Securities and Exchange Commission is evidence that a cash settlement contract should be considered a commodity in the ordinary financial sense.”).

³⁵ See, e.g., Rev. Rul. 73-158, 1973-1 C.B. 337 (“The word ‘commodities’ is used in section 864(b)(2)(B) of the Code in its ordinary financial sense and includes all products that are traded in and listed on commodity exchanges located in the United States.”). Note, though, that the ruling does not seem to rely on this statement.

³⁶ See generally Treas. Reg. sec. 1.864-2(d)(1) (providing only that an organized commodity exchange includes “a grain futures or a cotton futures market”). Organized commodity exchanges generally provide a market for trading futures or options on commodities and not a forum for trading the underlying commodities themselves. Digital asset exchanges, however, generally trade the underlying digital assets; thus, whether any digital asset exchange might qualify as an “organized commodity exchange” is uncertain. The comparison, though, is imperfect, given that digital assets, even if treated as commodities, are different in kind from sugar, cotton, and even gold; in many ways digital assets are much closer to futures, options, and other financial instruments. Thus, the concern over excluding the trading of physical property may not apply to digital assets, which generally are not considered to be “goods or merchandise in the ordinary channels of commerce.” See Treas. Reg. sec. 1.864-2(d)(3).

³⁷ Sec. 1058(a).

corporation, note, bond, debenture, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing.³⁸

To qualify for the treatment described above, an agreement must (1) provide for the return to the transferor of securities identical to the securities transferred; (2) require that payments be made to the transferor of amounts equivalent to all interest, dividends, and other distributions that the owner of the securities is entitled to receive during the period beginning with the transfer of the securities by the transferor and ending with the transfer of identical securities back to the transferor; (3) not reduce the risk of loss or opportunity for gain of the transferor of the securities in the securities transferred; and (4) meet such other requirements as the Secretary may by regulation prescribe.³⁹

Securities loans

A loan of securities held by a financial institution in almost all cases is governed by a standard form agreement that complies with the requirements described above.⁴⁰ For example, consider a taxpayer who holds stock in a brokerage account and allows her broker to engage in securities lending. The broker might lend the stock to another investor (say, one trading on margin) who wants to sell the stock short. Because the agreement governing the securities lending complies with the requirements of section 1058 (described above), the taxpayer recognizes no gain or loss on the lending of the stock (and will recognize no gain or loss on its return). Thus, a taxpayer's income on lending stock generally is only the compensation paid by the borrower.

Application to Digital Assets

Many investors choose to lend their digital assets in exchange for payments (known as “yield”). Nonetheless, because section 1058 applies only to a loan of securities, whether digital assets are within its scope is uncertain. Further complicating the status of crypto loans is that the agreements governing the lending of digital assets, especially through “decentralized finance” (“DeFi”) protocols, are far more diverse than those governing the securities lending. There is not yet a common standard.

While there are arguments that perhaps the law preceding the enactment of section 1058 (or at least its reasoning)⁴¹ might provide some relief for those lending digital assets, the arguments are untested in their application to digital assets and their strength is unclear.

³⁸ Sec. 1236(c).

³⁹ Sec. 1058(b).

⁴⁰ The International Swaps and Derivatives Association (“ISDA”) and the Securities Industry and Financial Markets Association (“SIFMA”) publish and maintain the two standard forms used throughout the financial industry.

⁴¹ See, e.g., GCM 36948 (finding a securities loan in which identical securities returned to be an exchange of securities in which no gain or loss is recognized).

4. Wash sales (section 1091)

Background and Present Law

In general, a sale or other disposition of property is a recognition event—meaning that, upon such sale or other disposition, a taxpayer calculates gain or loss with respect to the property. Certain exceptions to that general rule apply. For example, a taxpayer holding property at a loss may want to recognize the loss while still owning the property. As a close proxy, the taxpayer might try to sell the property and quickly buy it back. (Such a strategy is simplest with fungible, publicly traded property.)⁴² Upon such a sale (a “wash sale”), however, a loss in some cases is deferred until a later sale of the (new, identical) property.

Section 1091 provides that no deduction is allowed currently with respect to any loss claimed to have been sustained from any sale or other disposition of stock or securities if, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer acquires substantially identical stock or securities (the “wash sale rule”).⁴³ Instead, the basis of the new stock or securities is adjusted to reflect the loss not allowed.⁴⁴ This rule does not apply to a dealer in stock or securities if the loss is sustained in a transaction made in the ordinary course of such business.

For this purpose, the term “stock or securities” includes contracts or options to acquire or sell stock or securities. The Code, however, does not further define the term. Not all fungible, publicly traded property is within the scope of the wash sale rule. For example, neither foreign currency⁴⁵ nor commodities⁴⁶ are stock or securities. (Related derivatives are not either.)

Generally, if a taxpayer engages in a wash sale in a brokerage account, the broker must account for and report the wash sale (and loss deferred).⁴⁷

Application to Digital Assets

Digital assets are not expressly within the scope of section 1091.

⁴² A separate rule applies to sales between related parties. See sec. 267.

⁴³ Sec. 1091(a).

⁴⁴ Sec. 1091(d).

⁴⁵ Rev. Rul. 74-218 (foreign currency).

⁴⁶ Rev. Rul. 71-568 (commodity futures). By holding that commodity futures are not stock or securities, the ruling implicitly holds that commodities (*i.e.*, the underlying) are also not stock or securities. In other words, if the underlying commodities were stock or securities, then the commodity futures would also be stock or securities.

⁴⁷ See sec. 6045(g)(2)(B)(ii).

5. Constructive sales (section 1259)

Background and Present Law

Generally, a taxpayer is required to recognize gain upon a constructive sale of an appreciated financial position as if the position were sold, assigned, or otherwise terminated at its fair market value on the date of the constructive sale.⁴⁸ An appreciated financial position is generally defined as any position with respect to any stock, debt instrument, or partnership interest if there would be gain if the position were sold, assigned, or otherwise terminated at its fair market value.⁴⁹ The term “position” means an interest, including a futures or forward contract, short sale, or option.⁵⁰

A taxpayer is treated as having made a constructive sale of an appreciated financial position if the taxpayer (or a related person) (A) enters into a short sale of the same or substantially identical property; (B) enters into an offsetting notional principal contract with respect to the same or substantially identical property; (C) enters into a futures or forward contract to deliver the same or substantially identical property; (D) in the case of an appreciated financial position that is a short sale or a contract described in (B) or (C) with respect to any property, acquires the same or substantially identical property; or (E) to the extent prescribed by the Secretary in regulations, enters into one or more other transactions (or acquires one or more positions) that have substantially the same effect as a transaction described in (A), (B), (C), or (D).

Application to Digital Assets

Digital assets are not expressly within the scope of section 1259.

6. Exclusion of *de minimis* gain upon certain dispositions of nonfunctional currency (section 988(e))

Background and Present Law

In general

Special rules apply to foreign currency gain or loss attributable to certain financial transactions to account for economic exposure to changes in exchange rates. Such exposure is the result of directly or indirectly holding positions in foreign currency over time.

⁴⁸ Sec. 1259(a)(1). Any gain or loss realized after the constructive sale with respect to the position is adjusted to reflect any gain taken into account as a result of the constructive sale. In addition, the holding period of the position is determined as if the position were originally acquired on the date of the constructive sale. Sec. 1259(a)(2).

⁴⁹ Sec. 1259(b)(1).

⁵⁰ Sec. 1259(b)(3).

Foreign currency gain or loss

Special rules apply to foreign currency gain or loss attributable to certain financial transactions; such gain or loss is treated as ordinary and generally as interest income or expense (as the case may be).⁵¹ The financial transactions (“section 988 transactions”) include the three transactions described in the next sentence if the amount which the taxpayer is entitled to receive (or is required to pay) by reason of such transaction (i) is denominated in terms of a nonfunctional currency, or (ii) is determined by reference to the value of one or more nonfunctional currencies.⁵² The three transactions are: (i) the acquisition of a debt instrument or becoming the obligor under a debt instrument; (ii) accruing (or otherwise taking into account) for purposes of subtitle A of the Code any item of expense or gross income or receipts which is to be paid or received after the date on which so accrued or taken into account; and (iii) entering into or acquiring any forward contract, futures contract, option, or similar financial instrument.⁵³

Finally, any disposition of nonfunctional currency is treated as a section 988 transaction and any gain or loss is treated as foreign currency gain or loss.⁵⁴ For this purpose, nonfunctional currency includes coin or currency, and nonfunctional currency denominated demand or time deposits or similar instruments issued by a bank or other financial institution.⁵⁵

Personal transactions and exclusion of *de minimis* gain

Those special rules, however, do not apply to any personal transaction entered into by an individual.⁵⁶ A personal transaction is any transaction entered into by an individual, but generally does not include any transaction to the extent that expenses properly allocable to such transaction meet the requirements of (A) section 162⁵⁷ (trade or business expenses) or (B) section 212⁵⁸ (expenses for production of income).⁵⁹

⁵¹ Sec. 988(a)(1).

⁵² Sec. 988(c)(1)(A).

⁵³ Sec. 988(c)(1)(B).

⁵⁴ Sec. 988(c)(1)(C)(i).

⁵⁵ Sec. 988(c)(1)(C)(ii). Foreign currency is the coin and paper money of a country other than the United States that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance. See 31 C.F.R. sec. 1010.100(m). Thus, the designation by a foreign country of a kind of property (e.g., gold, silver, or Bitcoin (as in El Salvador and the Central African Republic)) as legal tender does not alone make the property foreign currency under U.S. law.

⁵⁶ Sec. 988(e)(1).

⁵⁷ There is an exception for traveling expenses described in section 162(a)(2).

⁵⁸ There is an exception for expenses under section 212 incurred in connection with taxes.

⁵⁹ Sec. 988(e)(3).

Further, there is an exclusion for gain with respect to certain dispositions. If nonfunctional currency is disposed of by an individual in a personal transaction, then no gain is recognized by reason of changes in exchange rates after such currency was acquired by such individual and before such disposition.⁶⁰ The exclusion does not apply if the gain that would otherwise be recognized on the transaction exceeds \$200.

The purpose of the exclusion is practical. In the past, before the rise of credit cards and digital payment options, individuals generally needed to use local currency (cash and coins) when traveling in foreign countries. The exclusion for personal transactions allows U.S. citizens and residents traveling abroad to avoid the burden of regularly calculating (unrecorded) small gains and losses that likely have no material bearing on their income.⁶¹

Application to Digital Assets

No digital asset is treated as currency that could generate foreign currency gain or loss for Federal income tax purposes. Thus, sales or other dispositions of digital assets do not give rise to foreign currency gain or loss.⁶²

7. Timing and source of income earned from staking

Background and Present Law

Staking

As described in the introduction, the purpose of the protocol behind the first digital asset, Bitcoin, was to create a scarce, purely digital good that did not rely on a central authority, such as a financial institution. That was achieved by using a consensus mechanism to allow participants to maintain a public distributed ledger, recording valid transfers of units of Bitcoin. Though today there is a wide variety of protocols, most adhere to the core principles behind Bitcoin, including the use of a consensus mechanism.

The consensus mechanism is the key to maintaining a distributed ledger of transactions on which all participants can agree without any of them being in control. Individuals maintain the distributed ledger by validating a batch of transactions (a “block”) from the protocol’s

⁶⁰ Sec. 988(e)(2).

⁶¹ See generally Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1997* (JCS–23–97), December 17, 1997 (“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[s]’ 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. The Congress believed that individuals should be given relief from the requirement to keep track of exchange gains on a transaction-by-transaction basis in *de minimis* cases.”).

⁶² See generally Notice 2014-21, sec. 4, Q-2 and Notice 2023-34 (modifying the background discussion in Notice 2014-21 but reaffirming the position that “convertible virtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes”).

transaction pool. Once an individual validates the transactions included in the block, the block is added to the blockchain; for their efforts, the individual is rewarded with newly minted digital assets native to the protocol. Existing holders are thereby diluted: in effect, existing holders are compensating those engaged in the work of maintaining the blockchain.

The Bitcoin consensus mechanism is known as “proof of work” (the activity of validating and recording transactions, which involves competing to be the first to find a given cryptographic hash, is known as “mining”). Other protocols use other consensus mechanisms, the most common being “proof of stake” (the activity of validating and recording transactions, which involves pledging native digital assets to the protocol, is known as “staking”). The largest digital asset to use proof of stake is Ether.⁶³

Because proof of work can be costly,⁶⁴ many protocols have started using proof of stake. In its simplest form, proof of stake requires participants only to pledge to the protocol for a set time a set amount of the native digital asset. The proof-of-stake mechanism allocates validation rights to participants based on how many units they have staked, with a participant’s probability of being selected being proportional to the number of units staked. Participants that have successfully validated transactions and recorded them on the blockchain receive newly created units of the native digital asset. Participants that have improperly validated fraudulent transactions may be penalized and lose some or all the units that they staked.

Timing and sourcing of income with respect to property received for services

The receipt of cash or property for services generally is taxable as ordinary income at the time of receipt.⁶⁵ For property received for services, the taxpayer generally includes in gross income the fair market value of the property on the date received. The basis of property in the hands of the taxpayer is the amount included in gross income. In contrast, income with respect to self-created property such as manufactured goods, farmed crops, and certain self-created intellectual property generally is not realized until the property is sold or otherwise disposed of.⁶⁶

The source of services income, which determines the amount of Federal and State income tax, generally is the place where the services are performed. For example, foreign persons who perform services in the United States generally are treated as engaged in a U.S. trade or business and income attributable to that business is taxable as ECI.⁶⁷

⁶³ See, e.g., CoinMarketCap summary statistics, available at <https://coinmarketcap.com/> (ranking Ether as the second-largest digital asset by market capitalization as of May 3, 2023).

⁶⁴ See, e.g., Dance, Gabriel J.X., “The Real-World Costs of the Digital Race for Bitcoin,” *New York Times*, April 9, 2023, available at <https://www.nytimes.com/2023/04/09/business/bitcoin-mining-electricity-pollution.html>.

⁶⁵ Secs. 61(a)(1) and 83(a).

⁶⁶ See generally Treas. Reg. secs. 1.61-3 and -4.

⁶⁷ Secs. 861(a)(3) and 871(b).

Application to Digital Assets

Without addressing staking directly, the 2014 Notice answers several questions relevant to the Federal tax treatment of digital assets received for validation services. First, the notice provides that a taxpayer who “receives virtual currency as payment for goods or services must, in computing gross income, include the fair market value of the virtual currency, measured in U.S. dollars, as of the date the virtual currency was received.”⁶⁸ The basis of virtual currency the taxpayer receives as payment for goods or services is the fair market value of the virtual currency in U.S. dollars as of the date of receipt.⁶⁹ As described above, that is the standard treatment for property received for services.⁷⁰

Second, related to timing, the 2014 Notice provides that “when a taxpayer successfully ‘mines’ virtual currency, [the taxpayer must include in gross income] the fair market value of the virtual currency as of the date of receipt.”⁷¹ This reasoning applies with equal force to digital assets received in consideration for staking.

At least one taxpayer, however, has challenged the principle that income derived from staking should be treated the same as other property received for services. In 2022, a taxpayer argued that the 2014 Notice did not apply to staking and that newly minted digital assets received in exchange for staking should not be treated as income upon receipt, but rather only upon sale, because the newly minted digital assets were “self-created property.”⁷² No final judgment on the merits was made, however; after the government provided the taxpayer with a refund, the District Court granted a motion to dismiss.

⁶⁸ Notice 2014-21, Q-3.

⁶⁹ Notice 2014-21, Q-4.

⁷⁰ See also Notice 2014-21, Q-5 (“For U.S. tax purposes, transactions using virtual currency must be reported in U.S. dollars. Therefore, taxpayers will be required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt. If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into U.S. dollars (or into another real currency which in turn can be converted into U.S. dollars) at the exchange rate, in a reasonable manner that is consistently applied.”).

⁷¹ Notice 2013-21, Q-8.

⁷² *Jarrett v. United States*, No. 3:21-cv-00419 (M.D. Tenn. 2022).

8. Valuation and substantiation of charitable contributions (section 170)

Background and Present Law

Valuation of charitable contributions of property

Certain taxpayers may reduce Federal income tax liability by taking a deduction for contributions to public charities, private foundations, and certain other organizations.⁷³ Charitable contributions of cash are deductible in the amount contributed. Contributions of long-term capital gain property to a public charity generally are deductible at the full fair market value of the property.⁷⁴

In certain other cases, however, the deductible value of appreciated property is limited to the donor's tax basis in the property.⁷⁵ This limitation applies, for example, to: (1) contributions of inventory or other ordinary income or short-term capital gain property;⁷⁶ (2) contributions of tangible personal property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose;⁷⁷ and (3) contributions to or for the use of a private foundation (other than certain private operating foundations).⁷⁸

Contributions of property with a fair market value that is less than the donor's tax basis generally are deductible at the fair market value of the property.

Substantiation of charitable contributions of property

No charitable contribution deduction is allowed for a contribution of \$250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.⁷⁹

⁷³ Sec. 170. This section generally applies to individuals who itemize deductions and to corporations. In certain cases, trusts and estates may claim an income tax deduction for a charitable contribution under section 642(c). Certain charitable contributions are also deductible for gift or estate tax purposes. See secs. 2055 and 2522.

⁷⁴ Sec. 170(e)(1)(A).

⁷⁵ See sec. 170(e).

⁷⁶ Sec. 170(e). Certain contributions of inventory qualify for an "enhanced deduction" in an amount greater than the taxpayer's basis. See sec. 170(e)(3).

⁷⁷ Sec. 170(e)(1)(B)(i)(I).

⁷⁸ Sec. 170(e)(1)(B)(ii). Certain contributions of publicly traded stock to a private nonoperating foundation are, however, deductible at the fair market value of the stock. Sec. 170(e)(5).

⁷⁹ Sec. 170(f)(8). The acknowledgement also must include the amount of cash and a description (but not value) of any property other than cash contributed. *Ibid.* In addition, any organization receiving a contribution exceeding \$75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to provide in writing an estimate of the value of the goods or services and a

If the total charitable deduction claimed for noncash property is more than \$500, the taxpayer generally must attach a completed Form 8283 (“Noncash Charitable Contributions”) to the taxpayer’s return.⁸⁰ In general, a taxpayer who claims a deduction of more than \$5,000 for contributions of property must obtain a qualified appraisal and attach an appraisal summary to the tax return.⁸¹ If the claimed value is more than \$500,000, the taxpayer must attach the qualified appraisal to the return.⁸²

The substantiation requirements described in the preceding paragraph for contributions of property with a claimed value of more than \$500, \$5,000, or \$500,000 do not apply if it is shown that a failure to meet the requirements is due to reasonable cause and not to willful neglect.⁸³ In addition, the appraisal requirements for contributions with a claimed value of more than \$5,000 or \$500,000 do not apply to certain contributions of readily valued property. For this purpose, readily valued property includes: (1) cash; (2) certain intellectual property; (3) securities for which (as of the date of the contribution) market quotations are readily available on an established securities market; and (4) certain vehicles for which separate substantiation rules apply.⁸⁴

Application to Digital Assets

In a January 10, 2023 memorandum⁸⁵ from the Office of Chief Counsel, the IRS considers whether a taxpayer who makes a charitable contribution of cryptocurrency and claims a deduction of more than \$5,000 is required to obtain a qualified appraisal. The taxpayer at issue transferred her units of Cryptocurrency B to a charity, attached Form 8283 to her return, and claimed a \$10,000 charitable deduction. The taxpayer based this \$10,000 value on a value listed at the exchange on which Cryptocurrency B was traded at the time of the contribution. The taxpayer did not obtain, or attempt to obtain, an appraisal.

The memorandum first notes that general tax principles applicable to property transactions apply to transactions involving cryptocurrency. The memorandum next states that Cryptocurrency B does not qualify as a readily valued asset to which the appraisal requirements do not apply, because it is not cash, a publicly traded security,⁸⁶ or any other type of property

statement that only the portion of the contribution that exceeds the value of the goods or services is deductible as a charitable contribution. Sec. 6115.

⁸⁰ See sec. 170(f)(11)(B).

⁸¹ Sec. 170(f)(11)(C).

⁸² Sec. 170(f)(11)(D).

⁸³ Secs. 170(f)(11)(A)(ii)(II).

⁸⁴ Secs. 170(f)(11)(A)(ii)(I) and 6050L(a)(2)(B).

⁸⁵ IRS Chief Counsel Memorandum 202302012, January 10, 2023.

⁸⁶ The memorandum notes that Treasury Regulation section 1.170A-13(c)(7)(xi) defines “publicly traded securities” for this purpose as meaning securities as defined by section 165(g)(2). Section 165(g)(2) defines a

that qualifies for the exception. The memorandum concludes that, because the taxpayer claimed a deduction of more than \$5,000, and Cryptocurrency B is not a “readily valued asset” that qualifies for an exception to the appraisal requirement, the taxpayer was required to obtain a qualified appraisal.

Finally, the memorandum considers whether the taxpayer’s use of a value reported by a cryptocurrency exchange constituted reasonable cause for failure to satisfy the appraisal requirement, such that the appraisal requirement would not apply to the taxpayer’s contribution. Concluding that the taxpayer did not establish reasonable cause, the memorandum states that “[t]he reasonable cause exception was not intended to provide taxpayers with the choice of whether to obtain a qualified appraisal, but to provide relief where an unsuccessful attempt was made in good faith to comply with the requirements of section 170.” As a result, the memorandum provides that the taxpayer’s deduction must be disallowed.

9. FBAR and FATCA reporting

Background and Present Law

The Secretary has authority to obtain access to financial information of citizens or residents of the United States arises under the Bank Secrecy Act of 1970 (the “Bank Secrecy Act”)⁸⁷ as well as the Code. With respect to foreign financial accounts and assets, the Bank Secrecy Act and the Code both require self-reporting (reporting by the holder) and third-party information reporting (reporting by a financial intermediary). The specific rules of each regime addressing foreign financial accounts and assets are described below.

Reporting under the Bank Secrecy Act

The Financial Crimes Enforcement Network (“FinCEN”), a bureau of the Department of the Treasury, administers the reporting under the Bank Secrecy Act as part of its activities related to anti-money laundering and countering the financing of terrorism (“AML/CFT”). Since 2013, FinCEN has required that persons administering, exchanging, or using “virtual currencies” comply with certain Bank Secrecy Act reporting requirements, such as suspicious activity reports and currency transaction reports.⁸⁸ In 2021, Congress codified FinCEN guidance on digital

security as a share of stock in a corporation, a right to subscribe for or to receive a share of stock in a corporation, or a bond, debenture, note, certificate, or other evidence of indebtedness issued by a corporation or a government or political subdivision with interest coupons or in registered form. The cryptocurrency at issue does not fall within the definition.

⁸⁷ 31 U.S.C. secs. 5311-5314e and 5316-5332e; 12 U.S.C. secs. 1829b and 1951-1959e. With the Act, Congress intended to provide enforcement tools necessary “to cope with the problems created by the so-called secrecy jurisdictions.” H.R. Rep. No. 975, 91st Cong., 2d Sess. 19 (1970). Those tools include mandatory reporting by financial institutions and account holders on a broad range of financial activity, including reports on currency transactions, suspicious activity, and foreign financial transactions to ensure the reports “are highly useful in ... criminal, tax, or regulatory investigations, risk assessments, or proceedings.” 31 U.S.C. 5311.

⁸⁸ FinCEN Guidance on the Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (FIN-2013-G001, March 18, 2013). See also FinCEN Guidance on the Application of

assets by means of the new definition of “monetary instruments.” That definition now encompasses, to the extent provided by the Secretary in regulations, “value that substitutes for any monetary instrument” as otherwise specified in the statute.⁸⁹

FBAR reporting

A citizen or resident of, or person doing business in, the United States is required to keep records and file an FBAR⁹⁰ when that person enters a transaction or maintains a relationship (e.g., an account) with a foreign financial entity (including a foreign bank or foreign trust).⁹¹ The FBAR must be filed on April 15⁹² of the year following the year in which the aggregate value of all foreign financial accounts in which the person has a financial interest or over which the person has signature or other authority exceeds \$10,000.⁹³ FinCEN has delegated to the IRS certain authority to administer and enforce FBAR reporting.⁹⁴

Failure to file the FBAR is subject to both criminal and civil penalties. Willful failure to file an FBAR may be subject to penalties in amounts not to exceed the greater of \$100,000 or 50 percent of the amount in the account at the time of the violation.⁹⁵ A non-willful, but negligent, failure to file is subject to a penalty of \$10,000 for each negligent violation.⁹⁶ Regulations provide that the failure-to-file penalty is asserted per account that was subject to reporting, not the number of reports required. Earlier this year, in a case involving non-willful failure to file, the Supreme Court held that the penalty is based on each report that includes a non-willful but negligent error.⁹⁷ The penalty may be waived if (1) there is reasonable cause for the failure to report and (2) the amount of the transaction or balance in the account was properly reported. In

FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies (FIN-2019-G001, May 9, 2019) (“2019 CVC Guidance”).

⁸⁹ 31 U.S.C. sec. 5312(a)(3), defining “monetary instruments” for purposes of Subchapter II “Records and Reports on Monetary Instruments Transactions,” as amended by section 6101(d)(1)(C) of National Defense Authorization Act for Fiscal Year 2021, Title LXIV, Pub. L. 116- 283.

⁹⁰ FinCEN Report 114, “Report of Foreign Bank and Financial Accounts” (the “FBAR”).

⁹¹ 31 USC sec. 5314.

⁹² Despite the filing date, the FBAR is neither part of the Federal income tax return nor filed in the same office as that return; as a result, the FBAR is not considered “return information” for purposes of Code section 6103, allowing FinCEN to share the information with other law enforcement agencies.

⁹³ 31 C.F.R. sec. 1010.350.

⁹⁴ 31. C.F.R. sec. 1010.810(g).

⁹⁵ 31 U.S.C. sec. 5321(a)(5)(C).

⁹⁶ 31 U.S.C. sec. 5321(a)(5)(B).

⁹⁷ *Bittner v. United States*, 143 S. Ct. 713, 215 L. Ed 1 (2023).

addition, serious violations are subject to criminal prosecution, potentially resulting in both monetary penalties and imprisonment.⁹⁸ Civil and criminal sanctions are not mutually exclusive.

Reporting of beneficial ownership

In compliance with their anti-money laundering responsibilities, U.S. financial institutions must exercise due diligence in ascertaining the identity of persons opening financial accounts and must maintain records and submit reports on certain cash or cash equivalent transactions. Financial institutions are required to verify enough customer information to enable the financial institution to form a “reasonable belief that it knows the true identity of each customer.”

In 2021, the Corporate Transparency Act⁹⁹ created a new standard for determining beneficial ownership and required creation of a Federal database to which reporting entities must report their beneficial ownership information.¹⁰⁰

Reporting under the Code

FATCA reporting

Under FATCA,¹⁰¹ a withholding tax is imposed equal to 30 percent of the gross amount of withholdable payments¹⁰² to a foreign financial institution unless the foreign financial institution meets certain requirements. Generally, withholding is required on withholdable payments unless the foreign financial institution enters into an information reporting agreement with the Secretary and complies with the terms of that agreement. Under such agreements, the institutions agree to obtain information necessary to determine whether any account at such institution are held or owned by U.S. individuals and are within the scope of FATCA,¹⁰³ as well

⁹⁸ 31 U.S.C. sec. 5322(a) and (b) (willful failure to file is punishable by a fine up to \$250,000, imprisonment for five years, or both; either or both of those punishments may double if the violation occurs in conjunction with certain other violations).

⁹⁹ National Defense Authorization Act for Fiscal Year 2021, Title LXIV, Pub. L. 116- 283, January 1, 2021; Conference Report to Accompany H.R. 6395, H.R. Rep. 116-617, p. 4458.

¹⁰⁰ 31 U.S.C. sec 5336, added by section 6403 of the Corporate Transparency Act.

¹⁰¹ The Hiring Incentives to Restore Employment (“HIRE”) Act, Pub. L. No. 111-147. Subtitle A of Title V of the HIRE Act, entitled “Foreign Account Tax Compliance,” was based on legislative proposals in the Foreign Account Tax Compliance Act (“FATCA”), a bill introduced in both the House and Senate on October 27, 2009, as H.R. 3933 and S. 1934, respectively. FATCA added new Chapter 4 to Subtitle A of the Code.

¹⁰² Section 1473(1) broadly defines “withholdable payments” to include FDAP and gross proceeds from sales of property that produces interest or dividend, except to the extent otherwise provided by the Secretary. Proposed regulations remove gross proceeds from the scope of “withholdable payment.” Prop. Treas. Reg. sec. 1.1473-1(a), REG-132881-17, 83 F.R. 64757, December 18, 2018. Although the regulations are not final, the preamble provides that taxpayers may rely upon the proposed exclusion.

¹⁰³ A United States account is any financial account held by one or more specified United States persons or United States owned foreign entities. Sec. 1471(d). Depository accounts are not treated as United States accounts for these purposes if (1) each holder of the account is a natural person and (2) the aggregate value of all depository

as to report annually with respect to any such financial accounts, in addition to seeking waivers of local law that would otherwise bar reporting to the United States and complying with other requirements that the Secretary may determine are needed. A foreign financial institution must report with respect to a U.S. account (1) the name, address, and taxpayer identification number of each U.S. person holding an account or a foreign entity with one or more substantial U.S. owners holding an account; (2) the account number; (3) the account balance or value; and (4) except as provided by the Secretary, the gross receipts, including from dividends and interest, and gross withdrawals or payments from the account.¹⁰⁴

The information to be reported for U.S. accounts includes (1) the name, address, and taxpayer identification number of each U.S. person or a foreign entity with one or more substantial U.S. owners holding an account, (2) the account number, (3) the account balance or value, and (4) except as provided by the Secretary, the gross receipts and gross withdrawals or payments from the account.¹⁰⁵ FATCA also limited the ability to use bearer bonds, treats certain dividend equivalent payments received by foreign persons as U.S. source dividends for withholding tax purposes, and modifies certain rules in respect of foreign trusts.

A foreign financial institution generally complies with its obligations under the terms of a bilateral intergovernmental agreements (“IGAs”) between its country of residence and the United States. These agreements conform to one of two types. Under Model 1, a foreign financial institution fulfills its FATCA reporting obligations by reporting information about U.S. accounts directly to their domestic tax authority rather than to the IRS. The information is then the subject of an automatic exchange of information on a government-to-government basis between the two jurisdictions. IGAs based on Model 2 require that foreign financial institutions report specified information directly to the IRS and may be supplemented by a government-to-government exchange of information on request. The United States has entered into such agreements with over 100 jurisdictions, enabling the government to implement FATCA widely.¹⁰⁶

Reporting under section 6038D

At the same time Congress enacted the third-party information reporting described above, Congress enacted a new disclosure requirement for U.S. individuals with foreign financial accounts or assets exceeding \$50,000 in value. Such individuals must disclose such assets on their Federal income tax returns.¹⁰⁷ To the extent required by regulations, any domestic entity

accounts held (in whole or in part) by each holder of the account maintained by the financial institution does not exceed \$50,000. Sec. 1471(d)(1)(B).

¹⁰⁴ Sec. 1471(c).

¹⁰⁵ Sec. 1471(c).

¹⁰⁶ For a complete list of jurisdictions and links to the relevant agreements, see <https://home.treasury.gov/policy-issues/tax-policy/foreign-account-tax-compliance-act>.

¹⁰⁷ Sec. 6038D.

that such individuals used to hold such assets, directly or indirectly, must also report.¹⁰⁸ Failure to do so results in both a failure to disclose penalty as well as an increase in any otherwise applicable accuracy-related penalty. A special limitations period for assessment of additional tax attributable to an asset that is subject to such reporting may also apply.¹⁰⁹

Application to Digital Assets

The Bank Secrecy Act was recently amended to confirm authority to regulate digital assets, but to date FinCEN has not revised guidance on required FBAR reporting to encompass digital assets. FATCA does not expressly address digital assets.

¹⁰⁸ Treas. Reg. secs. 1.6038D-1 to -8 (on the scope of reporting required, the threshold values triggering reporting requirements, and the method for valuing assets).

¹⁰⁹ Sec. 6501(e)(1)(A)(ii).