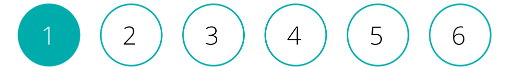
Tax information reporting in the age of crypto

November 2021

Overview

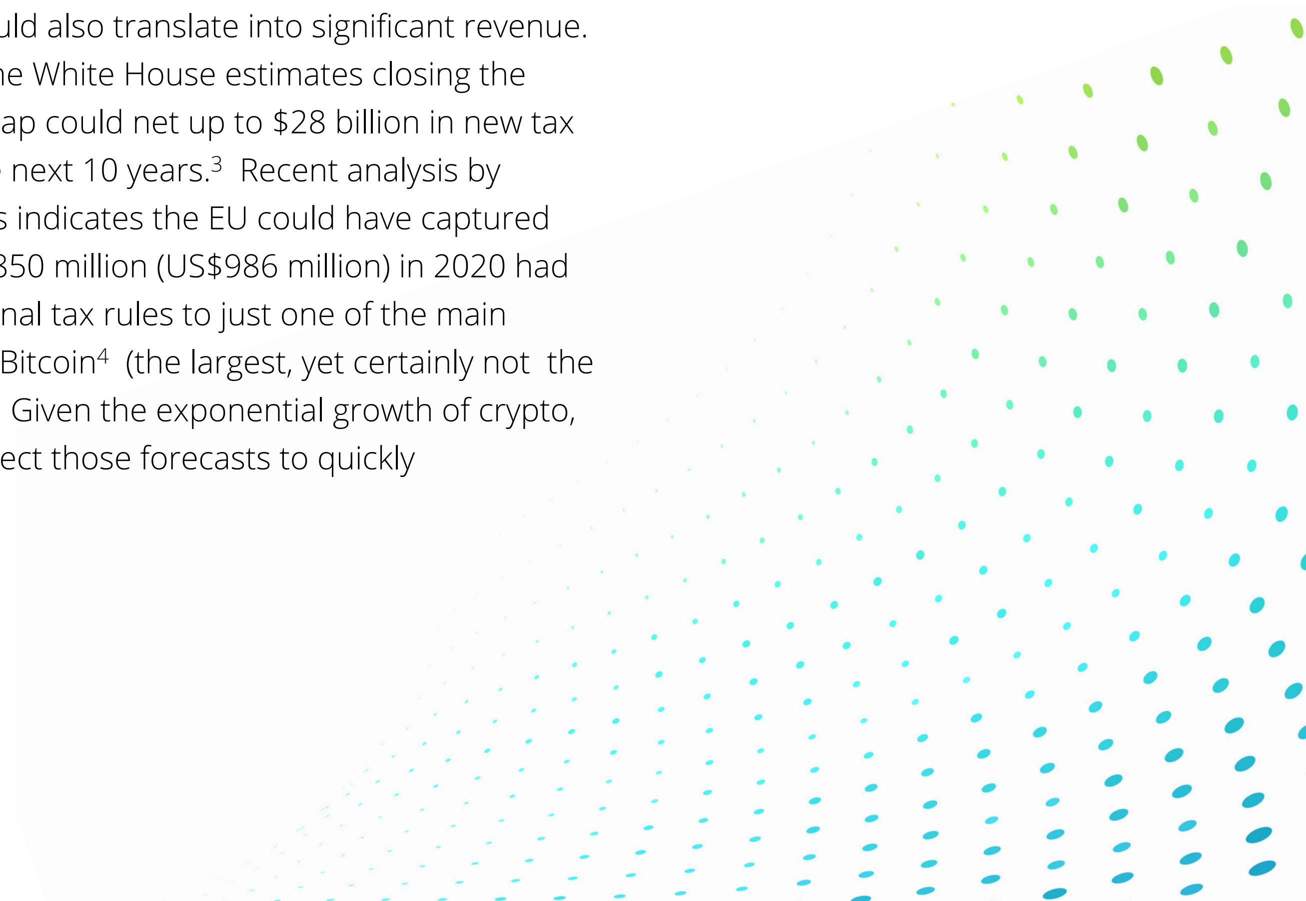


There are growing indications that crypto has become too big—and too mainstream—for tax authorities to ignore. The numbers are notable: At the end of last year, it was estimated there were more than 68 million crypto wallet holders in the US alone (more than 108 million globally)[1] and around 2,300 US businesses accepted bitcoin.[2] In fact, chances are high that someone in your circle of friends and neighbors owns (or perhaps even mines) crypto.

The writing is on the wall. Greater volumes and values are being traded through crypto. Enterprises are using them to transact. Consumers and retailers are increasingly comfortable with digital assets, and now governments and people are looking for greater clarity on how their transactions should be taxed and reported.

The challenge with clarifying and imposing tax regulation is that the field is both emerging and evolving. That makes it very difficult for tax authorities to understand how crypto should be reported, by whom and where. Over the past few years, some tax authorities (including the IRS in the US) have relied on so-called John Doe summons to get at the information they need in order to properly identify transactions and to communicate their interest in obtaining this information. But there is wide recognition that a more sophisticated and proactive approach is needed.

For the US Treasury and various tax authorities around the world, that could also translate into significant revenue. In the US alone, the White House estimates closing the crypto reporting gap could net up to $28 billion in new tax revenues over the next 10 years.[3] Recent analysis by Dutch researchers indicates the EU could have captured tax revenues of €850 million (US$986 million) in 2020 had they applied national tax rules to just one of the main cryptocurrencies, Bitcoin[4] (the largest, yet certainly not the only, digital asset). Given the exponential growth of crypto, many pundits expect those forecasts to quickly be shattered.



Forces collide

Crypto is emerging in the tax spotlight at an interesting time. Over the past few decades, tax authorities globally have been hard at work developing global tax information reporting standards. Many were already concerned they were losing revenue due to corporate base erosion and profit-shifting activity.

Regulators have long been focused on clarifying and enforcing anti-money laundering (AML) requirements and applicability, more recently homing in on crypto and the related activities of financial institutions. That has led to increased focus on areas such as customer onboarding and due diligence, regulatory compliance, risk management, and tax reporting. This trend will only increase as coverage is expanded to applicable commercial businesses.

Tax authorities know that global information reporting drives compliance. For the most part, corporations and individuals want to pay the correct taxes to the correct authorities. Harmonization and clarification of reporting helps them do that. And coordinated global information reporting ensures taxpayers aren't subjected to double taxation as a result.

It should surprise no one, therefore, that these two big trends are colliding. Tax authorities and regulators want to bring crypto into the Global Information Reporting system. Legislators and regulators are supporting this initiative and assisting them to make it happen.

Expectations take shape

Significant news on this front comes out of the US. In early November 2021, the Infrastructure Investment and Jobs Act was passed, which included a range of provisions aimed at bringing cryptocurrencies and other digital assets into the scope of existing codes (sections 6045 and 6050I, in particular).[5]

The new law included a number of important changes—it defines "digital assets," redefines "brokers" to include those providing any type of client-facing transfer service for digital assets, and redefines "specified security" to include digital assets, thereby including cryptocurrency in scope for Form 1099-B reporting.

The new law specifies a requirement for transfer statements to be furnished between brokers when digital assets are transferred, and it attempts to close gaps by extending transfer reporting to include transfers to non-brokers. The law also includes changes to Form 8300 reporting to include digital assets in the definition of "cash," requiring businesses to report any digital asset receipt that exceeds $10,000 in digital asset value.

The US Treasury Department is not the only major organization eyeing crypto. The OECD has been working to create a new Common Reporting Standard (CRS) that specifically addresses virtual assets. Having gone through a round of industry consultation, the draft is expected to be released before the end of this year.

Unwilling to wait for the OECD to release guidance, the European Commission has moved forward with its own proposal. DAC-8 is intended to update the EU's tax code by strengthening the existing rules and exchange of information frameworks to include crypto assets. An industry consultation process was executed in the spring of 2021, and observers expect drafts to circulate before the end of the year.

These proposed regulations sit on top of a complex web of existing national and global frameworks and tax rules regarding crypto assets and currencies. In many markets, the topic of crypto is being discussed by numerous different authorities—from financial stability boards to the US Treasury. Each is now considering how it will address concerns rising in their own particular sphere.

Prepare yourself

The impact of these proposals—individually and in combination—will likely be significant. For those who already boast robust information reporting capabilities and processes, preparing for the new requirements will likely take some careful thinking. Those with less capability or experience in this area may find themselves facing some rather heavy lifting.

That being said, there are four areas in particular that every organization should think about before considering what it will take to achieve compliance: applicability, requirements, impact, and operations.

Applicability (Am I in scope?)

The cryptocurrency ecosystem is complex, and there are literally thousands of different business models currently in the market. The language of the infrastructure bill cast the net wide (dragging in many ecosystem participants, such as miners and validators, who were likely outside of the intent). Observers expect these aspects of the law to be fine-tuned in yet-to-be-issued regulations.

For now, however, organizations will need to take a close look at their business model, their structure, and their operating markets to understand if they will be in scope. If you are still unsure, assume you are in scope.

Requirements (What's the impact?)

Remember, this is not just a tax issue but rather an operational risk issue. It will require input and coordination from the business, legal, compliance, sales, and others. When reviewing the requirements, make sure you have an integrated team at the table to ensure you understand the broad impacts on the business.

Disruption (What does it mean to my customers?)

Like it or not, there is an uncomfortable trade-off that must be made between information reporting compliance and customer experience. Global information reporting requirements will add a few extra steps to the customer onboarding process. At worst, they could turn the customer experience into a quagmire with multiple requests to clients for information, complex forms, and (potentially) wrong information filed in a jurisdiction.

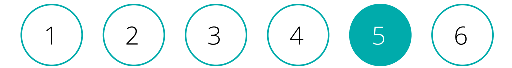
Understanding that balance will be key to creating your compliance strategy. Some companies will put customer experience first, finding opportunities to integrate various compliance processes and information-gathering interactions into a more seamless onboarding experience. Others may opt to take a less streamlined approach and request information through separate channels and/or departments.

Operations (Am I operationally ready?)

More often than not, the biggest barrier to compliance is infrastructure. So once you have a good idea of how the rules will apply to your organization, an important step will be to assess your readiness to meet those expectations – from data fields and enabling tools to enterprise data strategies and infrastructure, try to get a sound assessment of your current state of readiness and the gaps.

This is also the point where you should be thinking about overlap and integration between various information reporting requirements with the goal of achieving a one-time data collection process when onboarding new customers.

It’s on the agenda now



There is no longer any question as to whether crypto will be in scope for global information reporting purposes. For the US, it is now here; outside of the US, it’s a matter time. There is little doubt that these changes will have an impact on traditional financial services firms and digital asset ecosystem players alike. The question is what it will take to become compliant.

For crypto advocates and ecosystem participants, there is one very clear message in all of this: Crypto is now being seriously debated and explored at the very highest levels of various governments. For the first time, the definition of digital assets has landed explicitly in the US Internal Revenue Code. If you had any doubts as to the relevance and maturity of the industry, think again.

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Endnotes

1. Statista, "Number of Blockchain wallet users worldwide from November 2011 to November 4, 2021."

2. Maddie Shepherd, "How many businesses accept Bitcoin? Full list (2021)," Fundera, December 16, 2020.

3. Joint Committee on Taxation, Joint Committee on Taxation Report JCX-33-21 (August 02, 2021).

4. Andreas Thiemann, Cryptocurrencies: An empirical view from a tax perspective, JRC Working Papers on Taxation and Structural Reforms No. 12/2021, European Commission, Joint Research Center, 2021.

5. Infrastructure Investment and Jobs Act, HR 3684, 117th Cong. (2021).

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