

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



The Internal Revenue Service Is Developing a Digital Asset Monitoring and Compliance Strategy

December 18, 2023

Report Number: 2024-IE-005

HIGHLIGHTS: The Internal Revenue Service Is Developing a Digital Asset Monitoring and Compliance Strategy

Final Evaluation Report issued on December 18, 2023

Report Number 2024-IE-005

Why TIGTA Did This Evaluation

In August 2022, the Congress passed, and the President signed the Inflation Reduction Act of 2022 (IRA). This legislation provided the IRS with approximately \$78.9 billion in supplemental funding that was subsequently reduced to \$58.2 billion. The legislation also mandated that the IRS use part of its additional funding “to provide digital asset monitoring and compliance activities.” TIGTA initiated this evaluation to assess the IRS’s effort to develop a digital asset monitoring and compliance strategy.

Impact on Tax Administration

The number of taxpayers reporting transactions related to virtual currencies, a form of digital asset, has significantly increased in recent tax years. Based on information the IRS collected from Form 1040, *U.S. Individual Income Tax Return*, filed for Tax Year 2020, approximately 2.3 million filers reported transactions related to a virtual currency. For Tax Year 2021, this number increased to approximately 6.8 million filers.

The digital asset monitoring and compliance plan should establish the type of monitoring and compliance the IRS needs to better oversee increasingly used digital assets. The IRS noted that the overall focus of the plan being developed is to enforce the tax law fairly and efficiently, to increase voluntary compliance, and reduce the Tax Gap with respect to digital assets.

What TIGTA Found

Our evaluation identified that prior to Calendar Year 2022, the IRS addressed virtual currency tax issues with different procedures. Since then, the IRS has taken several actions to centralize its approach to addressing the significant impact that digital assets have and will continue to have on tax administration. For example:

- February 2022 – The IRS recognizes that a Service-wide approach is needed to address digital assets and created the Digital Asset Advisory Committee (DAAC). The DAAC provides Service-wide collaboration, planning and information sharing.
- June 2022 – The IRS develops its Digital Asset Initiative which outlines the IRS’s Service-wide digital asset priorities. The digital asset initiatives were subsequently linked during development of the IRS’s IRA Strategic Operating Plan released in April 2023 by providing an additional set of objectives to further voluntary compliance.
- October 2022 – The IRS stands up its Digital Asset Initiative Project Office (DAIPO). To date, the DAIPO continues to coordinate Service-wide efforts including developing forms, instructions, and guidance; information systems to receive, store, and access the new digital asset information reporting returns, as well as conducting other outreach activities.

However, the IRS cannot complete the development of the forms, instructions, and guidance until after the final digital asset regulations have been issued. Final regulations related to I.R.C. § 6045 and § 6050I have yet to be completed and remain under development within the various stages of the Federal Government’s required regulatory review process. Specifically, as of August 29, 2023, I.R.C. § 6045 Notice of Proposed Rulemaking was published in the Federal Register. The I.R.C. § 6050I regulations remain in draft mode within the Treasury Department.

Finally, the IRS is currently working towards operationalizing digital asset work, under a cohesive strategy, across the IRS in late Calendar Year 2024. The DAIPO will make recommendations on how to execute the IRS’s Digital Asset Strategy and address future digital asset priorities driven by legislation, policy, and mandates.

What TIGTA Recommended

TIGTA made no recommendations in this report.



TREASURY INSPECTOR GENERAL

for Tax Administration

DATE: December 18, 2023

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Russell P. Martin 
Deputy Inspector General for Inspections and Evaluations

SUBJECT: Final Evaluation Report – The Internal Revenue Service Is Developing a Digital Asset Monitoring and Compliance Strategy
(Evaluation # IE-23-017-1)

This report presents the results of our evaluation to assess the development of the Internal Revenue Service's (IRS) strategy to monitor digital assets. This review was part of our Fiscal Year 2023 Annual Program Plan and addresses the major management and performance challenges of *Improving Taxpayer Service, Modernizing IRS Operations, and Administering Tax Law Changes*. We made no recommendations in this report.

If you have any questions, please contact me or James A. Douglas, Director, Inspections and Evaluations.

Table of Contents

Background	Page 1
Results of Review	Page 2
<u>A Service-Wide Approach Is Needed to Address the Impact of Digital Assets on Tax Administration</u>	Page 3
<u>The Digital Asset Initiative Project Office Is Taking Actions to Address Critical Challenges Related to the Continually Evolving Digital Asset Industry</u>	Page 4
<u>Notices of Proposed Rulemaking Are Delaying and Impacting the IRS’s Implementation of New Digital Asset Reporting and Monitoring Requirements</u>	Page 7
Appendices	
<u>Appendix I – Detailed Objective, Scope, and Methodology</u>	Page 10
<u>Appendix II – Overview of the Regulatory Process</u>	Page 11
<u>Appendix III – Glossary of Terms</u>	Page 13
<u>Appendix IV – Abbreviations</u>	Page 14

Background

In August 2022, the Congress passed, and the President signed the *Inflation Reduction Act of 2022* (IRA).¹ This legislation provided the Internal Revenue Service (IRS) with approximately \$78.9 billion in supplemental funding² that was subsequently reduced to \$58.2 billion.³ The legislation also mandated that the IRS use part of its additional funding “to provide digital asset monitoring and compliance activities.” Internal Revenue Code (I.R.C.) Section (§) 6045(g)(3)(D) defines a digital asset for Federal tax purposes as:

“...any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.”

The IRS further defines digital assets to include non-fungible tokens⁴ and virtual currencies⁵ such as cryptocurrencies and stablecoins. If a particular asset has the characteristics of a digital asset, it will be treated as a digital asset for Federal income tax purposes. Based on information the IRS collected from Form 1040, *U.S. Individual Income Tax Return*, filed for Tax Year 2020, approximately 2.3 million filers (1.5 percent of 1040 filers) reported transactions related to a virtual currency. For Tax Year 2021, this number increased to approximately 6.8 million filers (4 percent of 1040 filers).

Prior to the passage of the IRA, Section 80603 of the *Infrastructure Investment and Jobs Act of 2021* (IIJA) amended I.R.C. § 6045 and § 6050I to include specific information on digital assets reporting.⁶ The amendments to I.R.C. § 6045 and § 6050I require that:

- Digital asset brokers report proceeds and, in certain cases, basis from sales (third-party information) to the IRS and their customers.
- Any person engaged in non-financial trades or businesses, who during such trade or business, receives, in combination, more than \$10,000 in cash and digital assets report this on a return to the IRS.

¹ Pub. L. No. 117-169 (2022), 136 Stat. 1818. Access online at: <https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf> Last visited: September 29, 2023.

² Pub. L. No. 117-169, 136 Stat. 1831. Section 10301(1)(A)(i), (ii), (iii), and (iv), Section 10301(1)(B), Section 10301(2), (3), (4) and (5).

³ The \$58.2 billion in IRA funding remaining is based on an agreement by the Biden Administration, reached during negotiations of the Fiscal Responsibility Act of 2023 to raise the debt ceiling, to shift \$10 billion each year from IRS IRA funding in Fiscal Year 2024 and Fiscal Year 2025 to other agencies for a total of \$20 billion, and a rescission in Section 251 of \$1.4 billion in Pub. L. No. 118-5 (2023), 137 Stat. 30. Access online at: <https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf> Last visited: September 29, 2023.

⁴ A non-fungible token is a cryptographic asset that represents something unique and is neither interchangeable (*i.e.*, cannot be replaced with another token of the same type) nor divisible. Non-fungible tokens are used to create unique verifiable digital identities and are employed in applications that require unique digital items.

⁵ A Virtual Currency is a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (*i.e.*, when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction and fulfils the above functions only by agreement within the community of users of the virtual currency.

⁶ Pub. L. No. 117-58 (2021), 135 Stat. 1339. Access online at: <https://www.congress.gov/117/plaws/publ58/PLAW-117publ58.pdf> Last visited: September 29, 2023.

These reporting requirements will be essential to the IRS's development of its Digital Asset Monitoring and Compliance Strategy. Specifically, the associated information returns will allow the IRS to monitor sales of digital assets on exchanges along with the ability to identify businesses receiving more than \$10,000 in digital assets.⁷ The information return reporting will also allow the IRS to match the third-party information to individual taxpayers' returns to assess reporting compliance.

We conducted this evaluation to assess the development of the IRS's strategy to monitor digital assets. The Treasury Inspector General for Tax Administration's Office of Audit is conducting an audit related to digital assets and cryptocurrencies to determine how effectively the IRS identifies income earned from transactions involving cryptocurrency.⁸ The estimated reporting date for this audit is December 2023.

Results of Review

Our evaluation identified that prior to Calendar Year 2022, each IRS function addressed virtual currency tax issues with different procedures. Since then, the IRS has taken several actions to centralize its approach to addressing the significant impact that digital assets have and will continue to have on tax administration. For example:

- **February 2022** – The IRS recognizes that a Service-wide approach is needed to address digital assets and created the *Digital Asset Advisory Committee* (DAAC). The DAAC was created to provide Service-wide collaboration, planning, and information sharing.
- **June 2022** – The IRS develops its *Digital Asset Initiative* which outlines the IRS's Service-wide digital asset priorities. The digital asset initiatives identified link to the IRS's IRA Strategic Operating Plan by providing an additional set of objectives to further voluntary compliance including educating taxpayers about tax obligations related to digital assets.⁹
- **October 2022** – The IRS stands up its *Digital Asset Initiative Project Office* (DAIPO) to further the IRS's efforts of providing a Service-wide perspective for digital assets. To date, the DAIPO continues to coordinate Service-wide efforts including developing forms, instructions, and guidance; information systems to receive, store, and access the new digital asset information reporting returns; as well as conducting other outreach activities.

However, the IRS cannot complete the development of the forms, instructions, and guidance until after the final digital asset regulations have been issued. Final regulations related to I.R.C. § 6045 and § 6050I have yet to be completed and remain under development within the various stages of the Federal Government's required regulatory

⁷ An exchange is a site that can be used to buy, sell, or exchange Cryptocurrency for either Fiat (a currency that is declared legal tender by a governmental entity that is not backed by a physical Commodity and has little to no intrinsic value (e.g., U.S. Dollars and Euros)) or other Cryptocurrency.

⁸ Treasury Inspector General for Tax Administration, Audit No. 202330015, *Identifying Cryptocurrency Taxable Events*.

⁹ *Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY 2023 – 2031*, pp 40, 62-64, 76-77, 86-87, and 98-99 IRS Publication 3744 (Apr. 2023). Access online at: <https://www.irs.gov/pub/irs-pdf/p3744.pdf> Last visited: September 29, 2023.

review process. Specifically, as of Tuesday, August 29, 2023, the I.R.C. § 6045 Notice of Proposed Rulemaking (NPRM) was published in the Federal Register.¹⁰ This opened the 60-day public comment period. Written comments regarding the proposed regulations were to be submitted by Monday, November 13, 2023.¹¹ A public hearing, via telephone only, was scheduled for the same day.¹² The I.R.C. § 6050I regulations remain in draft mode within the Treasury Department.

Finally, the IRS stated that it is currently working towards operationalizing digital asset work, under a cohesive strategy, across the IRS in late Calendar Year 2024. The DAIPO will make recommendations on how to execute the IRS's Digital Asset Strategy and address future digital asset priorities driven by legislation, policy, and mandates.

A Service-Wide Approach Is Needed to Address the Impact of Digital Assets on Tax Administration

The IRS's focus is on a Service-wide approach to address digital assets and in response created the DAAC. The DAAC is staffed by executives from various IRS functional areas. The DAAC collaborates with the DAIPO in the IRS's Service-wide approach to digital assets. IRS management noted that the Service-wide objectives of the DAAC include:

- Coordinating collaboration, planning, information sharing, and executive leadership over the IRS's digital asset strategy related to its compliance programs.
- Identifying and monitoring the management of digital asset programs and resources to ensure accountability, transparency, and consistency.
- Recommending funding and investment opportunities for digital asset technology and operational needs such as tracing software,¹³ or basis computational tools.¹⁴

¹⁰ Prop. Treas. Reg. 26 CFR Parts 1, 31, and 301 Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, 88 Fed. Reg. 59576 (Aug. 29, 2023) (amending 26 C.F.R. Parts 1, 31 and 301). Access online at: <https://www.federalregister.gov/documents/2023/08/29/2023-17565/gross-proceeds-and-basis-reporting-by-brokers-and-determination-of-amount-realized-and-basis-for> Last visited: September 29, 2023.

¹¹ Notice of proposed rulemaking; extension of comment period from October 30, 2023, to November 13, 2023. 88 Fed. Reg. 73300 (Oct. 25, 2023). Access online at: <https://www.federalregister.gov/documents/2023/10/25/2023-23624/gross-proceeds-and-basis-reporting-by-brokers-and-determination-of-amount-realized-and-basis-for> Last visited: November 14, 2023.

¹² Notification of rescheduling public hearing on a proposed rulemaking from November 7, 2023 to November 13, 2023, at 10 a.m. ET by telephone only. 88 Fed. Reg. 76717 (Nov. 7, 2023) Access online at: <https://www.federalregister.gov/documents/2023/11/07/2023-24608/gross-proceeds-and-basis-reporting-by-brokers-and-determination-of-amount-realized-and-basis-for> Last visited: November 14, 2023.

¹³ Digital asset tracing software is a tool used to track the movement of digital asset units on a distributed ledger (known as blockchain). Tracing software employs algorithms and other automation tools to permit a user to efficiently follow the movement of digital assets from a location on the ledger *e.g.*, an address, to other locations on the ledger.

¹⁴ Tax basis computation software is a tool which enables the user to take digital asset transaction data from various sources and import data into the software to create a unified history of digital asset transactions for a taxpayer. The software generally enables the user to transform data with distinct data structures into a common standard format, enrich the data with U.S. dollar values (for transactions not involving U.S. dollars), and ultimately generate various tax-related reports such as a calculation of capital gains and losses or taxable income received by a taxpayer.

- Reviewing digital asset related activities and briefing the Enforcement Committee and the Deputy Commissioner for Services and Enforcement, as needed.

Creation of the Digital Asset Initiative Project Office

IRS management initially noted that the DAIPO would only be in place for 12 to 18 months. However, they recently indicated the project office will operate in a temporary manner for an undetermined period of time. IRS management noted that the DAIPO is made up of a team of dedicated individuals, detailed from IRS Business Operating Divisions. The focus of this team is to prepare and organize the IRS to address digital assets across the agency while also driving progress in delivering near-term digital asset priorities. Specifically, the DAIPO is coordinating:

- Establishment of an internal and external communication plan.
- Development of a *Digital Assets Strategy and Implementation Plan* that details the type of compliance systems required to be created by Congress in the IIJA under I.R.C. § 6045. This plan is still under development. The IRS notes that the overall focus is to enforce the tax law fairly and efficiently, to increase voluntary compliance, and reduce the Tax Gap with respect to digital assets.
- Implementation of the regulations under I.R.C. § 6045 and I.R.C. § 6050I, as well the implementation of digital asset projects included in the IRS IRA Strategic Operating Plan Fiscal Years (FY) 2023 – 2030.
- Outreach to collaborate with industry, Federal and state government agencies to better understand how recent market innovations are impacting the digital asset landscape and to establish and maintain effective partnerships.¹⁵
- Assistance to Business Operating Divisions in terms of contracting for services, asset tracing, and basis computation.

At the point in time this temporary office structure ends, the digital assets strategy will be operationalized throughout the IRS.

The Digital Asset Initiative Project Office Is Taking Actions to Address Critical Challenges Related to the Continually Evolving Digital Asset Industry

In June 2022, the IRS held a Digital Asset Leadership Workshop to develop a strategic approach to address the most critical challenges and opportunities related to the continually evolving digital asset industry. This workshop resulted in the development of the IRS's *Digital Asset Initiative* which outlines the IRS's digital asset priorities. Figure 1 outlines these priorities.

¹⁵ Federal Government agencies include: The Commodity Futures Trading Commission, the Consumer Financial Protection Board, Federal Bureau of Investigation, and the Securities and Exchange Commission.

Figure 1: Service-wide Digital Asset Priorities

Priority	Description
Embrace Innovation	Leverage innovative business practices to quickly adapt and respond to rapid evolution in the Digital Asset Industry.
Create An Engaging Taxpayer/User Experience	Clearly communicate Digital Asset reporting requirements to taxpayers to promote voluntary compliance.
Manage Data and Technology	Develop a digital-focused plan for managing the intake, processing, and analysis ahead of the upcoming reporting requirement implementation.
Enhance Compliance and Enforcement	Develop a clear internal and external understanding of Digital Asset transactions and reporting requirements to make significant progress towards compliance and enforcement.
Develop Partnerships with Industry and Government Stakeholders	Establish relationships and collaborate with industry and cross-governmental partners to create open communication, knowledge sharing, and risk awareness and resolution.

Source: Internal Revenue Service.

The above priorities link to the digital asset tax reporting and compliance objectives detailed in the IRS's IRA Strategic Operating Plan by providing an additional set of objectives to further voluntary compliance and educate taxpayers about tax obligations related to digital assets.¹⁶ The planned completion date for these priorities is January 1, 2025. See below for a high-level overview of each of the priorities, which includes specific actions that the DAIPO has taken to date to address the priority.

Embrace innovation

The IRS has developed specific training for its workforce. The Director, DAIPO explained that digital asset training will be added to new employee training as well as existing employee's continuing professional education requirements that focuses on the current and pending impacts that digital assets will have on tax administration. This training effort started with offering a Virtual Currency Awareness Briefing in 2019. The Small Business/Self-Employed Division continued professional education for digital assets in 2020, 2021 and 2022, with the latter year being a mandatory requirement. Other divisions offered digital assets continuing professional education as well. The DAIPO has a goal of creating an enterprise-wide Digital Assets Learning Plan completed by the end of FY 2024. Finally, the IRS is also actively collaborating with private industry, including attending various digital asset conferences, to better understand recent market innovations as well as to explore digital asset innovations.

Create an engaging taxpayer/user experience

To assist taxpayers in understanding their digital asset reporting requirements, the IRS has updated applicable instructions and publications. For example, for Tax Year 2020, the IRS

¹⁶ Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY 2023 – 2031, pp 40, 62-64, 76-77, 86-87, and 98-99 IRS Pub. 3744 (Apr. 2023). Access online at: <https://www.irs.gov/pub/irs-pdf/p3744.pdf> Last visited: September 27, 2023.

revised the Form 1040 instructions to include a definition of virtual currency, provide examples on how to report a virtual currency transaction, and provide clarification on what is and is not a virtual currency transaction. The IRS also updated instructions for Form 8949, *Sales and Other Dispositions of Capital Assets*, to include a description of virtual currency, how it will be treated as property, and how to figure your holding period for short-term and long-term capital gains and losses.

In addition, the IRS also provides outreach and educational opportunities for tax professionals and taxpayers. This includes holding seminars for tax professionals at its Nationwide Tax Forums that include presentations on the tax implications of virtual currencies. The IRS also created a digital assets webpage that defines digital assets and tax consequences related to digital assets, provides guidance, advice, and private letter rulings.¹⁷ The IRS also developed a webpage of Frequently Asked Questions on Virtual Currency Transactions.¹⁸ This webpage provides the IRS's response to 46 frequently asked questions regarding virtual currencies.

The IRS notes that it has developed a draft of the new Form 1099-DA, *Digital Asset Proceeds from Broker Transactions*, and the related filer and recipient instructions. The IRS is also in the process of developing a form that can be used for trades or businesses to report receipt of digital assets and cash payments over \$10,000. As previously noted, the forms, instructions and publications are still subject to revision and final approval with the issuance of the final regulations. Once finalized, the IRS is planning to develop outreach and educational campaigns to familiarize taxpayers with the requirements included in I.R.C. § 6045 and § 6050I.

Manage data and technology

The IRS is evaluating and determining how the new Form 1099-DA and the form being developed for reporting under § 6050I will be received, stored, and accessed by IRS employees. The IRS estimates that between 13 and 16 million taxpayers could receive a Form 1099-DA and estimates that 100,000 forms for reporting digital assets and cash over \$10,000 under § 6050I could be filed once regulations are finalized. The IRS issued a Request for Information on June 12, 2023, that sought information regarding "solutions which can provide efficiencies to aid in compliance efforts to include, but not limited to, identifying digital asset transactions, and transaction patterns, bulk data analysis, computing tax consequences of digital assets activity, and assessing and analyzing digital asset transactions." The IRS is also evaluating additional actions that may need to be taken to upgrade data collection, storage, and access to systems to support compliance activities.

Enhance compliance and enforcement

The IRS is developing and updating internal guidance to provide its employees with the tools and processes needed to identify and address digital asset tax compliance risks. This includes updating existing guidance to add details as to the various forms of digital assets, such as virtual currencies, stablecoins, and non-fungible tokens; seizure of digital assets as part of collection activities; and converting digital assets into U.S. currency to satisfy tax debts. The IRS is also

¹⁷ IRS, *Digital Assets*: Access online at, <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets>
Last visited: September 29, 2023.

¹⁸ IRS, *Frequently Asked Questions on Virtual Currency Transactions*. Access online at:
<https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions>
Last visited: September 29, 2023.

revising examination lead sheets in administrative files to include procedures when examining digital assets.

Additionally, the IRS is enabling digital asset voluntary compliance through low touch, self-serve, and simple corrective actions. This includes coordination efforts between the Small Business/Self-Employed Division, the Large Business and International Division and the Automated Underreporter Program to establish processes to respond more rapidly to emerging issues and develop treatments that can be deployed quickly and integrated into enforcement efforts. For example, to identify digital asset fraud schemes, the IRS business operating divisions and Criminal Investigation are collaborating to develop processes to monitor future filings of non-financial trades or businesses reporting receipt of any combination of digital assets and cash payments over \$10,000 under § 6050I to mitigate increased risk of structuring transactions.¹⁹

Finally, the IRS is developing and updating its external guidance to assist taxpayers and practitioners in filing compliant information reporting returns and tax returns. This includes instructions, publications, fact sheets, news releases, and web sites.

Develop partnerships with industry and government stakeholders

The IRS continues to partner with the private sector to stay abreast of the latest digital asset technology advancements and behavioral trends to mitigate risks and improve compliance. The Director, DAIPO explained that the digital asset ecosystem is an ever-evolving, constantly changing environment. For example, the IRS is working with industry to formulate ideas and identify creative means to provide information on non-brokerage taxpayers, to ensure voluntary compliance. This includes attending speaking events to communicate with industry and taxpayers. The IRS also collaborated with international revenue agencies to promote social and economic mobility and is a participant in the Organisation for Economic Co-operation and Development (OECD).²⁰ In October 2022, the OECD released the Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard that will be used as the basis for automatic exchanges of information on digital assets between OECD members.²¹

Notices of Proposed Rulemaking Are Delaying and Impacting the IRS's Implementation of New Digital Asset Reporting and Monitoring Requirements

Our evaluation identified that the required regulatory development process is delaying the IRS's ability to finalize actions to be taken to implement § 80603 of the IJA amending I.R.C. § 6045 and I.R.C. § 6050I. This also includes the IRS's ability to comply with IRA legislation which mandates that the IRS develop a digital asset monitoring and compliance system. Implementing the various legislative mandates regarding digital assets requires the Department of the

¹⁹ Structuring is defined as breaking up a large cash transaction into small cash transactions.

²⁰ The OECD is an international organization founded in 1961, comprised of 38 member countries that works to build better policies for better lives. The goal of the organization is to shape policies that foster prosperity, equality, opportunity, and well-being for all by establishing evidence-based international standards and finding solutions to a range of social, economic, and environmental challenges.

²¹ OECD (2022), *Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard*, OECD. Access online at: <https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf> Last visited: September 29, 2023.

Treasury to create regulations.²² The IRS noted that the regulations are significant regulations because they are a legal mandate for third parties, *i.e.*, digital brokers and persons in a trade or business that receive more than \$10,000 in digital assets, to supply information to the IRS regarding transactions in digital assets with customers. Specifically, legislation requires that brokers of digital assets under I.R.C. § 6045 and that persons in a trade or business that receive more than \$10,000 in digital assets under I.R.C. § 6050I as a third-party to supply information reporting returns on their customers' digital asset transactions to the IRS. To comply with new digital asset reporting requirements businesses will be required to develop or modify their accounting and computer systems to capture the type of information required.

The regulatory development process is extensive, time consuming, and requires the participation of multiple external agencies

The regulatory approval process involves the Department of the Treasury, the IRS, and multiple other external agencies. As of August 29, 2023:

- The I.R.C. § 6045 NPRM was published in the Federal Register on August 29, 2023.²³ For certain digital asset sales and exchanges, the NPRM contains proposed regulations regarding:
 - Information reporting.
 - The determination of the amount realized and basis.
 - Backup withholding.

These proposed regulations would require brokers,²⁴ including digital asset trading platforms,²⁵ digital asset payment processors,²⁶ and certain digital asset hosted wallets,²⁷ to file information returns, and furnish payee statements on dispositions of digital assets effected for customers in certain sale or exchange transactions. The Department of the Treasury and the IRS are inviting comment on numerous issues. Written comments regarding the proposed regulations were originally required to be submitted by October 30, 2023, but due to strong public interest, on October 25, 2023, the IRS

²² Regulations are the highest level of administrative authority.

²³ Prop. Treas. Reg. 26 CFR Parts 1, 31, and 301 Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, 88 Fed. Reg. 59576 (Aug. 29, 2023) (amending 26 C.F.R. Parts 1, 31 and 301). Access online at: <https://www.federalregister.gov/documents/2023/08/29/2023-17565/gross-proceeds-and-basis-reporting-by-brokers-and-determination-of-amount-realized-and-basis-for> Last visited: September 29, 2023.

²⁴ A broker includes (i) a dealer, (ii) a barter exchange, (iii) any other person who (for a consideration) regularly acts as a middleman with respect to property or services and (iv) any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.

²⁵ A digital asset trading platform is a person that operates a trading platform or website that allows users to exchange digital assets in return for different digital assets or cash.

²⁶ A digital asset payment processor is defined in proposed § 1.6045-1(a)(22)(i)(A) as a person who in the ordinary course of its business stands ready to effect digital 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.

²⁷ A digital asset hosted wallet provider is a person that stands ready in the ordinary course of a trade or business to take custody of and electronically store the public and private keys to digital assets on behalf of others. In some cases, these providers also effect sales or possess information regarding the digital assets sales of their customers in much the way a bank custodian or other custodian does for securities.

extended the comment period to Monday, November 13, 2023. A public hearing previously scheduled for November 7, 2023, with a second public hearing date scheduled for November 8, 2023, was cancelled the day of the hearing, and replaced by a telephone only hearing on November 13, 2023.

- The regulation package for I.R.C. § 6050I NPRM remains in the drafting stage.

As the IRS awaits regulation approval, the DAIPO is still taking actions to coordinate the implementation of the third-party digital asset information monitoring and compliance system required by IJJA. As of July 19, 2023, the Legislative Analysis and Tracking Implementation Services program shows 42 actions that need to be taken to complete the implementation of IJJA provisions with four completed and 38 pending.²⁸ Finally, IRS management noted that the passage of additional legislation related to digital assets could further delay its ability to move forward. The IRS noted that more than 40 potential bills are pending, including, but not limited to:

- *The Keep Innovation in America Act.*
- *The Responsible Financial Innovation Act.*
- *The Virtual Currency Tax Fairness Act.*

²⁸ The Legislative Analysis and Tracking Implementation Services program is a computer system owned by IRS Legislative Affairs. Its mission is to manage, coordinate, and track actions the IRS takes to implement legislation impacting the IRS.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this evaluation was to assess the development of the IRS's strategy to monitor digital assets. To accomplish our objective, we:

- Reviewed documentation from the DAIPO to determine the status of the IRS developing a permanent, staffed digital asset program/organization.
- Reviewed documentation from the DAIPO; Legislative Analysis, Tracking and Implementation System; and the IRS Office of Chief Counsel to evaluate implementation of the legislative changes affecting digital assets, and determined and reported on the status of the regulation which will directly impact finalization of forms (Form 1099-DA and the development of a form for reporting digital assets and cash over \$10,000 under § 6050I), instructions, information systems, informal guidance, and outreach activities.
- Reviewed documentation from the DAIPO on the Digital Asset Initiative FY 2023 Strategy and Objectives that identifies the DAIPO team as the responsible team for monitoring goals and priorities and identifies January 1, 2025, as when priorities are to be achieved.
- Reviewed documentation from the DAIPO describing the IRS Digital Asset Engagement Plan and its current execution timeline. Also reviewed the FY 2023 – Digital Asset Communication Plan that the DAIPO is currently executing.

Performance of This Review

This review was performed with information obtained from the Services and Enforcement, Program Management Office and the Office of the IRS Chief Counsel located in Washington, D.C. during the period April 2023 through August 2023. We conducted this evaluation in accordance with the Council of the Inspectors General for Integrity and Efficiency Quality Standards for Inspection and Evaluation.

Major contributors to the report were James Douglas, Director; John da Cruz, Supervisory Evaluator; and Earl Burney, Lead Evaluator.

Appendix II

Overview of the Regulatory Process

A brief overview of this process is as follows:

- The regulatory process begins with the assignment of a drafting team at the IRS Office of Chief Counsel composed of a docket attorney, a reviewer, and an attorney advisor from Treasury's Office of Tax Policy.
- This team will draft the regulations after receiving input from the other Associate Offices, Division Counsels, and the IRS. The "green" draft package¹ will be circulated after approval from Treasury for comments.
- After incorporation of the comments a "pink" signature package² will be circulated and will receive final approval from the Chief Counsel, Commissioner of Internal Revenue, and Assistant Secretary of the Treasury (Tax Policy).
- The draft Notice of Proposed Rulemaking is then submitted to the White House's Office of Information and Regulatory Affairs (OIRA)³ for review in accordance with Executive Order 12866.
- After OIRA approval, the NPRM is published in the Federal Register beginning the 60-day public comment period.
- However, on June 9, 2023, the Department of the Treasury and OIRA entered into a new Memorandum of Agreement (MOA), superseding the prior MOA. Under the new MOA, Treasury regulatory actions issued by the IRS pursuant to the Code are no longer subject to the OIRA review under Executive Order 12866.
- At the end of the public comment period, a public hearing is held.
- Afterwards, the public comments are considered, and some may be incorporated into a revision of the final regulations.

¹ The "green" circulation draft is a draft approved for distribution outside the initiating Associate Chief Counsel office to other Counsel and IRS offices that have been involved in the project, or will be affected by it, for their review and comment. Prior to circulation, the "green" circulation draft must be reviewed by the Federal Register Liaison. Additionally, the Department of the Treasury, Office of Tax Policy Attorney Advisor assigned to the regulation will ensure that the Office of Tax Analysis has been made aware of the guidance, and reviewed and approved by, or on behalf of, the initiating Associate Chief Counsel prior to circulation.

² The "pink" signature package contains a group of documents, submitted to the Federal Register, through which the Chief Counsel, Commissioner (or Deputy Commissioner for Services and Enforcement), and Assistant Secretary for Tax Policy authorize publication of the NPRM or Treasury Decision in the Federal Register.

³ OIRA, located within the Office of Management and Budget, is the U.S. Government's central authority for the review of Executive Branch regulations, approval of Government information collections, establishment of Government statistical practices, and coordination of Federal privacy policy. OIRA coordinates with other Federal agencies with an interest in the issue, and reviews drafts of the NPRM and Treasury Decision (final regulations) under a variety of statutory and Executive Order authorities. Access online at: <https://www.whitehouse.gov/omb/information-regulatory-affairs/> Last visited: September 29, 2023.

- From this point, the process repeats itself with the draft Treasury Decision⁴ going through “green” and “pink” draft packages, and finally publication of the Treasury Decision in the Federal Register.

⁴ A Treasury Decision is a document that contains the text of a final or temporary regulation. It adds new text to or removes or revises text already published in the Code of Federal Regulations.

Appendix III

Glossary of Terms

Term	Definition
Blockchain	An immutable digital ledger that chronologically records computationally verified transactions or other data.
Cryptocurrency	A type of virtual currency that incorporates cryptography to enhance its security. Most, but not all, cryptocurrencies are decentralized.
Cryptographically	Of, relating to, or using cryptography, which is defined as information and communication techniques for securing information in computer systems.
Digital Asset	Means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary – I.R.C. § 6045(g)(3)(D).
Distributed ledger	A database split across every computer that elects to run Blockchain software. Data can be with or without permission to control who views it.
Fiat	A currency that is declared legal tender by a government entity that is not backed by a physical commodity and has little to no intrinsic value <i>e.g.</i> , U.S. dollars and euros.
Non-fungible token	A token that represents something unique and is neither interchangeable, <i>i.e.</i> , cannot be replaced with another token of the same type, nor divisible. Non-fungible tokens are used to create unique verifiable digital identities and are employed in applications that require unique digital items.
Stablecoins	A cryptocurrency that is pegged to a specific underlying asset and that is designed to have low volatility and consistently reflect the value of the underlying Asset.
Virtual currencies	A digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value but does not have legal tender status in any jurisdiction. It is not issued nor guaranteed by any jurisdiction and fulfills the above functions only by agreement within the community of users of the virtual currency.

Appendix IV

Abbreviations

DAAC	Digital Asset Advisory Committee
DAIPO	Digital Asset Initiative Project Office
FY	Fiscal Year
IIJA	Infrastructure Investment and Jobs Act of 2021
IRA	Inflation Reduction Act of 2022
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
NPRM	Notice of Proposed Rulemaking
OECD	Organisation for Economic Co-operation and Development
OIRA	Office of Information and Regulatory Analysis



**To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via e-mail at
oi.govreports@tigta.treas.gov.**

**To make suggestions to improve IRS policies, processes, or systems
affecting taxpayers, contact us at www.tigta.gov/form/suggestions.**

Information you provide is confidential, and you may remain anonymous.