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## WHITE PAPER

October 2022

### Digital Assets Defined: The Tax Code's Take

In June 2022, Senators Kirsten Gillibrand (D-NY) and Cynthia Lummis (R-WY) introduced the [Responsible Financial Innovation Act](#) (the “Bill”), one of most comprehensive responses by Congress to date with respect to digital assets and their increasingly significant role in the U.S. economy. The legislation proposed a governance and definitional framework for digital assets across numerous areas of law, including taxation. While it is unlikely this Bill will be passed given the limited time remaining for the 117th Congress, the Bill’s support of positions endorsed by the cryptocurrency industry is welcome. And it is widely anticipated that aspects of this bipartisan Bill will be incorporated in subsequent legislation, and are likely to shape the debate in future Congressional sessions.

In this *White Paper*, we discuss some of the Bill’s most significant tax proposals.

## SAFE HARBOR FOR DE MINIMIS TRANSACTIONS

The use of virtual currency to purchase goods and services is generally a taxable event to the purchaser under current law, and the resulting gain or loss is reportable to the U.S. Internal Revenue Service. The Bill would provide a long-sought-after de minimis exception to this rule by excluding from a taxpayer's income any gain or loss recognized on certain "personal" (i.e., non-business, non-investment) transactions up to \$200. The intent of this proposal is to relieve taxpayers from onerous calculations and reporting obligations in situations where virtual currency is being used to make small purchases. While the sorts of "personal transactions" contemplated by the Bill include the use of virtual currency for transactions such as buying a cup of coffee, they would not include transactions in which virtual currency is sold or exchanged for cash, other digital assets, or securities or commodities.

Helpfully, the \$200 threshold would be subject to an annual inflation adjustment so the rule's usefulness would not be eroded over time. In determining whether this threshold has been exceeded, all dispositions of virtual currency that are part of the same transaction or series of related transactions would be aggregated together. In other words, transactions in excess of \$200 could not be broken into smaller transactions in order to avoid tax reporting.

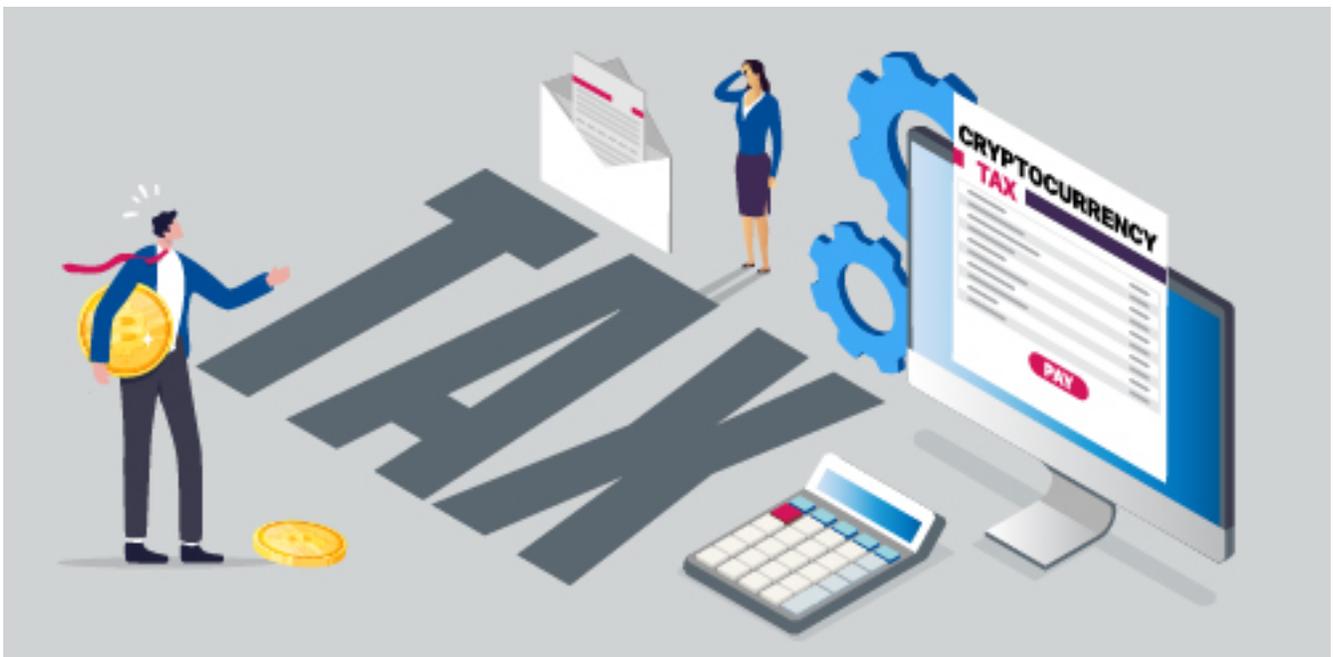
If a de minimis exception such as this were adopted, it would remove some of the practical barriers to the regular use of virtual currency by casual users. Notably, however, taxpayers coming within the scope of this exception would be unable to take advantage of losses triggered by such transactions.

Similar de minimis exclusions have been proposed. For example, the Virtual Currency Tax Fairness Act, proposed in July 2022 by Pat Toomey (R-PA) and Kyrsten Sinema (D-AZ), would provide an exclusion for gains of less than \$50 on similar transactions (although apparently would not also exclude losses triggered by such transactions).

## RELAXATION OF TAX REPORTING REQUIREMENTS

The 2021 Infrastructure Investment and Jobs Act (the "IIJA") created new tax reporting obligations related to digital assets beginning for 2023, as well as expanded the definition of "brokers" that are subject to the rules. Under these new rules, a broker is "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."<sup>1</sup>

The Bill would clarify—and narrow—the definition of "broker" for reporting purposes to "any person who (for consideration) stands ready in the ordinary course of a trade or business to effect sales of digital assets at the direction of their customers."



Critically, this revised definition appears to answer the industry's call to exclude persons presumably not intended to be swept within the definition of "broker"—including miners, stakers, and certain software and hardware vendors—as these persons typically would not have access to the relevant taxpayer information required to comply with such reporting obligations.

The definition of "broker" introduced by the IJA has been widely criticized as overbroad and the subject of numerous Congressional proposals attempting to narrow it in a fashion similar to the amendment contained in the Bill. One of the most recent such proposals, Senate Bill 4751, was also cosponsored by Senator Lummis.

## **EXPANSION OF THE SECURITIES AND COMMODITIES TRADING SAFE HARBOR**

A critical threshold question for foreign persons investing in the United States is whether they are considered "engaged in a U.S. trade or business" for U.S. income tax purposes—a question that does not always have an obvious answer. This answer, however, will determine whether the investor may be subject to U.S. income tax. Current law contains an important safe harbor that generally insulates foreign investors from U.S. income taxation for qualifying securities and commodities trading activities.<sup>2</sup>

The Bill would extend that safe harbor to expressly cover qualifying digital asset trading activities by foreign investors. Eligibility would require satisfying several technical conditions, including that the digital assets be of a kind customarily traded on a digital asset exchange. Intended to encourage foreign investment in the growing U.S. digital asset markets, the expansion of this taxpayer-favorable safe harbor would be a welcome development that would provide more tax certainty to investors and put the trading of digital assets on par with U.S. securities and commodities.

## **TAX-FREE LENDING OF DIGITAL ASSETS**

Under current law, securities loans that satisfy certain requirements are generally tax-free.<sup>3</sup> Loans of digital assets, however, generally are not covered by this statutory rule, which applies only to "securities" (as specifically defined for purposes of this rule).<sup>4</sup> The Bill would extend the application of this existing rule to qualifying digital asset lending transactions. Accordingly, if this proposal were enacted, no gain or loss would be recognized upon either the loan or repayment of digital assets under this statutory rule (as long as the various technical requirements were met).

This proposal would be welcomed by the fintech and financial sectors and is similar to a proposal made by the Biden administration in March 2022 in its 2023 Fiscal Year Budget.

## **MINING AND STAKING INCOME**

Finally, the Bill would require that Treasury publish formal guidance providing that digital assets obtained from mining and staking activities not be included in a taxpayer's income until the year in which those digital assets are disposed of. Currently, the IRS takes the position that when a person successfully mines virtual currency, the fair market value of any reward received is taxable income as of the date of receipt. There is more uncertainty as to the current tax treatment of staking awards,<sup>5</sup> so such a taxpayer-favorable clarification would be particularly welcomed by the industry and their tax advisors.

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## ENDNOTES

- 1 Internal Revenue Code Section 6045(c)(1)(D).
- 2 Internal Revenue Code Section 864(b)(2).
- 3 Internal Revenue Code Section 1058(a).
- 4 Internal Revenue Code Sections 1058(a) and 1236(c).
- 5 See *Jarrett et al. v. United States*, Docket No. 3:21-cv-00419 (M.D. Tenn. May 26, 2021).

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