

Part III - Administrative, Procedural, and Miscellaneous

Transitional Relief Under Sections 3403, 3406, 6721, 6722, 6651, and 6656 with Respect to the Reporting of Information and Backup Withholding on Digital Assets under Section 6045 for Digital Asset Brokers Providing Trading Front-End Services

Notice 2025-3

SECTION 1. PURPOSE

This notice provides transitional relief from penalties for certain brokers who fail to report sales of digital assets, as defined in §1.6045-1(a)(19),¹ other than digital assets not required to be reported as digital assets pursuant to §1.6045-1(c)(8)(ii), (iii), or (iv), on information returns (Form 1099-DA, Digital Asset Proceeds From Broker Transactions), or fail to furnish payee statements under section 6045. The penalty relief provided by this notice is available for brokers providing trading front-end services, as described in §1.6045-1(a)(21)(iii)(A) (DeFi brokers) and is available for information returns required to be filed and payee statements required to be furnished in 2028 for sales of digital assets effected in calendar year 2027, provided that the broker makes a good faith effort to file the appropriate information return and furnish the associated

¹ Unless otherwise specified, all “section” or “§” references are to sections of the Internal Revenue Code, the Income Tax Regulations (26 CFR part 1), or to the Employment Taxes and Collection of Income Tax at Source Regulations (26 CFR part 31).

payee statement accurately.

In addition, this notice provides transitional relief from the liability for the payment of backup withholding tax required to be withheld under section 3406 and its accompanying regulations as well as from penalties for DeFi brokers who fail to pay that tax with respect to certain sales of digital assets required to be reported under section 6045. Specifically, this notice provides certain relief from penalties (1) for any sale of a digital asset effected by a DeFi broker during calendar year 2027 and (2) for any sale of a digital asset effected by a DeFi broker during calendar year 2028 for a customer (payee) if the broker submits that payee's name and tax identification number (TIN) combination to the Internal Revenue Service's (IRS) TIN Matching Program and receives a response that the name and TIN combination furnished by the payee matches the name and TIN combination for that payee in IRS records. For sales effected before January 1, 2029, this notice also provides that a DeFi broker may treat a customer as an exempt foreign person if the customer has not been previously classified as a U.S. person by the DeFi broker, and the information that the DeFi broker has for the customer includes a residence address that is not a U.S. address.

This notice also provides transitional relief from penalties for DeFi brokers who fail to backup withhold and pay the full backup withholding tax due if such failure is due to a decrease in the value of withheld digital assets in a sale of digital assets in return for different digital assets effected on or before December 31, 2028, and the broker immediately liquidates the withheld digital assets for cash.

SECTION 2. BACKGROUND

.01 Section 6045 and Final Regulations

Section 6045(a) provides that every person doing business as a broker shall make a return to the IRS showing the name and address of each customer, with details regarding gross proceeds and other information as required. These rules apply when required by the Secretary of the Treasury or her delegate (Secretary) and in accordance with regulations prescribed by the Secretary. Other subsections of section 6045 require a broker to furnish a payee statement to customers, define the term broker, require basis reporting for specified securities that are also covered securities, and provide other applicable rules.

Section 80603 of the Infrastructure Investment and Jobs Act, Pub. L. No. 117-58, 135 Stat. 429, 1339 (2021) (Infrastructure Act) made several changes to the broker reporting provisions under section 6045 to clarify the definition of broker, to provide a definition of the term digital asset, and to expand the categories of assets for which basis reporting is required to include all digital assets.

On July 9, 2024, the Department of the Treasury (Treasury Department) and the IRS published in the Federal Register (89 FR 56480) final regulations (TD 10000) to require certain brokers to file information returns and furnish payee statements reporting gross proceeds and in certain circumstances adjusted basis on sales of digital assets effected for customers beginning for sales on or after January 1, 2025. TD 10000 applies to operators of custodial digital asset trading platforms, certain digital asset hosted wallet providers, certain processors of digital asset payments (PDAPs), owners of digital asset kiosks, brokers who accept digital assets as payment for commissions and certain other property, certain real estate reporting persons, brokers that transact as dealers in digital assets, and certain issuers of digital assets who regularly offer to redeem those digital

assets. TD 10000 did not finalize the portion of the definition of broker that would have treated certain DeFi participants (referred to in the preamble to TD 10000 as non-custodial industry participants) as brokers.

On July 15, 2024, Notice 2024-56 was published in the Internal Revenue Bulletin (2024-29 I.R.B. 64) (Notice 2024-56) to provide certain transitional relief to brokers described in TD 10000 and additional transitional relief available to all brokers. Section 3.03 of Notice 2024-56 provides that backup withholding under section 3406 will not be required on any digital asset sale effected by a broker where the reportable proceeds is a specified nonfungible token until further guidance is issued. Section 3.05 of Notice 2024-56 provides that backup withholding under section 3406 will not be required on any PDAP sale effected by a PDAP until further guidance is issued.

On December 27, 2024, final regulations (TD 10021) were filed for public inspection with the Federal Register (XX FR XXXXX) (final regulations) which treat certain persons as brokers that in the ordinary course of a trade or business stand ready to provide trading front-end services, as described in §1.6045-1(a)(21)(iii). Trading front-end service providers are treated as brokers when the nature of the service arrangement is such that the person providing that service ordinarily would know, or be in a position to know, within the meaning of §1.6045-1(a)(21)(ii) the nature of the transaction potentially giving rise to gross proceeds from the sale of digital assets. These brokers are required to file information returns and furnish payee statements reporting gross proceeds on sales of digital assets effected for customers beginning for sales of digital assets effected on or after January 1, 2027.

In addition to the relief provided by this notice, these DeFi brokers are also eligible

for the relief provided in sections 3.03 and 3.05 of Notice 2024-56. The Treasury Department and the IRS also intend to issue a notice of proposed rulemaking under §31.3406(h)-2(b) with proposed regulations that would provide brokers with greater flexibility to satisfy their backup withholding obligations with respect to digital asset transactions.

.02 Sections 6721, 6722 and 6724

Section 6721 imposes a penalty for any failure to file an information return on or before the required filing date, and for any failure to include all the information required to be shown on the return or the inclusion of incorrect information. Section 6724(d)(1)(B)(iii) defines an information return for this purpose as a return required by section 6045(a) and (d).

Section 6722 imposes a penalty for failure to furnish a payee statement on or before the required furnishing date to the person to whom such statement is required to be furnished, and for any failure to include all the information required to be shown on a payee statement or the inclusion of incorrect information. Section 6724(d)(2)(H) defines a payee statement for this purpose as a return required by section 6045(b) or (d).

Section 6724 provides that no penalty shall be imposed under sections 6721 and 6722 if the filer (payor) shows that the failure was due to reasonable cause and was not due to willful neglect.

.03 Sections 3403 and 3406

Section 3406(a)(1) requires certain payors of reportable payments to deduct and withhold a tax on a payment at the statutory backup withholding rate (backup withholding tax) if the payee fails to furnish the payee's TIN to the payor in the manner

required. Pursuant to section 3406(b)(3)(C), a reportable payment includes payments made by a broker that are required to be shown on an information return under section 6045.

Section 1.6045-1(g)(1) provides an exception to a broker's reporting of a sale of digital assets effected for a customer that is an exempt foreign person. Under §1.6045-1(g)(4)(ii)(B) and (g)(4)(vi)(A)(1), a U.S. digital asset broker may treat a customer as an exempt foreign person if the broker receives valid documentation upon which it may rely for this purpose (for example, Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)). Pursuant to §§31.3406(d)-1 and 31.3406(h)-3(a)(1), a payee that is not an exempt foreign person must generally furnish to the broker on a Form W-9, Request for Taxpayer Identification Number and Certification, the payee's TIN and certify under penalties of perjury that the furnished TIN is correct (certified TIN). Section 1.6045-1(g)(4)(vi)(F) permits a broker to treat a customer with an account established prior to January 1, 2026, as an exempt foreign person with respect to digital asset sales effected prior to January 1, 2027, if the customer has not been previously classified as a U.S. person by the broker and the information the broker has for the customer includes a residence address that is not a U.S. address.

Section 3406(a) provides that the current applicable rate of backup withholding is the fourth lowest rate of tax applicable under section 1(c) (currently 24 percent). A payor is also required to report the amount of backup withholding tax the payor withheld from the payee on Form 945, Annual Return of Withheld Federal Income Tax, and on the information return filed with the IRS and furnished to the payee. In the case of the Form

1099-DA, once it is approved by the Office of Management and Budget (OMB) for information collection under the Paperwork Reduction Act, the backup withholding tax withheld from the payee will be required to be reported in accordance with the instructions for that form. The payee may then report this tax as an income tax payment on the payee's Federal income tax return.

Section 3406(a)(1)(B) also requires the payor to deduct and withhold the backup withholding tax if the IRS notifies the payor that the payee has provided an incorrect name and TIN combination. The IRS notifies a payor of an incorrect name and TIN combination by sending the payor a CP2100 Notice, Please Check Your Backup Withholding List ("Large" Payers), or a CP2100A Notice, Please Check Your Backup Withholding, Contact Your Payee, and/or Update Your Records. The CP2100 and CP2100A Notices list each payee with an incorrect name and TIN combination reported on information returns filed by the payor. Upon receiving a CP2100 Notice or a CP2100A Notice, payors must send a copy of the notice identifying the incorrect name and TIN combination to the payee and request a corrected TIN (or name) from the payee before beginning backup withholding. See §31.3406(d)-5 (describing these procedures, which are commonly known as B Notice procedures).

Section 3406(h)(10) provides that payments subject to withholding under section 3406 shall be treated as if they were wages paid by an employer to an employee and amounts deducted and withheld under section 3406 shall be treated as if deducted and withheld under section 3402. Accordingly, a payor of reportable payments subject to backup withholding under section 3406 is liable under section 3403 for the payment of the backup withholding tax required to be withheld.

.04 TIN Matching Program

Section 31.3406(j)-1(a) provides that the Commissioner of Internal Revenue (Commissioner) has the authority to establish TIN matching programs and may prescribe by revenue procedure or other guidance the scope and terms and conditions for participating in such programs.

Section 31.3406(j)-1(b) provides that none of the matching details received by a payor through a matching program will constitute an IRS notification regarding incorrect name and TIN combination for purposes of imposing backup withholding under section 3406(a)(1)(B).

Section 31.3406(j)-1(d) provides that the IRS will not use a payor's decision not to participate in the TIN Matching Program as a basis to assert that the payor lacks reasonable cause under section 6724(a) for failure to file a correct information return under section 6721 or to furnish a correct payee statement under section 6722.

Revenue Procedure 97-31, 1997-26 I.R.B. 6 (June 30, 1997), established procedures under which Federal agencies could submit payee names and TINs and the IRS would inform the agency whether the names and TINs matched the information in the IRS's database for the program. Revenue Procedure 2003-9, 2003-8 I.R.B. 516 (February 24, 2003), established a TIN Matching Program that permits payors to verify name and TIN combinations provided by payees that are required to be reported on information returns and payee statements. To participate in the TIN Matching Program, the payor must complete an application. Then, prior to filing an information return, a TIN Matching Program participant may check the name and TIN combination furnished by the payee against the name and TIN combination contained in the IRS-maintained

database. More information is available at <https://www.irs.gov/tax-professionals/taxpayer-identification-number-tin-matching>. Publication 2108A, On-Line Taxpayer Identification Number (TIN) Matching Program, has complete program information.

.05 Sections 6651 and 6656

A payor who fails to withhold and pay backup withholding tax when required may be subject to civil penalties under sections 6651 and 6656. Section 6651 generally imposes an addition to the tax owed by a taxpayer for the failure to pay the amount shown as tax, including backup withholding tax, on a return required to be filed by the taxpayer unless the failure is due to reasonable cause and not due to willful neglect. Section 6656 provides that in the case of any failure by any person to deposit taxes on the prescribed date in an authorized government depository, a penalty applies unless the failure is due to reasonable cause and not due to willful neglect. A failure to deposit backup withholding tax as required under section 6302 would generally subject a payor to the section 6656 penalty.

SECTION 3. DISCUSSION

.01 Sales Effected in Calendar Year 2027

The final regulations under section 6045 require DeFi brokers to make information returns and furnish payee statements with respect to sales of digital assets effected on or after January 1, 2027. Sections 6721 and 6722 are applicable to brokers that fail to file those information returns and furnish those payee statements. In order to provide DeFi brokers with additional time to develop appropriate procedures to comply with these new reporting requirements, the IRS will not impose penalties under sections

6721 and 6722 on DeFi brokers that fail to file information returns and furnish payee statements under the final regulations with respect to sales of digital assets effected during calendar year 2027, provided that such brokers make good faith efforts to file accurate and timely Forms 1099-DA and furnish accurate and timely payee statements. For purposes of this notice, good faith efforts do not include any filing of returns or furnishing of payee statements made by the DeFi broker after the later of the date that the IRS first contacts the broker concerning an examination of such broker or one year after the original due date for filing such returns.

The final regulations under section 3406 and §31.3406(b)(3)-2 apply to reportable payments by a DeFi broker to a payee with respect to sales of digital assets on or after January 1, 2027, that are required to be reported under section 6045. Because the final regulations require DeFi brokers to report digital asset sales effected during calendar year 2027 and because these brokers may not have enough time to obtain a certified TIN from a payee prior to the date of a digital asset sale by that payee during 2027, the Treasury Department and the IRS are postponing the application of backup withholding with respect to sales of digital assets for an additional year to provide DeFi brokers with additional time to develop appropriate procedures for collecting certified TINs from customers and to otherwise comply with the backup withholding requirements on digital asset sales. Accordingly, backup withholding under section 3406 will not be required on any digital asset sale effected by DeFi brokers during calendar year 2027.

.02 Sales Effected in Calendar Year 2028

Section 3406 backup withholding applies to reportable digital asset sales if the broker has not obtained the payee's certified TIN. DeFi brokers subject to section 6045

reporting for digital asset sales may experience challenges in obtaining certified TINs from all payees that are existing customers. Accordingly, for digital asset sales effected in calendar year 2028, the IRS will permit DeFi brokers to rely on TINs provided by payees that are not certified if those uncertified TINs were provided by payees prior to January 1, 2028, and if the broker, prior to effecting the digital asset sale transaction, submits the payee's name and TIN combination to the IRS's TIN Matching Program and receives a response that the name and TIN combination furnished by the payee matches the name and TIN combination for that payee in the IRS records.

.03 Sales Effected Before January 1, 2029

To provide additional time for DeFi brokers to collect the necessary documentation to treat existing customers as exempt foreign persons, the IRS will permit DeFi brokers to treat a customer as an exempt foreign person for sales of digital assets effected before January 1, 2029, as set forth in the following sentence. A DeFi broker may apply this transitional rule only if the customer has not been previously classified as a U.S. person by the DeFi broker, the information that the DeFi broker has for the customer includes a residence address that is not a U.S. address, and this information was provided by the customer prior to January 1, 2028.

.04 Amount of Backup Withholding

In the case of a sale of a digital asset for different digital assets, the value of the digital assets received in such sales can change between the time of the transaction and the time the received digital assets are liquidated into U.S. dollars for depositing with the IRS. To provide DeFi brokers additional time to develop appropriate backup withholding procedures, the amount of backup withholding tax required to be withheld

and paid as a tax under section 3406 shall be limited to the amount that such broker receives upon the liquidation of 24 percent of the customer's received digital assets, notwithstanding that such amount may be less than 24 percent of customer's received digital assets at the time of the transaction giving rise to the backup withholding obligation, provided such liquidation is undertaken immediately after the transaction giving rise to the backup withholding liability. The amount that the broker receives upon liquidation should be reported as Federal income tax withheld on Form 1099-DA. This amount should also be included on the broker's Form 945. Accordingly, the IRS will not impose penalties under section 6651 or 6656 with respect to any decrease in the value of received digital assets between the time of the transaction giving rise to the backup withholding obligation and the time the broker liquidates 24 percent of the received digital assets. Finally, the IRS will not impose penalties on DeFi brokers that are required to file Form 945 with respect to the backup withholding tax due as described in this section 3.04 with respect to digital asset sales, provided such broker pays and reports the amount of backup withholding tax that is withheld and deposited with the IRS in accordance with this section 3.04. For this purpose, a broker that systemically liquidates the received digital assets when received as part of its services effectuating sales will be treated as immediately liquidating the received digital assets.

The relief provided by this section 3.04 applies only to the amount required to be withheld and paid as described in this section 3.04 and the requirement to file information returns and payee statements pertaining to reportable digital asset sales effected before January 1, 2029.

SECTION 4. EFFECTIVE DATE

This notice is effective December 27, 2024.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is the Office of the Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, please call (202) 317-5436 (not a toll-free number).