



# Information reporting of crypto: The big picture

The process doesn't end once you file  
your Form 1099s



# Introduction

Digital asset reporting is here. But the process doesn't end once you file your Form 1099s. In our newest article, we've outlined what to expect post-filing and key areas to focus on as you work through your full information reporting lifecycle.

No matter where you are in your blockchain journey, you are likely aware of new information reporting requirements. These provisions are part of the Infrastructure Investment and Jobs Act, which was signed into law Nov. 15, 2021. If you're in scope, you have also likely done your homework. You have received all the W-9 and W-8 tax forms from your account holders. You're tracking trading activity. You're managing transfer statements. And, if you haven't already, you are ready to report it all on IRS Form 1099. That's a great start.



# But wait ... that's just the start

If you thought filing would wrap up your reporting requirements for another year, think again.

As with all tax reporting regimes, the authorities (in this case, the IRS) review the data you filed for discrepancies, using their power of penalty assessments and withholding requirements to close the gaps. This is a purposeful feedback loop in the tax reporting life cycle, giving you, as payor, the opportunity to iteratively improve the data reported to the IRS for your account holders.

1099 reporting requires a data file from payors with all reportable records, including account holder ("payee") names and TINs (i.e., SSN or EIN). This file doesn't just sit in a data center at the IRS for future reference. Once received, the IRS checks the data represented on the forms against federal databases, including the EIN and SSN databases. As outlined by the IRS in Publication 1281, the IRS is primarily looking for missing TINs and mismatches between the TINs and the payees' names. If the data doesn't match, you'll find out through an IRS CP2100 Notice.

If it's a clerical problem—maybe you incorrectly pulled a name or TIN from a Form W-9—you will want to update your records with correct payee information. Technically, the IRS could levy a penalty for the clerical error, but it generally doesn't in cases where payees are able to explain the error.

If it looks like your account holders may have entered wrong information in their account opening documents, you've got a short window to go back to them for the right information.

You do that by issuing a "B" Notice, generally within 15 business days of receiving that CP2100 (you can find a template version on the IRS website). This "B" Notice basically informs the recipient of the discrepancy or data gap and asks them for an updated Form W-9.

The "B" Notice also informs the recipient that you will begin withholding within 30 business days of receiving the CP2100. That makes it critical that you mail the "B" Notices out as quickly as possible. If you haven't received the corrected Form W-9 in that 30-day window, you are obligated to withhold on all payments at 24%.

Sounds straightforward enough, but it can quickly get complicated and risky. 1099 filers that don't follow the procedures expose themselves to civil penalties and tax liabilities. There are also penalties for not paying those liabilities in a timely fashion and reputational risks with your account holders. These costs and potential implications can be disruptive to your business.

# Not just a tax issue

There are several reasons you will want to be on top of this process. Let's start with your customers. The reality is that many of your account holders will probably welcome receiving this new Form 1099 reporting of their crypto transactions as they need gain and loss information to complete their own tax returns. They also expect that the details are being submitted properly, and if not, that you are ready to correct it—without repeatedly coming back to them to confirm information.

They also don't want 24% withholding tax to be shaved off their transactions for no good reason. US taxpayers may need to wait for more than a year after the transaction to reclaim the withholding tax on their own return. That's a long time for your customers to wait for their money, particularly in a volatile crypto market. Not to mention that, for crypto-to-crypto transactions, you need to deposit fiat currency with the IRS (they don't accept crypto yet), which creates another window for values to change. From both a customer and business operations perspective, you don't want to get this wrong.

There is also a financial implication to you. Say you have a CP2100 with a list of records flagged by the IRS but don't take any action. You are responsible for the 24% withholding as the withholding agent, even if you cannot recover it from your account holders.

In the digital asset market, it is not unusual to see crypto exchanges clearing trillions of dollars in crypto trades across the year. If just a fraction of those transactions relates to account holders subject to backup withholding and the reporting entity failed to take action, you risk significant withholding tax liability.

Then there are the potential penalties that could be levied by the IRS if you didn't act within the window provided, currently at \$290 per filing error. The follow-up notice from the IRS proposes the penalties (through what's known as a 972CG). Since it is proposed, there are still some options to request a penalty abatement before the formal assessment from the IRS. This only helps if you can show that you did everything in your power to get the right information in time.





# Who's on point?

Having highlighted the reasons you should take action, consider some of the more tactical challenges with the CP2100 processes. For one, CP2100 Notices tend to show up from the IRS in the mail with a CD or DVD listing name/TIN mismatches and missing TIN errors (unless there are fewer than 50 names on your error list, in which case it shows up in paper format). Who in your organization is going to monitor for the notice? Who is going to reconcile the information in the CP2100 against your account records, and do you even have a disc drive to read the list? Who is responsible for sending out the "B" Notices to your account holders? Given that you generally have just 15 days from the time you receive the notice to notify customers, someone in your organization needs to be on point with a process already in place for rapid response.

If the updated Form W-9 data still isn't right and the next year's filings are submitted to the IRS, you'll see the same account holder listed on your CP2100. That requires you to send a second "B" Notice, which has different requirements than the first. The IRS doesn't specifically tell you whether the CP2100 Notice is a first or second notice, so someone needs to be responsible for reconciliation. Assuming some of your account holders are unresponsive, you also need to consider your withholding and deposit process. You also need a plan on how to timely respond to the IRS to address any penalties. These are complex questions that require robust and compliant answers. If you don't prepare now, you may be caught flat-footed.

# Four steps to getting it right

The good news is, while the questions may be complex, the answers don't need to be. The Form 1099 and "B" Notice process has been around for ages in the traditional banking world. In fact, at Deloitte Tax LLP, we've been working with digital asset players in both the CeFi and DeFi space to create smart solutions to these and other information reporting challenges for years.

When we work with clients in the digital asset industry, we encourage them to think through the "long-tail" of the information reporting cycle, directing them to focus on four key areas:

1.

Life cycle planning. Your business leaders may not be aware of the tax risks they face or the various actions that can be taken to mitigate them. Start by evaluating what resources the tax and other impacted functions will require to achieve compliance. Build these requirements into the investment and resource planning decisions upfront, accounting for technology, personnel, and outsourcing budget needs early.

2.

Process and control improvements. Form 1099 reporting and "B" Notices don't need to be scary. In fact, with the right processes and controls, Form 1099 reporting and "B" Notices can become manageable components of normal business operations. Look to peers, advisers, and even the IRS to find guidance, templates, and process maps that can help you efficiently develop your information reporting compliance framework.

3.

Data gap remediation. Now that you know what to do and how you want to do it, evaluate your current data and documentation to see where gaps might exist. As a newly-in-scope payor, you have a unique opportunity to get in front of any data deficiencies and remediate before any problems arise. The earlier gaps are identified, the sooner customer outreaches can be handled, mitigating data deficiency and lowering the risk of withholding and penalties.

4.

Operating model optimization. We often suggest that crypto companies assess their tax operations capabilities and decide what parts of this process they want to keep in-house and what they want to outsource. Consider teaming with a trusted adviser to help map out your path to compliance, evaluating where internal capacity and technology is sufficient and where engaging external assistance is strategic.



# Conclusion

Once you have your processes down, you will want to embed them into business as usual, focusing on making the process as simple as possible for the business and its customers.

Digital asset reporting is here. Form 1099 reporting and the iterative process that follows is part of this regulatory requirement. The IRS has decades of history in monitoring and enforcing compliance, and it is rapidly expanding its efforts. Taxpayers should consider addressing this piece of the tax compliance lifecycle as soon as possible. With the right focus and resource investment, your organization can easily take this on.



# Get in touch

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