KPMG

# Digital Assets: An evolving frontier

## Stay ahead of compliance complexity in crypto

Digital assets based on blockchain technology have evolved remarkably, often outpacing regulations. But the rules are finally starting to catch up, bringing new challenges to everyone from major exchanges to real estate firms. Regardless of the solution chosen, understanding the new landscape is essential.

For many companies, a managed services agreement may prove the most efficient way to prepare for this complex and rapidly changing set of rules. But whatever solution your business ultimately selects, you need to first understand the new landscape.

## Background: Types of blockchain-based digital assets

As the IRS continues to develop a digital asset monitoring and compliance strategy, below are the main categories of digital assets that are impacted.

### Cryptocurrencies

Digital or virtual currencies like Bitcoin and Ethereum that use blockchain technology for security, completeness, and accuracy operate independently of a central bank and can be used for peer-to-peer transactions.

### Security tokens

Represent ownership in a real-world asset such as stocks, bonds, or real estate. They are often specifically designed to be compliant with federal securities regulations.

### Stablecoins

Cryptocurrencies are designed to minimize price volatility by pegging their value to a reserve asset, typically a stable fiat currency like the US dollar or a precious metal like gold.

### Utility tokens

Provide users with access to a product or service within a specific ecosystem. They are often used in decentralized applications, such as trading virtual assets in a video game or paying for storage in a decentralized file storage network.

### Non-fungible tokens

Unique digital assets represent ownership or proof of authenticity of a specific item or piece of content. While Define here at first mention: non-fungible tokens (NFTs)  are typically used for digital art, collectibles, or other one-of-a-kind items, their use cases are expanding in creative ways.

# Did you know?

## 1

### Luxury goods sellers

Some of the prominent brands are exploring using NFTs in conjunction with the sale of a luxury item to not only verify the authenticity of the item but also enable them to earn royalties on secondary market sales. Every time a luxury good changes hands, the accompanying NFT is transferred, triggering a small percentage fee back to the luxury brand company.

- These royalty payments and secondary sales would be considered taxable events. Under the new regulations, depending on the platform the sales occur on, the sales could be reportable on Form 1099-DA, Digital Asset Proceeds from Broker Transactions.

## 2

### Real estate transactions

In certain markets, 20 percent of real estate transactions now involve cryptocurrency—reshaping property deals. For example, a $22.5 million penthouse in Miami Beach, Florida was purchased entirely with cryptocurrency in 2021*.

- The new rules bring crypto-based real estate transactions under reporting requirements for the first time, potentially complicating the traditionally straightforward reporting in real estate deals.

## 3

### Basketball moments

The NBA's Top Shot platform allows fans to buy, sell, and trade digital "moments" from basketball games. These NFTs have generated over $1 billion in sales, and the platform takes a percentage from each transaction, creating a new revenue stream for the NBA and players.

- Not only would the initial sales be reportable under the new rules, but each subsequent trade of these NFTs could trigger reporting obligations, potentially leading to millions of additional Form 1099-DAs being issued annually.

## 4

### Decentralized finance (DeFi)

DeFi platforms allow users to lend and borrow cryptocurrencies without traditional intermediaries. One popular DeFi protocol has facilitated over $50 billion in loans, with users earning income by providing liquidity to these platforms.

- While the new rules hold off on DeFi, future regulations are expected to address DeFi platforms, making that income potentially reportable.

*Source: Forbes website, Forbeslife section, May 7 2022

# KPMG: Leading the digital asset race

The complexity of these digital asset regulations, their rapid evolution, and the expected high volume of Form 1099-DA filings, underscore the importance of a proactive and comprehensive approach to compliance.

At KPMG LLP (KPMG), we have dedicated technology, resources, and talent to not only help you navigate the rules as they come online, but also remain a step ahead of their continued evolution:

### Broad range of managed services

We provide validation of Forms W-9 and TIN matching, along with Form 1099-K, Form 1099-DA, Form 1099-MISC, and Form1099-B reporting as appropriate. This can be structured as a full outsourcing arrangement or a cosourcing option, depending on your needs.

### Strategic planning

We assist in creating a crypto product matrix with corresponding due diligence, withholding, and reporting obligations, helping you identify and manage reportable transactions across your product lines.

### Technical services

We help review system logic and write the business requirements and test cases for system builds and operational changes. These include electronic form processing, cost basis calculations, and reporting mechanisms.

### Compliance support

We offer support for voluntary disclosures related to past filing issues or failures to file, helping you address any historical compliance concerns.

### Advisory services

Our services include readiness and impact surveys to assess your preparedness, general tax technical consulting, and advisory assistance tailored to your specific digital asset needs.

### eDelivery

Our eDelivery tool helps you streamline your reporting process with electronic forms.

### Quality assurance

We conduct health checks to assess your readiness and identify any potential noncompliance for prior years, or to test if your compliance process works as envisioned.

### Access to insights

We provide access to subscription services, keeping you informed about the latest developments in digital asset reporting regulations.

### Holistic approach

Our services cover the entire spectrum from initial assessment to ongoing compliance, including writing business requirements, reviewing test cases, and providing general tax technical consulting.

### Customized services

We tailor our services to your specific needs, whether you require full outsourcing, cosourcing, or targeted assistance in specific areas of digital asset reporting compliance.

# Constant change

**The world of digital assets is a creative space that is continuously changing.**

New reporting regulations represent a significant shift in the tax landscape, but they will also continue to shift as the underlying technology evolves and companies find new and innovative use cases for these assets. Building, maintaining, and continuously updating the compliance infrastructure to stay ahead of these regulations will likely present a significant challenge for all but the largest organizations.

KPMG can help. As leaders in tax, technology, and digital assets, we have the skills and resources to help you anticipate changes, maintain compliance efficiently, and seize opportunities in this new era of digital.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

**Learn about us:** | **kpmg.com**