

3Q Crypto Update – New FASB Guidance & IRS Rules

On September 6, 2023, FASB approved narrowly focused [accounting guidance](#) for certain digital assets and a final accounting standard update (ASU) is expected to be released in the fourth quarter. This paper includes details on a new IRS proposal and legal challenges to determine federal oversight of this asset class.

Effective Dates
(early adoption permitted)

All Entities
Annual & interim periods beginning after
December 15, 2024

I. FASB Accounting Guidance

In March 2023, FASB issued an exposure draft on accounting for certain crypto assets in response to investor and preparer requests for guidance for this emerging asset class. Eighty-two comment letters were received and stakeholders generally supported the proposal with suggestions to expand scope and request clarification on certain presentation issues. FASB regrouped on September 6, 2023 to review comment letter feedback and finalize deliberations. In an effort to get guidance out in an expeditious manner, FASB made only minor changes to the proposal, mostly editorial in nature. Additional comment letter suggestions will be considered for a future project.

All decisions are subject to change until a final ASU is issued.

Scope

The new guidance would apply to all entities holding certain crypto assets. Covered crypto assets must meet the following criteria:

- Meet the intangible asset definition in the Codification Master Glossary
- Do not provide the asset holder with **enforceable rights** to, or claims on, underlying goods, services, or other assets. The basis of conclusion will be updated to explain that enforceable rights is a term used in other accounting guidance and does not require a legal opinion. This evaluation will require management judgment
- Are created or reside on a distributed ledger or “blockchain.” The final ASU also will include “or similar technology” to capture future technological innovations
- Are secured through cryptography
- Are fungible
- Are not created or issued by the reporting entity or its related parties. FASB clarified during its initial deliberations that a miner is not the creator of the newly created crypto assets it received as consideration for performing services if that is the only involvement that an entity has in the creation of the crypto asset. FASB reaffirmed this decision in September noting that this topic may be considered in a future project.

The final guidance will not cover items such as:

- Non-fungible tokens
- Wrapped tokens. FASB concluded wrapped tokens are complex instruments without a consistent definition and, based on FASB's outreach, not widely pervasive at this time. FASB will monitor the need for additional standard setting if wrapped tokens become more pervasive. Because wrapped tokens are excluded from scope, they should continue to be accounted for using the cost-less-impairment model
- Governance tokens

Investment Companies

Although industry-specific guidance, such as guidance for investment companies, currently permits or requires accounting for crypto assets at fair value, FASB decided that it would be beneficial to include those entities within the scope of this new guidance because investors would benefit from enhanced disclosures. Subtopic 946-205, *Financial Services—Investment Companies—Presentation of Financial Statements*, requires presentation of a statement of net assets, which includes a schedule detailing an entity's investments on a more disaggregated basis, and provides guidance on the presentation of changes in the fair value of investments in an investment company's statement of operations. FASB concluded that investment companies should continue to present amounts related to crypto assets in their financial statements in accordance with that industry-specific guidance.

Measurement

Under the new guidance, crypto assets would be measured at fair value under Accounting Standards Codification 820, *Fair Value Measurement*, with any changes in fair value reported in net income each reporting period. Certain costs incurred to acquire crypto assets, such as commissions, would be recognized as an expense (unless a company follows specialized industry measurement guidance that requires otherwise). The aggregate amount of crypto assets would be presented separately from other intangible assets that are measured using other measurement bases. Gains and losses on crypto assets would be reported in net income separately from the income statement effects of other intangible assets, such as amortization or impairments. Crypto assets received as noncash consideration during the ordinary course of business that are converted nearly immediately into cash would be classified as operating cash flows.

Disclosures

For annual and interim reporting periods, an entity would be required to disclose the following information:

- The name, cost basis, fair value, and number of units for each significant crypto asset holding and the aggregate fair values and cost bases of the crypto asset holdings that are not individually significant
- For crypto assets subject to restriction(s), the fair value of those crypto assets, the nature and remaining duration of the restriction(s), and the circumstances that could cause the restriction(s) to lapse

For annual reporting periods, an entity would be required to disclose the following information:

- A rollforward, in the aggregate, of activity in the reporting period for crypto asset holdings, including additions (with a description of the activities that resulted in the additions), dispositions, gains, and losses. If gains and losses are not presented separately, the entity is required to disclose the income statement line item in which those gains and losses are recognized
- For any dispositions of crypto assets in the reporting period, the difference between the sale price and the cost basis and a description of the activities that resulted in the dispositions

- The method for determining the cost basis of crypto assets

II. IRS

On August 25, 2023, the U.S. Department of the Treasury and IRS issued [proposed regulations](#) on the sale and exchange of digital assets by brokers. The proposal would apply to certain types of fungible and nonfungible digital assets, including NFTs. The proposal is designed to crack down on tax evasion related to digital assets and would:

- Require brokers of digital assets to report certain sales and exchanges
- Subject digital asset brokers to the same information-reporting rules as brokers for securities and other financial instruments
- Apply to operators of some platforms known as decentralized exchanges, to digital-asset-hosted wallet providers if they facilitate the purchase or sale of digital assets, and to individuals who use digital assets to purchase real estate

The proposal would require brokers to provide a new Form 1099-DA to help taxpayers determine whether they owe taxes starting in 2026 for sales and exchanges in 2025. The comment deadline ends on October 30, 2023, and Treasury plans to hold a public hearing in early November.

“If done correctly, these rules could help provide everyday crypto users with the necessary information to accurately comply with tax laws. However, it’s important to remember that the crypto ecosystem is very different from that of traditional assets, so the rules must be tailored accordingly and not capture ecosystem participants that don’t have a pathway to compliance.” – Kristin Smith, chief executive officer of the Blockchain Association¹

See the following **FORsights**[™] articles for additional tax updates on digital assets:

- [Federal Tax Implications of Digital Assets](#)
- [Current Sales & Use Tax Landscape of Cryptocurrency & NFTs](#)

¹ “Blockchain Association CEO Kristin Smith Statement on Proposed IRS Rules,” theblockchainassociation.org, August 25, 2023

III. Regulatory Oversight – Who’s in Charge?

Congress	Banking Regulators	Financial Market Regulators
U.S. House of Representatives	Federal Reserve (Fed)	U.S. Securities and Exchange Commission (SEC)
U.S. Senate	Federal Deposit Insurance Corporation (FDIC)	Commodity Futures Trading Commission (CFTC)
	Office of the Comptroller of the Currency (OCC)	

With the exception of the IRS, federal agencies are divided in how to regulate this evolving asset class. Unlike the securities and derivatives market, no single regulator oversees cryptocurrency, exchanges, or brokers. A security subject to SEC oversight is defined in the *Securities Act of 1933* and the benchmark interpretation is based on a 1946 U.S. Supreme Court case that resulted in the Howey test. The Howey test established four criteria to determine if an investment contract exists and is subject to U.S. securities laws:

- An investment of money
- In a common enterprise
- To be derived from the efforts of others
- With the expectation of profit

The SEC’s ability to regulate digital assets under existing securities law is dependent on the outcome of this test. Legal experts generally believe the first three criteria are easily satisfied for digital currencies. Whether a digital asset qualifies as an investment contract largely depends on whether there is an “expectation of profit to be derived from the efforts of others.” This answer is subject to interpretation and—not surprisingly—there is a sharp divide between crypto entrepreneurs and the SEC.

Currently, most crypto exchanges are regulated at the state level. The SEC has indicated that crypto exchanges listing digital securities should be treated as national securities exchanges; however, the SEC has not undertaken any new rule making to establish registration requirements and no plans are indicated to do so in the SEC’s most recent Reg Flex agenda.

The CFTC took an early lead on enforcing cryptocurrencies when it allowed bitcoin futures to start trading in 2017, but its powers are mostly limited to overseeing derivatives. On August 3, 2023, the Senate Agriculture Committee, which oversees the CFTC, introduced a bill that would grant the CFTC exclusive jurisdiction over cryptocurrency trades that meet commodities law.² Although the draft has bipartisan support, it is not clear if this bill has the votes to result in a new law.

To date, the SEC has brought more than 100 enforcement actions on crypto assets,³ but most have ended in settlement, rather than moving to a legal conclusion about the Howey test. In June 2023, the SEC charged [Coinbase](#) and [Binance](#) with operating as an unregistered securities exchange, broker, and clearing agency. Both companies have deep pockets and indicated they will challenge the charges, perhaps forcing a Supreme Court review of the Howey test.

² “A Senate proposal would give CFTC responsibility for policing bitcoin, Ethereum,” [washingtonpost.com](#), August 3, 2022

³ “SEC Tightens Cryptocurrency Enforcement,” [cornerstone.com](#), January 18, 2023

Ripple/XPR – Partial Victory?

In 2020, the SEC sued Ripple, alleging that the firm was selling unregistered securities. On July 13, 2023, U.S. District Judge Analisa Torres [ruled](#) that Ripple did not violate federal securities law by selling XRP tokens on a public exchange. However, the judge held that Ripple did violate the law by selling XRP directly to sophisticated investors. The judge's ruling notes that Ripple's XRP sales on public cryptocurrency exchanges were not offers of securities under the law, because purchasers did not have a reasonable expectation of profit tied to Ripple's efforts. Torres ruled that Ripple's marketing aimed at institutional investors made clear the company "was pitching a speculative value proposition for XRP" that depended on company efforts to develop the blockchain infrastructure behind the digital asset. The split decision allowed both sides to claim victory, but the SEC has indicated that it will challenge this ruling, perhaps finally forcing a decision if crypto assets can be regulated by the SEC as securities.

Proposed Regulation

Until the Howey test is resolved, the SEC has recently issued several proposals that could impact the crypto industry. The SEC's authority to regulate these areas will likely be subject to legal challenges.

1. Asset Safeguarding & Custody Proposal

On February 15, 2023, the SEC approved a [proposal](#) to significantly expand investor protection on advisory client assets. The proposal would expand the custody rule's scope to cover additional client assets, including crypto assets that may not be classified as either funds or securities. The proposal's impact on the crypto market is unclear. Some crypto exchanges, like Coinbase, may meet the proposed definition of a qualified custodian. Others welcomed the clarity of rule setting versus an enforcement approach (although enforcement actions continue to ramp up).

On August 23, 2023, the SEC reopened the comment period until October 30, 2023, which means a final rule will be pushed to 2024 at the earliest.

Resource: [Expansion of Adviser's Safeguarding & Custody Rules?](#)

2. Alternative Trading Systems (ATs)

On January 26, 2022, the SEC issued a [proposal](#) to expand and modernize the ATS rules. ATs are trading systems for securities that meet the exchange definition under federal securities laws but are not required to register with the SEC as a national securities exchange (NSE) if the ATS complies with certain exemptions. Communication protocol systems (CPSs) are platforms that bring together security buyers and sellers and provide similar functionality to marketplaces operated by NSEs and ATs but are not subject to the same regulations. Investors using CPSs do not receive the same investor protection, transparency, and oversight. A CPS that meets the updated "exchange" definition has two choices:

- Register as an exchange and be a self-regulated organization subject to the requirements of Exchange Act Section 6
- Comply with the conditions of the Regulation ATS exemption, which includes registering as a broker-dealer

The new definition could encompass some cryptocurrency platforms to bring them under SEC supervision. Blockchain and decentralized finance groups pushed back on SEC overreach in applying existing concepts to recent technology innovations. The SEC's spring Reg Flex agenda does not list this as a deliverable before October 2023.

Resource: [New Rules & Expanded Scope for Alternate Trading Systems](#)

IV. Federal Reserve

In January 2023, the Fed issued a policy statement that limited state member banks to activities that are allowed for national banks. In [Interpretive Letter 1174](#), the OCC specifically recognized the authority of national banks to use distributed ledger technology or similar technologies to conduct payments activities as principal, including by issuing, holding, or transacting in dollar tokens if the bank has controls to conduct the activity in a safe and sound manner. On August 8, 2023, the Fed provided additional [details](#) for state banks. To verify that a state bank has the proper controls in place, it must receive a written notification of supervisory nonobjection from the Federal Reserve before engaging in the proposed activities. A state member bank must demonstrate that it has established appropriate risk management practices for the proposed activities, including having adequate systems in place to identify, measure, monitor, and control the risks of its activities, and the ability to do so on an ongoing basis, including, but not limited to:

- **Operational risks** – Risks associated with the governance and oversight of the network; clarity of the roles, responsibilities, and liabilities of parties involved; and the transaction validation process
- **Cybersecurity risks** – Risks associated with the network on which the dollar token is transacted, the use of smart contracts, and any use of open source code
- **Liquidity risks** – The risk that the dollar token could experience substantial redemptions in a short period of time that would trigger rapid outflows of deposits
- **Illicit finance risks** – Risks relating to compliance with the Bank Secrecy Act and Office of Foreign Assets Control requirements, which include requiring banking organizations to verify the identity of a customer, perform due diligence to understand the nature and purpose of the customer relationship, and perform ongoing monitoring to identify and report suspicious activity
- **Consumer compliance risks** – Risks related to identifying and ensuring compliance with any consumer protection statutes and regulations that apply to the specific dollar token activity

Conclusion

FORVIS will continue to follow cryptocurrency tax, regulatory, and accounting developments. For more information, visit forvis.com.

Contributors

Anne Coughlan

Director

anne.coughlan@forvis.com

Nik Fahrer

Senior Manager

nik.fahrer@forvis.com