

Key Digital Asset Proposals in the Biden Administration's Green Book

Article By:

John T. Lutz

William R. Pomierski

Andrew M. Granek

On March 28, 2022, the US Department of the Treasury released the Fiscal Year (FY) 2023 Revenue Proposals and Green Book, which describes the tax proposals in the Biden administration's FY 2023 budget (2023 Budget Proposal). The 2023 Budget Proposal, if enacted in its current form, would expand the treatment of securities loans and mark-to-market tax accounting to include digital assets. It would also expand information reporting by certain financial institutions and brokers, as well as the reporting requirements for certain taxpayers who hold foreign digital assets. However, the Green Book does not include a definition of digital assets for these purposes. As a result, we expect that "digital assets" will have the same meaning as new Section 6045(g)(3)(D) of the Internal Revenue Code (Code) of 1986, as amended. This article summarizes the key 2023 Budget Proposals concerning digital assets.

IN DEPTH

DIGITAL ASSET LOANS

Code Section 1058 generally provides that a taxpayer does not recognize gain or loss in connection with a loan of securities if certain requirements are met, including:

1. The return to the transferor of securities identical to the securities transferred
2. Certain payments made to the transferor of which the owner of the securities is entitled to receive during the course of the loan
3. No reduction of the transferor's risk of loss or opportunity for gain in the securities transferred.

For this purpose, "securities" means corporate stock, notes, bonds, debentures and other evidence

of indebtedness, and any evidence of an interest in, or right to, purchase any of the foregoing.

The 2023 Budget Proposal would extend the nonrecognition of Code Section 1058 to loans of actively traded digital assets that are recorded on cryptographically secured distributed ledgers, provided that the loan has terms similar to those currently required for loans of securities as described above (e.g., any digital assets received by the borrower from airdrops or hard forks that occur during the course of the loan will be transferred to the lender). The US Secretary of the Treasury would have the authority to determine when a digital asset is actively traded, as well as the authority to extend the rules to non-actively traded digital assets.

Adoption of this proposal would provide taxpayers with assurances that a transfer of digital assets pursuant to a properly structured Code Section 1058 loan agreement would not result in a taxable disposition.

MARK-TO-MARKET TAX ACCOUNTING

Code Section 475 requires dealers in securities to use the mark-to-market method of tax accounting for securities held at year end. Dealers in commodities and traders in securities or commodities may elect to use the mark-to-market method. Under current law, it's unclear whether most digital assets would constitute a "commodity" for Code Section 475 purposes. As we have previously noted, Bitcoin and Ethereum are likely to be treated as commodities for these purposes because futures on these cryptocurrencies are traded on a commodities exchange. Additionally, because the tax definition of a commodity relies, in part, on how the Commodity Futures Trading Commission (CFTC) regulates cryptocurrencies and other digital assets, certain other cryptocurrencies and futures could be treated as commodities for tax purposes as well. (See "[Can a Virtual Currency Position Be Treated as a Commodity for Tax Purposes?](#)") However, based on existing guidance, the tax treatment for such other cryptocurrencies and futures is less certain.

The 2023 Budget Proposal would add actively traded digital assets, including derivatives on—or hedges of—actively traded digital assets, as an additional category of assets that are covered by Code Section 475. This would avoid the question of what a commodity under current law is. Again, the Treasury Secretary would have the authority to determine which digital assets are treated as actively traded, taking into account relevant facts and circumstances, which may include whether the digital asset is regularly bought and sold for US dollars or other fiat currencies, the volume of trading the digital asset on exchanges that have reliable valuations and the availability of reliable price quotations.

While the 2023 Budget Proposal is silent as to whether certain digital assets might be considered as commodities under current law, it does state that digital assets are eligible for the mark-to-market election for Code Section 475 purposes *only* if such digital asset meets the requirements of an "actively traded digital asset."

DIGITAL ASSETS HELD OFFSHORE

Under current law, Code Section 6038D requires individual taxpayers (and certain US entities) who hold an interest in one or more "specified foreign financial assets" with an aggregate value of at least \$50,000 during a taxable year to attach a statement (currently provided on Internal Revenue Service (IRS) Form 8938, Statement of Specified Foreign Financial Asset) to the individual taxpayer's federal income tax return. A "specified foreign financial asset" means (1) a financial account maintained by a foreign financial institution and (2) certain specified foreign assets not held in a financial account

maintained by such a financial institution. In general, taxpayers are required to report the name and address of the financial institution where an account is maintained, the account number and identifying information about assets not held in a financial account. Failure to provide the required information for a taxable year can result in penalties.

The 2023 Budget Proposal would expand the definition of “specified foreign financial assets” to include any account that holds digital assets maintained by a foreign digital asset exchange or other foreign digital asset service provider (foreign digital asset account). A foreign digital asset account would be based on where the exchange or service provider is organized or established.

INFORMATION REPORTING

Generally, any person doing business as a broker (*i.e.*, a dealer, barter exchange or a person who, for a consideration, regularly acts as a middleman with respect to property or services) is required to report certain information about its customers to the IRS, such as the identity of each customer and the gross proceeds from sales of certain securities and commodities. Recently enacted Section 80603 of the Infrastructure Investment and Jobs Act of 2021 clarified that a broker includes any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person. For this purpose, the term “digital asset” means any digital representation of value that is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Treasury Secretary.

The 2023 Budget Proposal provides that brokers, such as US digital asset exchanges, would be required to report information relating to the substantial foreign owners of the passive entities that hold digital assets. By adopting such rules, brokers would be required to report gross proceeds and other information as the Treasury Secretary may require regarding the sale of digital assets with respect to customers and, in the case of certain passive entities, their substantial foreign owners.

EFFECTIVE DATES

In general, most of the proposals described herein take effect for taxable years beginning after December 31, 2022, except the rules relating to brokers, which would take effect for taxable years beginning after December 31, 2023.

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