

Identifying Digital Assets

Take-Away: The IRS recently provided guidance on how to identify digital assets held by a broker when the digital assets are sold or exchanged for the purpose of determining tax basis and the holding period for the transferred digital assets.

Background: The IRS has defined cryptocurrency as *property*, which means that the sale or surrender of cryptocurrency can lead to gain recognition event for the owner's tax reporting purposes.

Notice 2025-7: In its recent Notice 2025-7 (issued on December 31, 2024) the IRS describes methods for adequately identifying digital assets held by a broker when those digital assets are sold or exchanged. This Notice is a follow-up to the Final Treasury Regulations issued last July 9, [effective January 1, 2025] which addressed when multiple units of the same digital asset are held in the custody of a broker, requiring *adequate identification* of the digital asset that is subject to tax reporting.

Digital Asset: A *digital asset* is defined as any digital representation of value that is recorded on a cryptographically secured distributed ledger, or any similar technology, without regard to whether each individual transaction involving that digital asset is recorded on that ledger, and which is not cash. [Regulation 1.1012-1(j)(1); Regulation 1.6045-1(a)(19)(i).]

Adequate Identification: *Adequate identification* of the digital asset occurs if, not later than the date and time of the sale, disposition, or transfer, the individual digital asset owner:

- Specifies to the broker the particular units of the digital asset to be sold, disposed of, or transferred by reference to any identification, such as purchase date and time, or purchase price, that the broker designates as sufficiently specific to identify the digital units sold, disposed of, or transferred; **or**
- The broker has a standing order or instruction for the specific identification of digital assets, which is treated as an *adequate identification* made at the time of sale, disposition, or transfer.

- If a broker only allows one method of making a specific identification, for example by the earliest date on which units of this same digital asset were acquired, the latest date on which units of the same digital asset were acquired, or the highest cost basis- this method is treated as a standing order or instruction by the digital asset owner. [Regulation 1.1012-1(j)(3)(ii).]

Presumption if No Adequate Identification: In the absence of any *adequate identification*, units of digital assets held by a broker are treated as sold, disposed of, or transferred in order of the time from the earliest date on which units of that same digital asset held by the broker were acquired by the asset owner, in other words a ***first in, first out rule*** will be applied by the IRS. [Regulation 1.1012-1(g)(3)(i).]

Temporary Relief: Since many digital asset brokers may not have in place the technology that is needed to accept specific instructions from a digital asset owner, or any standing orders from the asset owner, the IRS will provide asset owners temporary relief throughout 2025. [Notice 2025-7, Sections 2, 3.03, and 4.01.] However, if a digital asset owner makes an *adequate identification* under Notice 2025-7, the rule that treats the owner whose broker offers only one method of making specific identification as having made a standing order or instruction **will not apply during the relief period**. [Notice 2025-7, Section 4.03.]

Conclusion: As more individuals decide to speculate and hold digital assets, the need to identify those digital assets sold or exchanged by their owner will become even more important for tax reporting purposes, along with the tax revenues that Congress expects to receive from this higher level of tracking and reporting. The final Regulations and Notice 2025-7 are just the beginning of the expected onslaught of rules and regulations that will be applied to digital currencies in the next few years.

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