

## Treasury Department, IRS Issue Final Regulations and Transitional Guidance for Digital Asset Industry Applicable to Decentralized Finance Platforms

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On December 30, 2024, the US Department of the Treasury and IRS issued [final regulations](#) providing guidance on tax reporting requirements applicable to certain decentralized finance (DeFi) platforms operating as “brokers” of digital assets. These regulations finalize the proposed regulations that we covered in [this October 2023 alert](#), which were finalized in part by regulations that we discussed in [this July 2024 alert](#).

The final regulations extend broker reporting requirements to certain participants in the digital asset industry. Specifically, the regulations apply to DeFi platforms in the form of trading front-end services if the nature of the services is such that the service providers ordinarily would know or be in a position to know the nature of the transactions potentially giving rise to gross proceeds from the sale of digital assets. A trading front-end service is a service that receives a person’s order to sell a digital asset and processes that order for execution by providing user interface services designed to enable the person to input and transmit order details with respect to a transaction that will be carried out or settled on a cryptographically secured distributed ledger (or any similar technology), including by transmitting the order details to the person’s wallet in a form that, if authorized by the person, causes the order details to be transmitted to a distributed ledger network for interaction with a digital asset trading protocol.

As discussed in our July 2024 alert, the previous final regulations generally addressed digital asset industry participants that take custody or possession of customers’ digital assets (custodial brokers) and private keys, and functionally resemble traditional securities brokers. Those regulations did not address other participants in the DeFi industry that do not take custody of private keys – such as “digital asset middlemen” – which generally raise more complex technical and policy issues.

The newly finalized regulations are aimed at this gap. In the preamble to the new final regulations, the Treasury Department and IRS describe the DeFi industry using a three-part model composed of interface, application and settlement layers. The interface layer provides user-friendly interfaces and other tools that connect digital asset users to other parts of the DeFi ecosystem. The application layer includes DeFi protocols that execute user trades through smart contracts, as well as aggregators that place trades through one or more other DeFi protocols based on user inputs. Finally, the settlement layer records executed transactions on a distributed ledger.

The new final regulations focus on the interface layer as a common point of contact between most digital asset users and the rest of the DeFi industry. Consistent with the approach of the proposed regulations, the final regulations treat digital asset middlemen as brokers for purposes of the information reporting and backup withholding requirements. The final regulations generally define digital asset middlemen as providers of trading front-end services, meaning user interfaces that enable customers to trade digital assets through DeFi protocols, but only if the service provider ordinarily would know or be in a position to know the nature of the transaction potentially giving rise to gross proceeds from the sale of digital assets.

Providers of certain other services that effectuate trades of digital assets also are included within the final regulations’ definition of digital asset middleman. Processors of digital asset payments (PDAPs) that stand ready to facilitate payments between parties by

receiving payments of digital assets from one party and paying digital assets or cash to another party are treated as digital asset middlemen. However, merchants that accept digital assets as payment generally aren't treated as brokers. The new final regulations also explicitly exclude unhosted wallets (to the extent not providing trading front-end services) and validation services (whether through proof of work, proof of stake or any other similar consensus mechanism).

A provider of trading front-end services ordinarily will know or be in a position to know the nature of a transaction if they are able to maintain sufficient control or influence over such services to determine whether and to what extent a transfer of digital assets involves a transaction giving rise to gross proceeds. A provider of trading front-end services that has the ability to amend, update or otherwise substantively affect the terms on which services are provided or the manner in which an order is processed is treated as having sufficient control to determine the nature of a transaction. Furthermore, a provider with the ability to confirm that a transaction has been executed generally will be able to determine whether a transfer gives rise to gross proceeds. For example, a provider could add to each order a sequence of instructions to query the distributed ledger to confirm that the order has been processed. Alternatively, a provider with the ability to collect fees for trading front-end services directly from the transaction flow will be able to determine that a transaction has been completed when their fee is received. In adopting this standard, the Treasury Department and IRS rejected numerous comments from the public that various types of trading front-end service providers do not have sufficient visibility to be in a position to know the nature of a transaction and placed the onus on such providers to update their policies to accommodate tax reporting compliance.

The final regulations do not include a separate requirement that a digital asset middleman ordinarily be in a position to know the identity of the party that makes a sale. The preamble to the final regulations observes that the definition of digital asset middleman is limited to service providers with direct connections to customers, and therefore the digital asset middlemen should be able to require information about the identity of customers as part of their onboarding procedures. In contrast, the proposed regulations had a broader definition that potentially included participants in the application layer that would not necessarily be in a position to know information about the parties to a transaction. The preamble also noted that there is currently no knowledge standard for any other brokers regarding the identity of customers, because the rules treat as brokers only those persons that have access to customers.

The Treasury Department and IRS continue to study certain transactions involving digital assets that are not included in the scope of the final regulations. The final regulations do not require information reporting or backup withholding for transactions made using DeFi protocols or aggregators of DeFi protocols that are not initiated through a trading front-end service provider. In addition, the Treasury Department and IRS continue to study the transactions enumerated in [Notice 2024-57](#), as discussed in [this July 2024 alert](#).

The final regulations will apply to sales of digital assets on or after January 1, 2027. Contemporaneously with the new final regulations, the IRS issued [Notice 2025-3](#), which provides transition relief from reporting penalties that would otherwise apply to failures to report sales of digital assets on information returns or furnish payee statements effected in calendar year 2028 for sales of digital assets effected in calendar year 2027. Relief is available for brokers providing trading front-end services that have made a good-faith effort to comply with applicable regulations. Notice 2025-3 also provides transition relief from liabilities and penalties associated with such a broker's failure to comply with backup withholding requirements for any sales of digital assets during calendar year 2027 and certain digital asset sales during calendar year 2028 for which the broker submits payee information to the IRS tax identification number matching system.

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