

## **Reg. Section 1.1012-1(j)(3)(i)**

### **Basis of property**

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(j) Sale, disposition, or transfer of digital assets. Paragraphs (j)(1) and (2) of this section apply to digital assets not held in the custody of a broker, such as digital assets that are held in an unhosted wallet. Paragraph (j)(3) of this section applies to digital assets held in the custody of a broker. For the definitions of the terms wallet, hosted wallet, unhosted wallet, and held in a wallet or account, as used in this paragraph (j), see § 1.6045-1(a)(25)(i) through (iv). For the definition of the term broker, see § 1.6045-1(a)(1). For the definition of the term digital asset, see § 1.6045-1(a)(19); however, a digital asset not required to be reported as a digital asset pursuant to § 1.6045-1(c)(8)(ii), (iii), or (iv) is not subject to the rules of this section.

(1) Digital assets not held in the custody of a broker. If a taxpayer sells, disposes of, or transfers less than all units of the same digital asset not held in the custody of the broker, such as in a single unhosted wallet or in a hosted wallet provided by a person other than a broker, the basis and holding period of the units sold, disposed of, or transferred are determined by making a specific identification of the units in the wallet that are sold, disposed of, or transferred, as provided in paragraph (j)(2) of this section. If a specific identification is not made, the basis and holding period of the units sold, disposed of, or transferred are determined by treating the units not held in the custody of a broker as sold, disposed of, or transferred in order of time from the earliest date on which units of the same digital asset not held in the custody of a broker were acquired by the taxpayer. For purposes of the preceding sentence, the date any units were transferred into the taxpayer's wallet is disregarded.

(2) Specific identification of digital assets not held in the custody of a broker. A specific identification of the units of a digital asset sold, disposed of, or transferred is made if, no later than the date and time of the sale, disposition, or transfer, the taxpayer identifies on its books and records the particular units to be sold, disposed of, or transferred by reference to any identifier, such as purchase date and time or the purchase price for the unit, that is sufficient to identify the units sold, disposed of, or transferred. A specific identification can be made only if adequate records are maintained for the unit of a specific digital asset not held in the custody of a broker to establish that a unit sold, disposed of, or transferred is removed from the wallet.

(3) Digital assets held in the custody of a broker. This paragraph (j)(3) applies to digital assets held in the custody of a broker.

(i) Unit of a digital asset sold, disposed of, or transferred. Except as provided in paragraph (j)(3)(iii) of this section, where multiple units of the same digital asset are held in the custody of a broker, as defined in § 1.6045-1(a)(1), and the taxpayer does not provide the broker with an adequate identification of which



units are sold, disposed of, or transferred by the date and time of the sale, disposition, or transfer, as provided in paragraph (j)(3)(ii) of this section, the basis and holding period of the units sold, disposed of, or transferred are determined by treating the units held in the custody of the broker as sold, disposed of, or transferred in order of time from the earliest date on which units of the same digital asset held in the custody of a broker were acquired by the taxpayer. For purposes of the preceding sentence, the date any units were transferred into the custody of the broker is disregarded.

(ii) Adequate identification of units held in the custody of a broker. Except as provided in paragraph (j)(3)(iii) of this section, where multiple units of the same digital asset are held in the custody of a broker, as defined in §1.6045-1(a)(1), an adequate identification occurs if, no later than the date and time of the sale, disposition, or transfer, the taxpayer specifies to the broker having custody of the digital assets the particular units of the digital asset to be sold, disposed of, or transferred by reference to any identifier, such as purchase date and time or purchase price, that the broker designates as sufficiently specific to identify the units sold, disposed of, or transferred. The taxpayer is responsible for maintaining records to substantiate the identification. A standing order or instruction for the specific identification of digital assets is treated as an adequate identification made at the time of sale, disposition, or transfer. In addition, a taxpayer's election to use average basis for a covered security for which average basis reporting is permitted and that is also a digital asset is also an adequate identification. In the case of a broker offering only one method of making a specific identification, such method is treated as a standing order or instruction.

(iii) Special rule for the identification of certain units withheld. Notwithstanding paragraph (j)(3)(i) or (ii) of this section, in the case of a transaction described in paragraph (h)(1)(iv) of this section (digital assets exchanged for different digital assets) and for which the broker withholds units of the same digital asset received for either the broker's backup withholding obligations under section 3406 of the Code, or for payment of services described in §1.1001-7(b)(1)(ii) (digital asset transaction costs), the taxpayer is deemed to have made an adequate identification, within the meaning of paragraph (j)(3)(ii) of this section, for such withheld units regardless of any other adequate identification within the meaning of paragraph (j)(3)(ii) of this section designating other units of the same digital asset as the units sold, disposed of, or transferred.

(4) Method for specifically identifying units of a digital asset. A method of specifically identifying the units of a digital asset sold, disposed of, or transferred under this paragraph (j), for example, by the earliest acquired, the latest acquired, or the highest basis, is not a method of accounting. Therefore, a change in the method of specifically identifying the digital asset sold, disposed of, or transferred, for example, from the earliest acquired to the latest acquired, is not a change in method of accounting to which sections 446 and 481 of the Code apply.

(5) Examples. The following examples illustrate the application of paragraphs (j)(1) through (j)(3) of this section. Unless the facts specifically state otherwise, the transactions described in the following examples occur after the applicability date set forth in

paragraph (j)(6) of this section. For purposes of the examples under this paragraph (j)(5), assume that TP is a digital asset investor and that the units of digital assets in the examples are the only digital assets owned by TP.

(i)

Example (1). Identification of digital assets not held in the custody of a broker.

(A) Facts. On September 1, Year 2, TP transfers two lots of digital asset DE to a new digital asset address generated and controlled by an unhosted wallet, as defined in § 1.6045-1(a)(25)(iii). The first lot transferred into TP's wallet consists of 10 units of digital asset DE, with a purchase date of January 1, Year 1, and a basis of \$2 per unit. The second lot transferred into TP's wallet consists of 20 units of digital asset DE, with a purchase date of January 1, Year 2, and a basis of \$5 per unit. On September 2, Year 2, when the DE units have a fair market value of \$10 per unit, TP purchases \$100 worth of consumer goods from Merchant M. To make payment, TP transfers 10 units of digital asset DE from TP's wallet to CPP, a processor of digital asset payments as defined in § 1.6045-1(a)(22), that then pays \$100 to M, in a transaction treated as a sale by TP of the 10 units of digital asset DE. Prior to making the transfer to CPP, TP keeps a record that the 10 units of DE sold in this transaction were from the second lot of units transferred into TP's wallet.

(B) Analysis. Under the facts in paragraph (j)(5)(i)(A) of this section, TP's notation in its records on the date of sale, prior to the time of the sale, specifying that the 10 units sold were from the 20 units TP acquired on January 1, Year 2, is a specific identification within the meaning of paragraph (j)(2) of this section. TP's notation is sufficient to identify the 10 units of digital asset DE sold. Accordingly, TP has identified the units disposed of for purposes of determining the basis (\$5 per unit) and holding period (one year or less) of the units sold in order to purchase the merchandise.

(ii)

Example (2). Identification of digital assets not held in the custody of a broker.

(A) Facts. The facts are the same as in paragraph (j)(5)(i)(A) of this section (the facts in Example 1), except in making the transfer to CPP, TP did not keep a record at or prior to the time of the sale of the specific 10 units of digital asset DE that TP intended to sell.

(B) Analysis. TP did not make a specific identification within the meaning of paragraph (j)(2) of this section for the 10 units of digital asset DE that were sold. Pursuant to the ordering rule provided in paragraph (j)(1) of this section, the units disposed of are determined by treating the units held in the unhosted wallet as disposed of in order of time from the earliest date on which units of the same digital asset held in the unhosted wallet were acquired by the taxpayer. Accordingly, TP must treat the 10 units sold as the 10 units with a purchase date of January 1, Year 1, and a basis of \$2 per unit, transferred into the wallet.

(iii)

Example (3). Identification of digital assets held in the custody of a broker.

(A) Facts. On August 1, Year 1, TP opens a custodial account at CRX, a broker within the meaning of § 1.6045-1(a)(1), and purchases through CRX 10 units of digital asset DE for \$9 per unit. On January 1, Year 2, TP opens a custodial account at BEX, an unrelated broker, and purchases through BEX 20 units of digital asset DE for \$5 per unit. On August 1, Year 3, TP transfers the digital assets TP holds with CRX into TP's custodial account with BEX. BEX has a policy that purchase or transfer date and time, if necessary,

is a sufficiently specific identifier for customers to determine the units sold, disposed of, or transferred. On September 1, Year 3, TP directs BEX to sell 10 units of digital asset DE for \$10 per unit and specifies that BEX sell the units that were purchased on January 1, Year 2. BEX effects the sale.

(B) Analysis. No later than the date and time of the sale, TP specified to BEX the particular units of digital assets to be sold. Accordingly, under paragraph (j)(3)(ii) of this section, TP provided an adequate identification of the 10 units of digital asset DE sold. Accordingly, the 10 units of digital asset DE that TP sold are the 10 units that TP purchased on January 1, Year 2.

(iv)

Example (4). Identification of digital assets held in the custody of a broker.

(A) Facts. The facts are the same as in paragraph (j)(5)(iii)(A) of this section (the facts in Example 3) except that TP directs BEX to sell 10 units of digital asset DE but does not make any identification of which units to sell. Additionally, TP does not provide purchase date information to BEX with respect to the units transferred into TP's account with BEX.

(B) Analysis. Because TP did not specify to BEX no later than the date and time of the sale the particular units of digital assets to be sold, TP did not make an adequate identification within the meaning of paragraph (j)(3)(ii) of this section. Thus, the ordering rule provided in paragraph (j)(3)(i) of this section applies to determine the units of digital asset DE sold. Pursuant to this rule, the units sold must be determined by treating the units held in the custody of the broker as disposed of in order of time from the earliest date on which units of the same digital asset held in the custody of a broker were acquired by the taxpayer. The 10 units of digital asset DE sold must be attributed to the 10 units of digital asset DE acquired on August 1, Year 1, which are the earliest units of digital asset DE acquired by TP that are held in TP's account with BEX. In addition, because TP did not provide to BEX customer-provided acquisition information as defined in §1.6045-1(d)(2)(ii)(B)(4) with respect to the units transferred into TP's account with BEX (or adopt a standing order to follow the ordering rule applicable to BEX under §1.6045-1(d)(2)(ii)(B)(2)), the units determined as sold by BEX under §1.6045-1(d)(2)(ii)(B)(1) and that BEX will report as sold under §1.6045-1 are not the same units that TP must treat as sold under this section. See §1.6045-1(d)(2)(vii)(C) (Example 3).

(v)

Example (5). Identification of the digital asset used to pay certain digital asset transaction costs.

(A) Facts. On January 1, Year 1, TP purchases 10 units of digital asset AB and 30 units of digital asset CD in a custodial account with DRX, a broker within the meaning of §1.6045-1(a)(1). DRX has a policy that purchase or transfer date and time, if necessary, is a sufficiently specific identifier by which its customers may identify the units sold, disposed of, or transferred. On June 30, Year 2, TP directs DRX to purchase 10 additional units of digital asset AB with 10 units of digital asset CD. DRX withholds one unit of the digital asset AB received for transaction fees. TP does not make any identification of the 1 unit of digital asset AB withheld by DRX. TP engages in no other transactions.

(B) Analysis. DRX's withholding of 1 unit of digital asset AB from the 10 units acquired by TP is a disposition by TP of the 1 unit as of June 30, Year 2. See §§ 1.1001-7 and 1.1012-1(h) for determining the amount realized and basis of the disposed unit,

respectively. Despite TP not making an adequate identification, within the meaning of paragraph (j)(3)(ii) of this section to DRX of the 1 unit withheld, under the special rule of paragraph (j)(3)(iii) of this section, the withheld unit of AB must be attributed to the units of AB acquired on June 30, Year 2 and held in TP's account with DRX.

(vi)

Example (6). Identification of the digital asset used to pay certain digital asset transaction costs.

(A) Facts. The facts are the same as in paragraph (j)(5)(v)(A) of this section (the facts in Example 5) except that TP has a standing order with BEX to treat the earliest unit purchased in TP's account as the unit sold, disposed of, or transferred.

(B) Analysis. The transaction is an exchange of digital assets for different digital assets and for which the broker withholds units of the same digital asset received in order to pay digital asset transaction costs. Accordingly, although TP's standing order to treat the earliest unit purchased in TP's account (that is, the units purchased by TP on January 1, Year 1) as the units sold is an adequate identification under paragraph (j)(3)(ii) of this section, TP is deemed to have made an adequate identification for such withheld units pursuant to paragraph (j)(3)(iii) of this section regardless of TP's adequate identification designating other units as the units sold. Thus, the results are the same as provided in paragraph (j)(5)(v)(B) of this section (the analysis in Example 5).

(6)Applicability date. This paragraph (j) is applicable to all acquisitions and dispositions of digital assets on or after January 1, 2025.

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