

What the IRS's New Form 1099-DA Means for DeFi Users

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In this article, Zaslowsky and Holleman argue that, for users who engage in decentralized finance, the rollout of Form 1099-DA, "Digital Asset Proceeds," may cause increased confusion, inaccurate reporting, and heightened audit risk stemming from the mismatch between how crypto transactions function and how they will be reported on the form.

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For years, U.S. crypto owners operated in a tax gray zone. The IRS made clear that digital assets were taxable, but information reporting lagged far behind the systems used for stocks and other traditional securities. That gap is now closing. Beginning with the rollout of the new IRS Form 1099-DA, “Digital Asset Proceeds,” for the 2025 tax year, the federal government is moving crypto reporting toward the familiar broker-based regime long used for stocks and bonds. Brokers were required to furnish these forms to taxpayers by February 17, 2026.

For some crypto holders, this shift may feel overdue but manageable. For others — particularly those who actively engage with decentralized finance (DeFi) — Form 1099-DA represents something more problematic: a growing mismatch between how crypto transactions actually function and how the tax system assumes financial activity occurs. The result may not be improved clarity, but increased confusion, inaccurate reporting, and heightened audit risk.

What Is Form 1099-DA?

Form 1099-DA is designed to require “digital asset brokers” to report certain transactions involving digital assets to both taxpayers and the IRS. In concept, it mirrors the securities world: Brokers report gross proceeds, dates, and (eventually) cost basis, allowing the IRS to match taxpayer returns against third-party information.

For investors who treat crypto like stock — buying on a centralized exchange, holding, and then selling — this framework may appear relatively straightforward. A sale generates a Form 1099-DA, the numbers flow to Schedule D, and the compliance exercise is familiar. But crypto is not merely a speculative asset. It is programmable, composable, and often used as financial infrastructure rather than as an investment product. And it is at that point — when crypto is used rather than traded — that the reporting model begins to break down.

Crypto Is Not a Stock — And DeFi Makes That Clear

Traditional securities reporting assumes a simple transactional model:

1. You buy an asset.
2. You hold it.
3. You sell it.
4. Gain or loss is measured by comparing purchase price to sale price.

DeFi activity rarely fits that pattern.

DeFi users lend tokens, borrow against them, stake them, restake them, wrap them, unwrap them, provide liquidity, receive liquidity provider tokens, swap assets across protocols, and interact with smart contracts in ways that rarely resemble a “sale” in any economic or tax sense. Yet many of these actions involve on-chain transfers that, when viewed in isolation, can appear indistinguishable from dispositions. Form 1099-DA risks collapsing this complexity into a stock-like reporting model — treating multifaceted protocol interactions as simple brokerage transactions when they are anything but.

The Broker Problem: Who Is Reporting What?

One of the most controversial aspects of Form 1099-DA is the definition of a digital asset broker. In traditional finance, brokers are easy to identify. In DeFi, they are not.

Many DeFi protocols rely on autonomous smart contracts to execute core functions. There is no intermediary executing trades, holding customer funds, or even knowing the identity of users. In response, the regulatory focus has shifted toward front ends, hosted interfaces, and other participants who may facilitate access to protocols.

One of the central problems with the new IRS Form 1099-DA is that it assumes the existence of an intermediary capable of reliably identifying and reporting taxable events — an assumption that often fails with decentralized finance. Thus, an intermediary may see a wallet interact with a contract, but does not know:

- the user’s overall tax posture;
- the original cost basis of assets;
- whether a transaction is economically a loan, a deposit, a swap, or something else; or
- whether the transaction is part of a multistep strategy rather than a stand-alone disposition.

Phantom Income and Mismatched Reporting

Because Form 1099-DA requires the reporting of gross proceeds rather than net economic outcomes, DeFi users face a heightened risk of phantom income.

For example:

- Providing liquidity may result in receipt of liquidity provider tokens, which could be interpreted as proceeds.
- Wrapping or bridging tokens may appear as a “disposal” followed by an acquisition.
- Moving assets between wallets or protocols may look like a transfer to a third party.

If a Form 1099-DA reports gross proceeds without context, the IRS may assume taxable income where none exists. In that case, if the taxpayer’s report of income and loss on their tax return differs materially from what was reported on the Form 1099-DA, the taxpayer may bear the burden of explaining the discrepancy on audit. Without the ability to independently reconstruct cost basis and provide transactional context (such as identifying nontaxable self-transfers or wrapped tokens), users may be taxed on the full value of their assets rather than their actual profits.

Cost Basis: The DeFi Nightmare

Cost basis tracking is hard enough for centralized trading. In DeFi, it can be nearly impossible. Consider a user who:

- acquires ether;
- uses it as collateral to borrow a stablecoin;
- deploys the borrowed funds into a yield strategy;
- repays the loan with proceeds; and
- withdraws collateral.

At no point has the user “sold” ether in the ordinary sense or exited their position economically. Yet multiple on-chain events occur, each potentially visible to a broker, front-end, or other entity attempting to comply with transaction-level reporting. Determining whether any of these events constitutes a taxable disposition — and, if so, assigning cost basis — requires an understanding of the entire transaction life cycle, something Form 1099-DA is not designed to capture.

This complexity is compounded by the challenge of asset identification. Without a centralized broker to track which specific “lot” of a token is deployed into a lending protocol or liquidity pool, taxpayers may be unable to substantiate specific identification. In those circumstances,

the IRS may apply a first-in, first-out method by default, potentially triggering gains on assets the user never intended to dispose of. And where cost basis cannot be adequately documented, the IRS may treat basis as zero — effectively converting reported proceeds into phantom taxable gain.

Ironically, the users most likely to face problems under Form 1099-DA are often the most sophisticated and compliance-minded. DeFi users who actively engage with protocols generate far more on-chain transactions — and therefore more potentially reportable “events” — than passive holders who transact through centralized platforms. Each additional event increases the likelihood of discrepancies between a taxpayer’s return and third-party reporting. The result is a perverse incentive: The more a user engages with crypto for one of its primary intended purposes — as a decentralized financial system — the greater the compliance burden and the higher the risk of audit exposure driven not by tax avoidance but by data mismatch.

Practical Implications for Crypto Owners

Crypto owners — particularly those involved in DeFi — should take several steps now:

- Assume IRS scrutiny is increasing. Information reporting for digital assets is expanding, and the era of minimal third-party reporting is coming to an end.
- Maintain independent records. Do not rely solely on Forms 1099-DA. These forms may be incomplete, lack context, or mischaracterize on-chain activity.
- Understand transaction character. Be prepared to explain why certain on-chain events — such as collateral postings, loan repayments, or liquidity movements — do not constitute taxable dispositions.
- Work with tax professionals who understand DeFi. Traditional crypto reporting experience may be insufficient; protocol-level mechanics and transaction life cycles matter.
- Expect disputes. As third-party reporting expands, correcting erroneous or misleading Forms 1099-DA may become a routine part of crypto tax compliance rather than an exceptional event.

A System Built for Stocks, Applied to Software

At a high level, Form 1099-DA reflects a familiar regulatory instinct: extending an existing reporting framework to new technology. That approach can work when the new technology behaves like the old one. Crypto — especially DeFi — does not.

By treating digital assets as if they were merely another category of broker-traded property, the reporting regime risks overstating income, mischaracterizing transactions, and imposing substantial compliance burdens on users who are not speculators, but participants in a new financial architecture.

Whether future guidance can close this gap remains to be seen. For now, Form 1099-DA marks a turning point. Crypto taxation is becoming more formal and more visible — and for users who do more than simply buy and hold, far more complex.



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