November 13, 2023

Via Electronic Upload

CC:PA:LPD:PR (REG–122793–19) Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

Re: IRS Proposed Rulemaking REG-122793-19; Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions ("Proposed Regulations")

Ladies and Gentlemen:

The Blockchain Association respectfully submits this letter providing comments regarding the Proposed Regulations and the rules therein concerning reporting for digital asset transactions.

The Blockchain Association is the leading nonprofit membership organization dedicated to promoting a pro-innovation policy environment for the digital asset economy. The Blockchain Association endeavors to achieve regulatory clarity and to educate policymakers, regulators, courts, and the public about how blockchain technology can pave the way for a more secure, competitive, and consumer-friendly digital marketplace. The Blockchain Association represents over 100 member companies reflecting the wide range of the dynamic blockchain industry, including software developers, infrastructure providers, exchanges, custodians, investors, and others supporting the public blockchain ecosystem.

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I. INTRODUCTION

The Infrastructure Investment and Jobs Act (the "IIJA"), Pub. L. No. 117-58, was signed into law by President Biden on November 15, 2021. The IIJA set forth the initial reporting requirements for digital assets under Section 6045,[1] but left many details to be determined by the Secretary of the Treasury.

Nearly two years after the IIJA was signed into law, the Secretary of the Treasury issued the Proposed Regulations, which purport to interpret and implement the reporting requirements of Section 6045. *See* 88 Fed. Reg. 59,573 (Aug. 29, 2023). A 60-day period was provided for public comments.

On September 15, 2023, the Blockchain Association submitted a letter in response to the Proposed Regulations, respectfully requesting that the Secretary of the Treasury extend the comment period by at least an additional 60 days for the Proposed Regulations. As noted therein and despite the mere two-week extension, the 74-day comment period is insufficient to address the myriad issues and questions raised by the Proposed Regulations, which are too lengthy, too complex, and too consequential to be rushed. As a result, the Blockchain Association's ability to respond fully to the Proposed Regulations has been hindered by the short amount of time afforded to read, digest, and analyze the Proposed Regulations, understand fully their potential implications, and craft useful comments.

We note that the U.S. Department of the Treasury ("Treasury") requested specific comments from the public about no fewer than 50 discrete topics related to the Proposed Regulations. While we applaud the willingness of Treasury to request comments from the public, and have attempted to answer some of those questions in this comment letter, the sheer number of issues about which Treasury is still uncertain demonstrates how the Proposed Regulations are necessarily riddled with ambiguities and conceptual holes. This provides further reason why 74 days is not a sufficient timeframe to provide adequate comments.

Nonetheless, this comment letter highlights several concerns with the Proposed Regulations. Our comments are limited to the reporting regime laid out in the Proposed Regulations. While certain aspects of the taxation of digital assets could be debated, we do not dispute the basic principle that gains on sales of digital assets should be taxed.

The Proposed Regulations, however, reflect fundamental misunderstandings about the nature of digital assets and decentralized technology. Consistent with the Blockchain Association's goal of educating regulators and policymakers, this comment letter attempts to highlight areas of apparent misunderstanding in order to promote more effective and efficient final regulations.

For entities that are "centralized,"[2] and for whom reporting under the Proposed Regulations may be possible, the Proposed Regulations are in some respects unrealistic or overly burdensome,

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1 Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the Treasury Regulations thereunder.

2 For purposes of this comment letter, we intend "centralized" entities to mean those who create and operate trading platforms through which users can send and receive digital assets. Funds housed with centralized platforms are maintained in the platform's custody, and customers typically reveal some

particularly with regard to the short timelines given to implement required changes. For decentralized projects, compliance with the Proposed Regulations will be practically impossible for at least two reasons. First, the Proposed Regulations are overbroad, sweeping in parties whose only means of compliance would be to abandon the decentralized technology that makes them unique. This construction will drive all U.S.-based decentralized projects abroad or out of existence, full stop. Second, the Proposed Regulations are unclear as to whether certain participants have a reporting requirement at all.

II. THE PROPOSED REGULATIONS GO BEYOND THE STATUTE IN SEVERAL AREAS.

In general, Section 6045 and the corresponding regulations require a person doing business as a broker to file information returns and furnish payee statements for each customer for whom the broker has transacted business.[3] The IIJA extended Section 6045 to apply to brokers of digital assets.

The Proposed Regulations expand upon the definitions of "digital asset" and "broker" as set forth in the IIJA.[4]

This section provides an overview of the changes undertaken by the Proposed Regulations, while subsequent sections will describe the ruinous effects of those changes on the members of the Blockchain Association and other digital asset market participants.

A. The Proposed Regulations broaden the definition of digital asset.

The IIJA expanded the types of assets subject to information reporting under Section 6045 to include digital assets, and amended Section 6045(g)(3) to define a digital asset:

> Except as otherwise provided by the Secretary, the term "digital asset" means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.

Prop. Treas. Reg. § 1.6045-1(a)(19)(i) further expands on the definition of digital asset:

> For purposes of this section, the term digital asset means 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 actually recorded on that ledger, and that is not cash.

As discussed below, this broad definition of digital asset means that the Proposed Regulations capture not only assets that are held for investment by customers, but also property such as non-fungible tokens ("NFTs"), digital assets whose value is pegged to an underlying commodity, currency, or security (so-called "stablecoins"), tokenized real estate, and tokenized commodities.

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personal information to the platform when creating an account. Some of these parties operate in a similar manner to traditional financial intermediaries.

3 A broker is generally not required to report sales by foreign persons if the broker can rely on documentation showing that the seller is indeed a foreign person (e.g., an IRS Form W-8).

4 *See infra* Section VI.B. for a discussion of the surprisingly wide range of participants who may be captured under the expansions of these definitions in the Proposed Regulations.

Because these types of property are used for other functions besides being held for investment, they often are not analogous, either in investment intent or in function, to the types of property previously subject to the broker reporting rules.

B. The Proposed Regulations broaden the definition of broker.

Prior to the IIJA, Section 6045(c)(1) defined "broker" to include a dealer, a barter exchange, and any other person who (for a consideration) regularly acts as a middleman with respect to property or services. The IIJA amended Section 6045(c)(1) to provide that the term broker includes: "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." Congress expressly described this amendment as a mere "clarification" of the definition of "broker." IIJA, Sec. 80603(a). Accordingly, Congress's revised definition of "broker" is a clarification of what it means to "act[] as a middleman" with respect to digital assets.

Current Treas. Reg. § 1.6045-1(a)(1) provides that the term broker "means any person (other than a person who is required to report a transaction under section 6043), U.S. or foreign, that, in the ordinary course of a trade or business during the calendar year, stands ready to effect sales to be made by others."

We note that while the IIJA was under consideration, a broader formulation of "broker," which would appear at least somewhat closer to what the Proposed Regulations carry out, was proposed in draft form—"any person who (for consideration) regularly provides any service responsible for effectuating transfers of digital assets, *including any decentralized exchange or peer-to-peer marketplace*" (emphasis added).[5] Congress ultimately rejected that language—making it all the more troubling for the Proposed Regulations to now attempt to broadly pull in decentralized participants.

Although the wording used in the definition of "broker" in Prop. Treas. Reg. § 1.6045-1(a)(1) remains the same as in the current regulations, the Proposed Regulations create cascading, expansive definitions of the terms used in the definition of "broker" in a way that dramatically departs from past practice, the concept of a middleman, and the rules applicable to traditional assets. In particular, the Proposed Regulations significantly expand the term "effect" and thereby revise the definition of "broker" beyond the statutory definition. As discussed below, through these expansive definitions, the Proposed Regulations capture parties beyond those contemplated by Congress, such as decentralized finance (DeFi) developers, providers of websites that merely educate users about ways to use DeFi protocols, and even providers of tools that are not specific to digital assets, such as internet service providers.[6]

Specifically, the Proposed Regulations modify the definition of "effect" in Treas. Reg. § 1.6045-1(a)(10) to include acting as "a digital asset middleman as defined in paragraph (a)(21) of this section for a party in a sale of digital assets." Prop. Treas. Reg. § 1.6045-1(a)(10)(ii) & (iv). The Proposed Regulations go on to define "digital asset middleman" as:

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5 See attached as Exhibit A a copy of July 28, 2021, draft legislation received and reviewed by the Blockchain Association.

6 *See infra* Section VI.B. for a discussion of the inappropriate way that the Proposed Regulations may sweep in providers, including access service and tool providers.

> any person who provides a facilitative service as described in paragraph (a)(21)(iii) of this section with respect to a sale of digital assets wherein the nature of the service arrangement is such that the person ordinarily would know or be in a position to know the identity of the party that makes the sale and the nature of the transaction potentially giving rise to gross proceeds from the sale.

Prop. Treas. Reg. § 1.6045-1(a)(21)(i).

The Proposed Regulations broadly define a "facilitative service" in Prop. Treas. Reg. § 1.6045-1(a)(21)(iii) to "include" "the provision of a service that directly *or indirectly* effectuates a sale of digital assets" (emphasis added). The Proposed Regulations go on to provide the following non-exclusive examples of facilitative services:

- providing a party in the sale with access to an automatically executing contract or protocol,
- providing access to digital asset trading platforms,
- providing an automated market maker system,
- providing order matching services,
- providing market making functions,
- providing services to discover the most competitive buy and sell prices, or
- providing escrow or escrow-like services to ensure both parties to an exchange act in accordance with their obligations.

The Proposed Regulations then exclude two specific functions from the definition of "facilitative service": "validating distributed ledger transactions . . . without providing other functions or services if provided by a person solely engaged in the business of providing such validating services"; and "the selling of hardware or the licensing of software for which the sole function is to permit persons to control private keys which are used for accessing digital assets on a distributed ledger if such functions are conducted by a person solely engaged in the business of selling such hardware or licensing such software."

The Proposed Regulations provide that a person ordinarily would know or be in a position to know the identity of the party that makes the sale:

> if that person maintains sufficient control or influence over the facilitative services provided to have the ability to set or change the terms under which its services are provided to request that the party making the sale provide that party's name, address, and taxpayer identification number upon request.

Prop. Treas. Reg. § 1.6045-1(a)(21)(ii)(A). Under the Proposed Regulations, a person with the ability to change the fees charged for facilitative services automatically meets this standard.

Similarly, the Proposed Regulations provide that a person ordinarily would know or be in a position to know the nature of the transaction potentially giving rise to gross proceeds from a sale:

> if that person maintains sufficient control or influence over the facilitative services provided to have the ability to determine whether and the extent to which the transfer of digital assets involved in a transaction gives rise to gross proceeds, including by reference to the consideration that the person receives or pursuant to the operations of or modifications to an automatically executing contract or protocol to which the person provides access.

Prop. Treas. Reg. § 1.6045-1(a)(21)(ii)(B). Again, the Proposed Regulations provide that a person with the ability to change the fees charged for facilitative services automatically meets this standard.

Aside from the non-sequitur that the ability to change the fees charged for a service constitutes "sufficient control or influence" to cause other types of information to be obtained from users, the Proposed Regulations do not provide guidance as to what else would (or would not) constitute "sufficient control or influence."

Through these cascading definitions, the Proposed Regulations potentially include certain parties, groups, or systems as "brokers" subject to the reporting regime even though they do not—and in many instances, cannot—in fact act as brokers, intermediaries, or middlemen. Consequently, and as discussed further below, a wide swath of participants would be required to comply with the information reporting requirements of the Proposed Regulations despite being ill-suited or unable to do so. This outcome directly contravenes statements made by Treasury that "ancillary parties who cannot get access to information that is useful to the IRS are not intended to be captured by the reporting requirements for brokers."[7]

Moreover, despite the fact that the statutory definition of a "broker" contains the requirement that the person provide a service for consideration on behalf of another person,[8] the Proposed Regulations omit any "for consideration" requirement.

Instead, the Proposed Regulations define a "broker" as a person who effects sales made by others "in the ordinary course of a trade or business." Treasury takes the position in the Preamble to the Proposed Regulations that persons engaged in a trade or business are necessarily performing their services for consideration. However, the regulation that Treasury cites for this conclusion states the exact opposite. *See* Treas. Reg. § 1.6041-1(b)(1) ("all persons engaged in a trade or business" "includes not only those so engaged for gain or profit, but also organizations the activities of which are not for the purpose of gain or profit"). Thus, the Proposed Regulations by their own terms do not contain a "for consideration" requirement and contradict the statutory language, capturing even more parties outside the scope of the text of the IIJA.

C. The Proposed Regulations broaden the definition of sales.

Treas. Reg. § 1.6045-1(a)(9) provides the definition of "sale" for the reporting obligations under Section 6045. The Proposed Regulations add a new subpart to the definition of "sales" and provides that the term sale also includes:

1. Any disposition of a digital asset in exchange for cash or stored-value cards;
2. Any disposition of a digital asset in exchange for a different digital asset; and

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[7] Letter from Jonathan C. Davidson, Department of the Treasury, Assistant Secretary for Legislative Affairs, to various Senators (February 11, 2022), available at https://www.stradley.com/insights/publications/2022/02/-/media/e295168ea3714c528af55eb44cad7e30.ashx.

[8] As amended by the IIJA, Section 6045(c)(1) provides that the term "broker" includes "any person who (*for consideration*) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person" (emphasis added).

> 3. The delivery of a digital asset pursuant to the settlement of a forward contract, option, regulated futures contract, any similar instrument, or any other executory contract which would be treated as a sale of a digital asset under this paragraph (a)(9)(ii) if the contract had not been executory.

Prop. Treas. Reg. § 1.6045-1(a)(9)(ii)(A).

This definition of sale differs from that used for non-digital assets: Treas. Reg. § 1.6045-1(a)(9) provides that for non-digital assets, the term sale means any disposition of securities, commodities, options, regulated futures contracts, securities futures contracts, or forward contracts, *but only to the extent any of these dispositions are conducted for cash*. Thus, in-kind exchanges are expressly carved out from the reporting requirements under Section 6045. The Proposed Regulations include no such exclusion for in-kind exchanges; instead, any disposition of a digital asset in exchange for a different digital asset is a reportable event. To avoid confusion, and to reflect the similarities between digital and non-digital assets, there should be parity in the tax treatment between digital and non-digital assets. This lack of a carve out for in-kind exchanges of digital assets in the Proposed Regulations is unwarranted.

III. A RANGE OF MARKET PARTICIPANTS ARE AFFECTED BY THE PROPOSED REGULATIONS.

As described above, these rules would negatively affect the digital asset landscape if adopted in their current form. Many projects simply will not survive their implementation—Treasury's own estimate is that up to 98 percent of impacted parties could be small businesses, who may not have the resources necessary to achieve compliance.[9] To understand this result, it is helpful to understand some of the various participants that will be affected by the Proposed Regulations.

To that end, we describe below certain participants who will be affected by the rules as currently proposed.

A. Centralized parties will have difficulty complying.

Certain centralized parties create and operate trading platforms through which users can send and receive digital assets. Funds housed with the platforms are maintained in the platform's custody, and customers typically reveal some personal information to the platform when creating an account. Some of these parties operate in a similar manner to traditional middlemen or intermediaries. As such, these centralized platforms arguably fall within the Code and the Proposed Regulations' definition of "broker."

Although we understand the desire to impose reporting obligations on operators of centralized platforms as a general matter, implementing the Proposed Regulations as currently drafted within the contemplated time period will be extremely challenging or impossible for many participants. These issues are discussed in Section IV below.

B. Wallet software developers will have difficulty complying.

Wallets provide the means to store and access digital assets. Wallets use digital addresses called "public keys" (essentially a public address to which digital assets can be directed) and private

9 *See* 88 Fed. Reg. 59,621 (Aug. 29, 2023).

passcodes called "private keys" (which are kept private and are used to verify transactions and prove ownership of the assets inside the wallet).

Certain wallets are "custodial," meaning that a third party holds the private keys and thus controls the assets inside the wallet on behalf of their owner. Non-custodial wallets, on the other hand, ensure that only the owner of the digital assets in the wallet holds the private keys. Non-custodial wallets therefore provide a level of security that custodial wallets cannot.

The primary function of most non-custodial wallet software is to provide secure infrastructure to allow users to safely manage their own private keys. This infrastructure enables the user to determine when and how to initiate the movement of their digital assets without the use of an intermediary. Many non-custodial wallets offer some additional functionality beyond allowing users to control their private keys. For example, non-custodial wallets may provide an interface through which users can access other platforms or protocols, such as centralized trading platforms or decentralized software protocols that enable users to engage in disintermediated transactions involving digital assets ("DeFi" or "DEX" systems or protocols).[10] Providing such additional functionality does not give those who create and publish wallet software and tools ("wallet software developers")[11] access to the customer's wallet nor does it give wallet software developers access to any customer or transaction information. The Proposed Regulations would have the effect of creating new cybercriminal attack vectors by requiring non-custodial wallet software developers to alter their software and its primary functionality to collect and store personal financial and identifying information about their users. As another example, non-custodial wallets may help a user translate a desired transaction into the proper and necessary computer language to interact with a protocol. Again, providing such a service does not give wallet software developers access to the customer's wallet nor to any customer or transaction information (beyond what is already publicly available on the blockchain).

C. DeFi participants are fundamentally unable to comply.

Participants in DeFi technology ("DeFi participants") are very different from centralized actors. DeFi protocols, by their nature, are designed to provide a self-executing, self-enforcing protocol through which users can transact directly with one another or with the smart contract without the involvement of any centralized intermediary or middleman. DeFi developers draft the source

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[10] A digital asset "protocol" is a basic set of rules that allow data to be shared between computers. They establish the structure of the blockchain — i.e., the distributed database that allows digital assets to be securely exchanged on the internet. *See* Coinbase, *What is a protocol?*, available at https://www.coinbase.com/learn/crypto-basics/what-is-a-protocol. Such protocols are open-source and entirely transparent, allowing anyone to examine and verify their underlying code. One typical characteristic of digital asset protocols is that they enable the use of "smart contracts," which are "self-executing, self-enforcing programs" that enable the execution of transactions between parties in connection with the protocol — "that is, when a given event occurs, the [transaction] auto-executes, without the need for third-party intervention from banks, lawyers, accountants, or the like." *Risley v. Universal Navigation Inc.*, --- F. Supp. 3d ---, No. 22-CV-2780 (KPF), 2023 WL 5609200, at *5 (S.D.N.Y. Aug. 29, 2023).

[11] In referring to "wallet software developers," this comment letter intends to include both those who create and publish wallet software and tools, and user interfaces that rely on wallet connectivity.

code for, and may initially deploy, the smart contracts that make up a DeFi protocol;[12] once deployed, these contracts execute user commands automatically without the need for any further human intervention or intermediation, operation or maintenance. Governance of the system and "smart contracts" is often distributed amongst holders of "governance tokens," which give their holders the right to vote on certain system changes or other governance matters ("DeFi tokenholders").

DeFi developers do not have access to DeFi user identifying information and, indeed, generally do not interact with DeFi users at all. In some instances, developers may not interact with the protocol in any manner after the drafting of the underlying source code and its deployment. DeFi tokenholders likewise do not have access to DeFi user identifying information and typically interact with the protocol only to the extent of voting on certain specified matters for which their tokens allow them to vote. There is generally no party with the ability to unilaterally alter the parameters of a DeFi system absent such a vote; indeed, this is an essential feature of DeFi. There generally is no one person who can pull the strings to simply "make the changes" necessary to attempt to capture user information in these systems.

To transact on a DeFi system, a DeFi user needs internet access and generally will use one or several types of access tools that are made available by other market participants or for free public use. Internet service providers have access to customer identifying information but do not have access to information regarding digital asset transactions. Those who create and publish DeFi access tools ("DeFi providers") similarly provide tools for accessing a DeFi system but are not intermediaries to transactions and generally do not interact with DeFi users in a way that would allow for the collection of customer identifying information.

All DeFi participants—indeed, all members of the public—have access to information regarding the transactions that occur on a DeFi system. Information regarding transactions on both centralized platforms and decentralized systems is pseudonymous, meaning that each transaction is recorded immutably on a publicly available ledger and linked to a wallet address—but transactions are not linked to personal identities. Due to the public and immutable nature of the vast majority of information regarding digital asset transactions on a blockchain, any attempt to link wallet addresses to personal identities would create a serious and permanent privacy issue for those users. Comparable to having a lifetime of credit card transactions published online, this would mean exposing each user's entire transaction history to the world. It does not take much imagination to understand that this is an unacceptable outcome that would pose risks to both the basic tenet of privacy and, in some cases, a user's physical safety and well-being. Accordingly, the ability to keep user identities private is one of the fundamental concerns of many digital asset holders. This is decidedly different from traditional finance, where providing your bank with a W-9 does not (or at least is not intended to) result in your personal information and transaction history becoming publicly accessible for all those with the technological skills to look.

These privacy concerns explain why DeFi systems add value to digital asset users. They provide a way to transact in digital assets without having to divulge sensitive personal information to a centralized entity that could be vulnerable to security breaches and hacks. Although humans are involved in protocol development, governance, and designing the tools used to access a DeFi

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[12] After a protocol is launched, and because the source code is open source, any developer can add software to the base protocol without relying on or needing involvement from the developers who built the base protocol.

system, they do not act as intermediaries in a transaction between DeFi users. Moreover, humans may not be involved in a protocol at all once it is deployed on the blockchain – certain protocols simply exist and cannot be modified.

There is a pervasive misunderstanding on the part of policymakers about whether human beings are necessary for the continued performance of DeFi systems. The latest example of this misunderstanding is the recent report issued by IOSCO.[13] The IOSCO Report states that it is a "common misperception" that "DeFi products and services are offered in a fully automated manner using smart contracts, with no human involvement." On the contrary: this is not a "misperception," it is an accurate description of one of the defining characteristics of DeFi. The IOSCO Report may be trying to articulate the undisputed fact that humans are involved in *creating and deploying* a DeFi system, but after that point, users interact with one another directly. Consequently, there is no person or entity in the middle collecting DeFi user identities that could be used for purposes of information reporting. If there were, the system definitionally ceases to be a DeFi system, and would more closely resemble a centralized platform.

IV. THE PROPOSED REGULATIONS AS APPLIED TO CENTRALIZED PARTIES CREATE SEVERAL CONCERNS.

The Proposed Regulations create enormous obstacles for centralized platforms. Specifically, the Proposed Regulations fail to adequately account for the many implementation challenges that centralized platforms will face and the amount of time and money it will take these parties to comply with the type of reporting described in Section 6045.

A. There is inadequate time to implement the necessary system and documentation requirements.

The timeframe for required compliance with the Proposed Regulations is too short. The Proposed Regulations provide that the information reporting rules regarding gross proceeds are proposed to apply to sales and exchanges of digital assets effected on or after January 1, 2025, and the information reporting requirements relating to adjusted basis are proposed to apply to sales and exchanges of digital assets effected on or after January 1, 2026. The Proposed Regulations were published in the Federal Register on August 29, 2023. Assuming that the regulations are finalized in a timely manner,[14] affected parties would only have a little more than a year to build and implement internal systems in order to ensure compliance.

To see just how inadequate this time period is, compare it with the timelines for implementation under similar reporting rules governing non-digital assets. For example, the Foreign Account Tax

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[13] The Board of the International Organization of Securities Commissions, *Policy Recommendations for Decentralized Finance (DeFi): Consultation Report*, CR/04/2023, September 2023 (the "IOSCO Report").

[14] As a practical matter, centralized parties who are subject to the Proposed Regulations cannot begin to build the internal mechanisms necessary for collecting, processing, tracking, confirming, and reporting the required information without the certainty of finalized regulations. Our members believe that the costs of building out the required reporting systems will be quite significant, and it would be imprudent to begin incurring costs based on guesswork as to how the final regulations will read while there are currently over 50 questions posed for consideration, the answers to many of which could have a fundamental impact on what is or is not required for real-world compliance efforts.

Compliance Act ("FATCA") withholding regime was enacted on March 18, 2010. Treasury and the IRS published proposed regulations in early 2012, which were subsequently finalized and published on January 7, 2013. Although originally intended to take effect in the beginning of 2013, the IRS continued to push back the effective date of the regulations, in large part because commentators indicated that they would need additional time to make the system adjustments necessary to be able to report income and gross proceeds.[15] And although the regulations finally took effect on July 1, 2014, the IRS provided transition relief from IRS enforcement for calendar years 2014 and 2015. Thus, affected parties were given ***nearly four years*** to implement and comply with the rules contained in the FATCA regulations. It is telling that taxpayers in the traditional finance industry needed—and were accordingly given—this much time despite already having robust systems in place with respect to collecting information and withholding from customers that could be used as a starting point for building FATCA compliance systems.

Similarly, the broad application of the Section 871(m) regulations (relating to U.S. source dividend equivalents under Code §§ 871(m), 1441, 1461, and 1473) has yet to take effect. Treasury and the IRS proposed Section 871(m) regulations at the end of 2013, and issued final regulations on September 17, 2015 and January 24, 2017. The Section 871(m) regulations were set to take effect in January of 2017—however, the IRS postponed implementation of the regulations numerous times, again to allow the industry time to develop the necessary systems. The IRS noted that delays in enforcement were necessary to permit dealers, issuers, and other withholding agents additional time to continue to design, build, and test new withholding and reporting systems.[16] Most recently, the IRS further extended until 2025 full implementation of the U.S. withholding regime under the Section 871(m) regulations with respect to "dividend equivalent" amounts (Notice 2022-37). ***Nearly a decade has passed*** since the Section 871(m) regulations were published—and affected parties have still not been subject to enforcement of those requirements.

The implementation of the tax withholding regulations under Chapter 3 (Sections 1441-1464) of the Code were similarly delayed. Those regulations, which were proposed in April 1996 and finalized on October 14, 1997, significantly revised information reporting and backup withholding regulations under Chapter 61 and Section 3406 of the Code. The regulations were meant to apply to all payments made after 1998; however, Treasury and the IRS recognized that the final regulations would "likely require significant changes to business practices and information systems for many U.S. foreign withholding agents."[17] Accordingly, the effective date of the withholding requirements was delayed until January 1, 2001—a little over three years after the final regulations were promulgated.

Like the FATCA regime, the Section 871(m) regulations, and the Chapter 3 withholding regulations, the Proposed Regulations are similarly complex and far-reaching. Yet, parties transacting in digital assets will have far less time to comply with the Proposed Regulations. The constricted time period for implementation of the Proposed Regulations reflects an unacceptable

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[15] Preamble to "Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities," REG-121647-10 (Feb. 8, 2012).

[16] Notice 2018-72.

[17] Notice 98-16.

lack of parity between digital assets and non-digital assets (discussed further below) that must be addressed.

Discussed below are some of the specific difficulties that will make implementation within the allotted time frame impractical or, in some cases, impossible.

1. System Requirements

Centralized brokers will not have the necessary time to put into place all of the required systems to comply with the Proposed Regulations in the time period allotted. The implementation challenges facing centralized brokers subject to Section 6045 are immense. Centralized brokers are not currently required to collect the necessary information for any of their existing customers, requiring remediation efforts for current customer populations, as well as new mechanisms to collect the information from new customers. At a minimum, the steps that centralized brokers need to take include the following, each of which will take significant time:

- **Build systems to capture gross proceeds, cost basis, and other required information regarding transactions.** Centralized brokers will need to develop systems to capture gross proceeds and cost basis information with respect to transactions, which is not currently required.

- **Build systems to capture customer information and maintain required documentation.** The reporting obligations under Section 6045 do not apply to sales effected for a customer that a broker may treat as an exempt recipient or as an exempt foreign person (Treas. Reg. § 1.6045-1(c)(3) and (g)(1)). A broker may treat a customer as an exempt recipient based on a Form W-9, and may treat a customer as an exempt foreign person based on a beneficial owner withholding certificate, such as a Form W-8BEN (Treas. Reg. § 1.6045-1(c)(3)(i)(C)). While determining a customer's status as either an exempt recipient or an exempt foreign recipient obviates the need to report under Section 6045 and the Proposed Regulations, many centralized parties do not have the systems necessary to collect and validate the necessary information reported on Forms W-9 or W-8. Currently, centralized parties are not required to collect this information from their customers—the Proposed Regulations implicitly require such centralized parties to build an additional set of compliance systems in order to validate their customers' status.

- **Collect customer information from existing customers.** All current customers will need to be remediated to ensure that sufficient information is on file to comply with the reporting regulations. This can happen only once the appropriate systems and processes are in place to gather and store the required information and to review the information for completeness. Brokers and their customers should be given sufficient time and opportunity to work through documentation issues prior to imposing backup withholding.

- **Build systems with significant tracking capabilities to monitor US indicia.** For foreign brokers, reporting and potential backup withholding will be required under the Proposed Regulations if certain "U.S. indicia" are present. The list of U.S. indicia in the Proposed Regulations includes indicia such as a customer's association with an IP address within the United States. Because any customer who ever travels to the United States would likely have "U.S. indicia" under this standard, the burden on foreign brokers to track these events and store IP address data—and to obtain Forms W-8 when such events occur—will be enormous. Another "U.S. indicia" in the Proposed Regulations is that a customer's account is linked to a digital asset broker that the broker has "reason to know" is organized in the United States. Putting systems into place to sufficiently monitor and reliably capture situations where there is "reason to know" will be difficult and time-consuming, if possible at all.

- **Build systems for backup withholding.** To the extent that customers of centralized parties do not complete and turn in the required Forms W-9 or W-8, or other necessary documentation to establish that they are not subject to the Proposed Regulations, centralized parties must impose backup withholding in accordance with Section 3406. Centralized parties do not currently maintain systems capable of withholding; this is an additional requirement imposed by the Proposed Regulations which necessitates further time for compliance.

- **Build systems to track what method customers use for cost basis.** Because taxpayers have the option of using different methods to determine cost basis (e.g., FIFO versus specific identification), brokers need to build systems to assist customers in specifying these methods and tracking basis based on the customer's chosen method.

In the Proposed Regulations, Treasury recognizes that brokers will likely need to build systems to (i) collect and store customers' information, including names, addresses, and tax identification numbers, (ii) collect and store information about customers' digital asset transactions, (iii) report this information to the IRS and taxpayers (or find a service provider to do so), (iv) develop and maintain the ability to backup withhold and (v) deposit withheld tax with the IRS for applicable taxpayers. The burden estimate provided for compliance, however, is only $27,000 per broker, per year. But this figure grossly underestimates the costs involved in creating numerous systems from scratch. Based on information reported by Blockchain Association members, a more realistic figure would be in the tens—if not hundreds—of millions of dollars. Further complicating and slowing the efforts of brokers are the myriad other reporting regimes with which they may need to simultaneously comply (e.g., CARF, DAC8, CESOP).

Another complication is that where withholding is required on digital assets, brokers would presumably need to remit withholding amounts in U.S. dollars, requiring brokers to sell digital assets. We note this is a particular challenge given the lack of an exclusion in the current draft for in-kind exchanges, meaning that there may be numerous reportable transactions where no cash or cash equivalents are part of the exchange. While it would be interesting to explore whether the IRS would consider accepting an in-kind payment for such transactions, we have assumed that backup withholding, when needed, would have to be done in cash. This raises a bevy of unanswered questions and issues: brokers should not be responsible for bearing market losses, but how would that be implemented? And if brokers end up selling digital assets at a gain in order to have sufficient U.S. dollars for withholding, to whom is that gain attributable? As discussed below, moving towards closer parity for non-digital assets, where non-cash exchanges are generally exempt, would aid in allowing brokers to comply.

2. Documentation Requirements

In addition to the required systems needed to comply with the Proposed Regulations, brokers will face a host of documentation challenges when attempting to implement gross proceeds and basis reporting. Many of those documentation challenges are evident from the discussion of systems challenges above (e.g., after building a system to track U.S. indicia, centralized brokers will need to create and securely store massive amounts of documentation relating to their customers).

Because so many actors may be considered "brokers" under the Proposed Regulations, it is feasible—and indeed likely—that numerous parties to a transaction will provide the end-user with varying documentation attempting to quantify the transaction's gross proceeds and basis. Because of the limited perspectives that each broker has with regard to a transaction, this documentation would be varied, representing each broker's "best guess" as to the nature of the transaction. This would serve to confuse end-user taxpayers, who must report their gains and losses from digital asset transactions, but are relying upon others for the required information and to ensure that information is correct.

For these reasons, the Blockchain Association urges Treasury to provide that the rules regarding gross proceeds reporting take effect no sooner than the taxable year beginning at least *twenty-four months* after any finalized regulations are published, and that the rules regarding cost basis reporting take effect no sooner than the taxable year beginning at least *thirty-six months* after such finalized regulations are published.

B. The retroactive cost basis reporting requirement should be eliminated.

The Proposed Regulations require cost basis reporting for digital assets acquired after January 1, 2023. In reliance on official guidance from Treasury,[18] however, brokers have not yet built systems for tracking the basis of customers' assets. Requiring brokers to retroactively construct cost basis information for assets acquired by customers prior to the finalization of the regulations and without sufficient time to build systems consistent with the final regulations is untenable and inconsistent with the prohibition on retroactive regulations in Section 7805(b).

Requiring cost basis reporting retroactively for digital assets acquired before brokers are able to implement systems consistent with the final regulations will only create more confusion for the IRS and taxpayers. Because brokers have not been tracking customers' elections to use lot relief methods (such as specific identification) when disposing of digital assets, brokers will be forced to apply a "default" tracking method (e.g., FIFO). This "default" method will in many cases not match the actual method used by the taxpayer, leading to inconsistent reporting and confusion. This confusion and inconsistency will last indefinitely; taxpayers could sell an asset years later that the "default" method used by the broker deems as having already been sold, whereas the correct cost basis is different under the taxpayer's specific identification method. Brokers need time to implement systems that will allow them to track customers' selection of lot relief methods and report cost basis accordingly.

C. Stablecoins pegged to the U.S. dollar should be excluded.

As discussed above, the broad definition of "digital asset" in the current Proposed Regulations captures assets whose value is pegged to an underlying currency, commodity, or financial instrument, including stablecoins. Certain stablecoins are pegged to the U.S. dollar and operate as a stand-in for fiat money, particularly in online transactions. Such stablecoins are often backed by a reserve of treasury bonds or other highly secure assets, and afford rights to exchange such

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[18] IRS Announcement 2023-2 (stating that "[b]rokers will not be required to report or furnish additional information with respect to dispositions of digital assets under section 6045 . . . until those new final regulations under sections 6045 and 6045A are issued").

stablecoins for fiat, such that holders are confident that the value is essentially locked, in all material respects, to their pegged dollar amount. Holders do not invest in stablecoins for gain through price appreciation, but rather utilize them as a form of payment for digital commerce – in the same way that one would utilize a credit card, a debit card, PayPal, Venmo, or a host of other payment options, in lieu of paying for 21st-century transactions with cash or checks. Notwithstanding that transactions in such stablecoins are functionally equivalent to electronic transfers of dollars, and that it would be extremely unusual for a holder to recognize gain or loss on such stablecoins, the Proposed Regulations would subject stablecoins whose value is pegged to the dollar to the same reporting obligations as other assets held purely for investment.

Transactions in currencies are generally not required to be reported – even foreign exchange transactions where gain or loss may well be present. Under current law, foreign currency transactions are exempted from reporting under Section 6045. It is highly inappropriate to require reporting for stablecoins that are functioning as an equivalent to the U.S. dollar while exempting those transactions on which gain or loss may well occur and where a holder is far more likely to be seeking to profit from value movements.

The Proposed Regulations solicit comments on whether the regulations should "exclude reporting on transactions involving the disposition of U.S. dollar related stablecoins that give rise to no gain or loss, and if so, how should those stablecoin transactions be identified" (Part I.K. of the *Explanation of Provisions*). Digital assets that are pegged to currency should be excluded from the definition of "digital asset" under the Proposed Regulations. We acknowledge the statement in the Preamble to the Proposed Regulations that "the value of a stablecoin may not always be stable and therefore may give rise to gain or loss." However, this approach is essentially throwing the baby out with the bathwater by imposing reporting burdens on billions of transactions out of concern that in a few corner cases, a particular stablecoin may not live up to the name. To the extent that Treasury believes a meaningful number of stablecoin transactions may be effected at a price that does not match the underlying U.S. dollar peg, and hence may give rise to meaningful gain or loss that would not otherwise be reported, we would suggest imposing a broad exception for stablecoins pegged to the U.S. dollar, with a limitation (turning off the exception) for instances where the trading price of the stablecoin at issue varies from its U.S. dollar peg in a meaningful way. Allowing for only a very limited range of value fluctuation (perhaps 1% at the time of the transaction) would address the concerns raised in the Preamble, while eliminating the vast majority of the staggering number of transactions that would otherwise be required to be reported. In addition to improving outcomes for both taxpayers and the IRS by capturing only those transactions with meaningful gain or loss, common-sense approaches of this sort also would appear likely to increase buy-in and compliance from industry participants.

If Treasury will not entertain such an exclusion from the definition of "digital asset," such stablecoins should still largely be excepted from reporting under Section 6045 under a *de minimis* threshold (discussed below). If such stablecoins are not excepted from reporting, compliance may be effectively impossible, given the large number of small value exchanges using stablecoins—potentially billions of transactions per year on a single exchange.

D. A *de minimis* exception is needed.

A meaningful *de minimis* threshold would increase compliance with the Proposed Regulations, help avoid an overwhelming amount of unnecessary information being sent to taxpayers and the IRS, and better reflect Treasury's stated reasons for the new information rules for digital assets.

The Proposed Regulations point to limits on third party information reporting as an important factor contributing to the tax gap. In addition, the Proposed Regulations stipulate that third-party information reporting by brokers would lead to higher levels of compliance.

An annual *de minimis* threshold—both for gross proceeds and for gain or loss—would be a practical solution to address both of these stated goals. A *de minimis* threshold would likely increase compliance with the Proposed Regulations and the practical utility of the information reported to Treasury, as affected parties would not have to wade through the deluge of small-value transactions to ensure each one is accurately reported. And in the event that numerous "brokers" report on the same transaction, taxpayers would not have to spend time determining which Form 1099 they receive is the most accurate reflection of their small-value transaction. Decreasing the amount of unnecessary and inefficient paperwork would also increase end-user compliance with tax requirements.

A *de minimis* threshold under which transactions of digital assets are exempted from reporting would not meaningfully increase or contribute to the tax gap. The foregone income tax from exempting small digital asset transactions is relatively small when compared to the entire universe of taxable digital asset transactions. The large costs of compliance for any broker and any affected taxpayer greatly outweigh the trivial amount of any income tax that would be remitted to the fisc.

We further note that it is not clear whether Treasury has accurately weighed the increased costs that would be placed upon it to attempt to absorb billions and billions of filings per year relating to *de minimis* amounts. Any additional tax collected by reason of reporting such *de minimis* amounts surely would be dwarfed by the costs of attempting to gather, store, and utilize the data.

Accordingly, the Blockchain Association suggests that any final regulations include an annual *de minimis* threshold of $20,000 in gross proceeds and $10,000 in gain or loss—i.e., no reporting would be required if gross proceeds are less than $20,000 and gain or loss is less than $10,000.

E. The Proposed Regulations should provide parity with non-digital assets.

When applying Section 6045 to digital "brokers," the existing reporting standards used for traditional finance and non-digital assets should be replicated unless there is sufficient justification for a deviation from those existing rules. The Proposed Regulations materially deviate in many ways from those existing rules without sufficient justification and in a way that will create additional difficulties, confusion, and implementation issues.

1. Unjustified departures from existing rules

Definition of "sale." Digital assets should be treated no differently from stocks or other securities (as defined by the tax code) when determining what should constitute a "sale" for broker reporting purposes. A "sale" of securities for purposes of broker reporting is generally limited to dispositions for cash, Treas. Reg. § 1.6045-1(a)(9), while a "sale" of digital assets for purposes of broker reporting includes exchanges for other types of property such as different digital assets. The Proposed Regulations do not offer a justification for this disparity.

Documentation requirements. The Proposed Regulations require digital asset brokers to report more information than is required for brokers of traditional assets. For example, reporting for digital assets would require not just reporting of the date of a transaction but also the exact time. Reporting the exact time of a transaction is unnecessary, will add to the voluminous nature of the reports received by taxpayers and the IRS, creates additional difficulty with implementing the use of a single time zone, and is an unjustified invasion of taxpayer privacy. This information is not required to accurately determine tax liability, as evidenced by the fact that it is not required for transactions of non-digital assets. These types of parity issues could be avoided by using the existing Form 1099-B rather than a new Form 1099-DA.

Another way in which the documentation requirements for digital asset brokers are more onerous than those for brokers of traditional assets is the "U.S. indicia" that foreign brokers of digital assets will need to track. As explained above, foreign brokers will be required to expend massive amounts of resources to build and monitor the systems needed to track "U.S. indicia" such as IP addresses and "reason to know" that a customer's account is interacting with or linked to a U.S. digital asset broker. As further explained above, these "U.S. indicia" are not meaningful (e.g., a user could ping a US IP address while on vacation or using an employer's VPN) and are not used for brokers of traditional assets, despite the fact that a great amount of traditional financial activity now happens via the Internet.

Multiple broker rule. For non-digital assets, the "multiple broker rule" applies to avoid duplicative reporting.[19] This rule should apply to digital assets as well.

In the Preamble to the Proposed Regulations, Treasury explains that this rule should not apply to digital asset brokers for two reasons. First, Treasury states that "it may be difficult for a broker to determine whether a particular digital asset platform also qualifies as a broker for purposes of these proposed regulations." Treasury is thus admittedly aware of the deeply problematic ambiguity in the regulations regarding who qualifies as a "broker" of digital assets. Treasury's failure to draft clear guidance regarding who qualifies as a "broker" does not justify its further failure to mitigate the duplicative reporting of potentially massive amounts of transactions by an unknown number of brokers.

Second, Treasury states that the IRS does not feel assurance that digital asset brokers will comply with their tax reporting obligations. In other words, Treasury is imposing massive duplicative reporting requirements on parties who may be ill-equipped or simply unable to comply with those requirements because of an unsubstantiated fear that the parties who are best equipped to comply will not do so. If Treasury and the IRS do not expect brokers to comply with the Proposed Regulations, and are drafting them with this expectation in mind, this undermines the justification for the entire reporting regime in the first place and punishes the entire ecosystem based on expectations rather than reality.

Additional time to implement. As explained above, the traditional finance industry has historically received time to implement reporting changes well beyond the time anticipated in the Proposed Regulations. Because the digital asset industry is starting from scratch, this is a reason to provide *more* time to the digital asset industry, not less.

2. Necessary departures given the unique aspects of digital assets

Backup withholding guidance and flexibility. Backup withholding for certain digital assets is very different from backup withholding for traditional assets. For example, to the extent that NFTs are included as "digital assets" (which, in general, they should *not* be as explained below),

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19 *See* Treas. Reg. § 1.6045-1(c)(3)(iii).

backup withholding should not be required. Digital assets such as NFTs are impossible to withhold against directly; in order to comply, brokers would need to set up margin accounts with cash or cash equivalents, or take other assets from the customer's account as the required withholding. Treasury and the IRS have also acknowledged that there are challenges in valuing property such as NFTs, which makes determining the proper amount of withholding difficult or impossible.

De minimis thresholds. For both reporting and backup withholding purposes, *de minimis* thresholds make sense for digital assets, as explained above. Even with *de minimis* thresholds, the sheer number of transactions in digital assets will result in overwhelming reporting for both taxpayers and—perhaps even more so—the IRS.

F. The Proposed Regulations should be inapplicable to NFTs.

Unlike some other digital assets, non-fungible tokens (NFTs) are not representations of value. Each NFT has a unique set of characteristics and is therefore not fungible. Some NFTs are akin to digital collectibles such as a baseball card or a piece of artwork. Other NFTs may represent the digital form of a physical asset. Still others represent a form of media such as a song or video clip. NFTs may also represent a form of digital identity, social media profile or username, admission ticket, digital credential, or participation in a consumer rewards program. The value of each NFT derives from its own particular attributes and from individuals' subjective evaluations of its desirability.

The Proposed Regulations do not grapple with the varied use cases for NFTs. As one example, Starbucks offers its rewards members the opportunity to earn and purchase NFT collectibles, which provide access to benefits and other experiences (such as virtual espresso martini making classes, or visits to coffee farms). Starbucks rewards members earn NFTs by engaging in a series of activities such as interactive games or challenges. Users can also purchase limited-edition NFTs through a marketplace using a credit card. Because the Proposed Regulations sweep all NFTs into its reporting requirements, Starbucks would seemingly need to comply with the broker reporting rules under Section 6045, though it would seem clear that this is not within the scope of what Congress would rationally have intended.

Just as physical collectibles, social media profiles or usernames, songs, video clips, admission tickets, credential certificates, or rewards points are not subject to reporting under Section 6045, NFTs should be similarly exempt.

V. THE PROPOSED REGULATIONS ARE INFEASIBLE WHEN APPLIED TO NON-CUSTODIAL WALLET SOFTWARE DEVELOPERS.

As explained above, non-custodial wallets require the digital asset owner to hold the private keys and therefore provide control and privacy to the owner in contrast to a custodial wallet. Non-custodial wallets eliminate the risk of a third party misusing the private keys because the digital asset owner is not required to share them with anyone. This also decreases the risk of a breach or attack on the digital assets, since the only way to access the private keys to any non-custodial wallet would be to target the specific digital asset owner.

Non-custodial wallet software developers often provide certain additional functionalities for their users. For example, as also explained above, non-custodial wallet software developers often provide some interface or functionality to make exchange protocols or blockchains accessible for users, but they do not act as intermediaries for digital asset transactions and have no visibility into these transactions. Offering these additional types of functions does not give non-custodial wallet software developers any additional information regarding customers or their transactions.

In the Proposed Regulations, Treasury recognizes that providing wallet functionality does not make a party a "broker" and provides an exception from "broker" status for wallet software developers. But this exception is so limited as to be practically useless. The wallet exception to "broker" status extends only to "the selling of hardware or the licensing of software for which the *sole* function is to permit persons to control private keys which are used for accessing digital assets on a distributed ledger if such functions are conducted by a person solely engaged in the business of selling such hardware or licensing such software" (emphasis added). This exception is unduly narrow given that most non-custodial wallet software offers some supplemental functionality in addition to allowing users to securely control their private keys. The Proposed Regulations also clarify that "[s]oftware that provides users with direct access to trading platforms from the wallet platform is not an example of software with the sole function of providing users with the ability to control private keys to send and receive digital assets." Thus, wallet software developers who do no more than provide a link to a wholly unrelated platform—or who merely provide translation services of English to computer code that users can then use to interact with unrelated platforms on their own—may be considered "brokers" notwithstanding the exception for wallet software developers. We do not believe this is the intention of Congress or Treasury.

These wallet software developers have no more access to customer or transaction information than do wallet software developers who do fall under the regulatory exception. There is no principled reason to distinguish between these types of functionality. When users of non-custodial wallets connect to a trading platform within the wallet software, the software simply provides access to the trading platform through an iframe or API, which is akin to a portal or window within a window. By simply providing a link to a separate trading platform where the transaction actually occurs, the non-custodial wallet software is not actually carrying out a transaction as a traditional broker would. The non-custodial wallet software provider has no insight into the information going in or coming out of the user's activity on the trading platform, thus providing no means by which the software provider could collect or report the information required by the Proposed Regulations.

Non-custodial wallet software developers also cannot perform any necessary backup withholding because they have no ability to reach into a customer's wallet to access funds. A distinctive feature of non-custodial wallets is that the user is the only one with access to the private key. The non-custodial software provider does not maintain access to the private key. To comply with the Proposed Regulations, non-custodial wallet software developers who also provide standard ease-of-access services would need access to the private key in order to conduct any necessary backup withholding. This would result in non-custodial wallet software developers having to provide *custodial* wallets. In other words, compliance would require wallet software developers to fundamentally change the nature of their activities or shut down. The Proposed Regulations do not address this issue nor do they analyze the cost to wallet software developers of theoretical compliance.

Moreover, defining non-custodial wallet software developers as brokers would result in duplicative reporting. In the example above, both the trading platform and the non-custodial wallet software provider would be required to collect and report the same transaction information even though the non-custodial wallet software is not actually carrying out the transaction. This falls out of line with the broker reporting regime in traditional finance, which places reporting obligations onto the broker actually performing the transactions. Treasury's explanation of the definition of broker as applied to digital assets inappropriately creates disparities between assets solely based on whether or not those assets are stored on a distributed ledger. This is improper and does not align with Congress's intent.[20]

VI. THE PROPOSED REGULATIONS ARE INFEASIBLE WHEN APPLIED TO DEFI.

As explained above, DeFi provides a way for users to transact with one another without involving any intermediary or middleman—i.e., it allows for "peer-to-peer" transactions or transactions directly with a smart contract. As a result, DeFi provides increased efficiency and lower transaction costs, and provides a way to transact without the risk that any third party or intermediary will make a mistake, steal assets, misuse user information, or subject user data or funds to a security breach.

DeFi by its very nature lacks any centralized party who acts as an intermediary or middleman for digital asset transactions and who could be responsible for compliance with the Proposed Regulations. The Proposed Regulations nonetheless attempt to impose obligations on various participants in DeFi. For some such participants, the Proposed Regulations are so vague that it is unclear whether or not the Proposed Regulations apply to them in the first instance. For others, it will be functionally impossible to comply with the Proposed Regulations as currently drafted. The sum result is that the Proposed Regulations would likely cause many DeFi participants to simply cease any activity, or result in their shifting entirely overseas.

Because of the issues inherent in regulating DeFi systems in this manner, we strongly suggest a staged approach that focuses first on centralized trading platforms. Centralized trading platform reporting alone would result in a massive amount of reporting. If a significant tax gap still exists that justifies further regulation after the rollout of tax reporting for centralized trading platforms, we believe that it is imperative for the government to collaborate with DeFi participants to find workable solutions in that space. With more time, and with lessons learned from the roll-out of the digital asset reporting requirements to centralized trading platforms, all parties will be better equipped to consider appropriate tools to help facilitate tax reporting while continuing to safeguard the privacy of DeFi users and allowing DeFi to exist and evolve. Such an approach could help facilitate overall tax compliance by encouraging buy-in from DeFi users.

Practically speaking, attempting to apply the Proposed Regulations to DeFi as they are currently drafted would not likely result in widespread compliance. As noted above, for many DeFi protocols, the system can be altered only by, at a minimum, an affirmative vote of governance tokenholders (many of whom may not be in the United States). There is no party with a unilateral ability to force changes of the sort that would be necessary to comply. Even assuming that parties involved with a given DeFi system (be it a founder, a developer, a holder of governance tokens, or others) wished to attempt to revise the system or protocol such that a user's identifying

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[20] At a minimum, we suggest that the final regulations explicitly exclude from the definition of "broker" unhosted wallets that are linked by users to third-party service providers that facilitate the sale or transfer of digital assets. Such an exception would be an appropriate acknowledgement that (1) non-custodial wallet software developers do not have access to the information required to be disclosed under the Proposed Regulations, and (2) if somehow such non-custodial wallet software developers did have access to the requisite disclosure information, that information would be duplicative of other disclosures made by other parties who fall under the definition of "broker."

information were to be embedded in the blockchain or otherwise tracked, a majority of all governance tokenholders would need to approve such a change, as the system (by its very coding) would not allow such changes without recording the affirmative vote (if at all).

Given the concerns raised below, as well as the fact that many (and in some instances a majority) of the holders of governance tokens may well be located outside the United States, it seems likely, based on The Blockchain Association's discussions with its members and other DeFi participants, that changes of the sort necessary to comply with the Proposed Regulations would not be approved, even if those changes could be made at all. This would leave U.S. parties who are, or may (given the vagueness noted below) be, subject to the Proposed Regulations, and who wish to avoid any risks of noncompliance, in a position of simply having to abandon their projects. Ex-U.S. participants, on the other hand, would presumably continue their activities. Driving tax-compliant U.S. involvement in DeFi out of existence or to a dramatically reduced level would not serve the national interest, but would create a significant risk were the Proposed Regulations enacted in their current form.

A. "Broker" status is contrary to the fundamental premise of DeFi.

To comply with the tax reporting regime, DeFi would have to change its very nature. As explained above, the fundamental premise of DeFi is that users can interact directly with one another and any person who could reasonably be considered a broker—i.e., any type of transactional intermediary or middleman—is eliminated. In other words, the distinguishing feature of DeFi is its decentralized, distributed nature, including the lack of any centralized party who could possibly collect the type of information that the Proposed Regulations requires "brokers" to report.

If any participant—or multiple participants—in DeFi were forced to find a way to collect information from DeFi users in a way that would allow the reporting required by the Proposed Regulations, DeFi would ultimately cease to exist. The centralization required for any party to collect this information is not compatible with the underlying concept of DeFi. In essence, the Proposed Regulations would be *creating* intermediaries where none previously existed in the DeFi space.

Congress did not authorize Treasury to destroy DeFi; it merely "clarifi[ed]" the definition of "broker" for purposes of Section 6045, suggesting that "brokers" with respect to digital assets are statutorily required to be "middlemen." Similarly, even Treasury previously expressed the "view that ancillary parties who cannot get access to information that is useful to the IRS are not intended to be captured by the reporting requirements for brokers."[21] Whether by intended effect or failure to understand the nature of decentralized finance, Treasury has drafted regulations that capture just such parties and that are fundamentally incompatible with DeFi itself rather than regulations that simply regulate DeFi. As discussed in the next section of this comment letter, the issues raised by the flawed drafting here are so profound as to raise significant Constitutional questions.

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[21] Letter from Jonathan C. Davidson, Department of the Treasury, Assistant Secretary for Legislative Affairs, to various Senators (February 11, 2022) [available at https://www.stradley.com/insights/publications/2022/02/-/media/e295168ea3714c528af55eb44cad7e30.ashx].

B. The definition of "broker" is infeasibly overbroad.

Through the nested definitions of "broker," "effect," "digital asset middleman," and "facilitative services" discussed above, the Proposed Regulations include certain parties or platforms as "brokers" subject to the reporting regime even though they do not in fact act as brokers, intermediaries, or middlemen; do not interact with any "customers"; and as such do not have a realistic pathway to compliance.

In particular, the following parties appear to be included in the definition of "broker":

- **Access service providers**. Although unclear, an access service provider—such as an internet service provider ("ISP")—appears to meet the definition of "broker" in the Proposed Regulations. Under Prop. Treas. Reg. § 1.6045-1(a)(iii)(A), a "facilitative service" includes (but is presumably not limited to) "the provision of a service that directly or indirectly effectuates a sale of digital assets," such as "providing access to digital asset trading platforms." An ISP indirectly effectuates such sales by providing access to the websites and internet connection necessary to access a digital asset trading platform. In addition, according to the Proposed Regulations, an ISP "would know or be in a position to know" the identity of the party that makes the sale and the nature of the transaction, because under Prop. Treas. Reg. § 1.6045-1(a)(ii)(A) and (B), an ISP would have the ability to change the fees charged for its facilitative service.

  This example illustrates the overbreadth of the Proposed Regulations, both in the definition of a "facilitative service" and the concept of being in a "position to know" certain information. We believe that it is not the intent of the Proposed Regulations to reach ISPs, but nevertheless the language of the Proposed Regulations brings them within scope.

- **Access tool providers**. Developers of tools and software that allow for more convenient access to a DeFi system or that assist users in their interactions with a DeFi system would appear to be included in the definition of "broker" in the Proposed Regulations, in a similar manner to an ISP. Examples may include browsers, block explorers, wallet applications, and other website or app developers that provide tools for users to help them interact with a DeFi protocol. None of these providers actually transacts on behalf of a customer or is in a position to gather information about customer trades any more than an ISP could theoretically ask its customers to identify digital asset trades accomplished through its internet service as a part of its terms of service.

- **Non-custodial wallet software developers**. As discussed above, most non-custodial wallet software developers also provide other functionality to their customers (such as providing an interface to interact with an unrelated exchange's protocol) and therefore would be "brokers" who do not fall under the Proposed Regulations' extremely narrow exemption for wallet providers. But by providing this additional functionality, these non-custodial wallet software developers do not gain any additional insight into customer or transaction information.

- **DeFi Developers**. DeFi developers create and many times deploy the protocol that may ultimately be accessed by users to effectuate transactions, but this does not give them any awareness of any particular digital asset transactions beyond what is publicly known via the blockchain, and they are not realistically in a position to know the identity of transacting parties and the nature of those transactions. Indeed, after drafting the code (or part of the code) to establish a DeFi protocol, a DeFi developer may never interact with the protocol again.

- **DeFi Tokenholders**. DeFi tokenholders often act in a decentralized manner that may include voting on certain aspects of a DeFi system. They can vote by virtue of holding governance tokens, but they do not have the ability to unilaterally take action. By voting on certain aspects of the protocol, they, like other DeFi participants, may help to allow users to interact with the system. They do not act as an intermediary for any users.

- **Website Providers**. Websites of various types have information and functionality that can assist holders of digital assets in effectuating trades, but these websites never act as intermediaries for trades and have very limited interaction with customers. Examples include websites that serve as bulletin boards or message boards focused on digital assets; websites that help users "explore" the blockchain and interact with unrelated protocols; websites that "translate" English into potentially usable computer code; and websites that simply explain how to access the blockchain.

- **Web2 Companies**. Various types of web2 companies, such as search engine providers and app stores, have information and functionality that can ostensibly "facilitate" holders of digital assets in effectuating trades. These web2 companies do not act as intermediaries for trades and likewise have very limited interaction with customers.

None of the parties in the categories above are serving a role that would generally be thought of as a broker or middleman, or that falls within the statutory definition. While their activities are forced into the scope of "middleman" via the Proposed Regulations, a plain English reading of the Code ("any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person") forecloses finding that any of these parties meet such standard.

C. The definition of "broker" is infeasibly vague.

Another major problem with the Proposed Regulations is their lack of clarity. The definition of "broker"—and its subsidiary definitions, such as "facilitative service" and "position to know"—are so vague that they leave many digital asset participants with no clear understanding of whether they are subject to the reporting requirements.

One example in the Proposed Regulations of a "facilitative service" is "providing an automated market maker system." It is unclear whether writing and publishing computer code for an automated market maker would constitute "providing" the system to customers. Similarly, it is unclear whether an individual who publishes a website or wallet application that allows access to a DeFi system would be considered to be "providing access to an automatically executing contract or protocol" or digital asset trading platform. What about a website or wallet application that merely describes what functions a user should input to effectuate transfers on a DeFi system? The definition of "facilitative service" is not limited to its examples, covering any service that "directly or indirectly effectuates a sale of digital assets."

As another example, the definition of "facilitative service" excludes certain types of validating transactions. However, the concept of "validating" is much more nuanced than the Proposed

Regulations appear to contemplate. For example, in many systems there are separate parties called "block builders," who arrange the transactions into blocks for validators to validate. These entities facilitate validation, but do not perform validation themselves. As currently drafted, the Proposed Regulations contain a broad definition of "facilitative service" with a narrow exclusion for "validating," indicating that block builders may be providing "facilitative services" as the Proposed Regulations are currently drafted, as illogical as that may be.

Another source of uncertainty is the definition of "person" for purposes of the regulations. Although the Proposed Regulations themselves do not contain a definition of "person," the Preamble states that the term "person" "generally has the meaning provided by section 7701(a)(1), which provides that the term generally includes an individual, a legal entity, and an unincorporated group or organization through which any business, financial operation, or venture is carried on." Putting aside the lack of clarity in the word "generally" used in the Preamble, this definition of "person" inserts significant uncertainty into the operation of the Proposed Regulations. Especially in decentralized contexts, groups of individuals who may not even be aware of each others' identities may, collectively, engage in common behavior (such as independently voting their tokens in connection with a DeFi system).[22] In the context of DeFi, there is no precedent to help determine whether such distributed groups could potentially constitute a partnership or "unincorporated group" for U.S. federal income tax purposes—and, to our knowledge, there has been no consideration given to the broader impact of such a characterization on DeFi and its participants.

One of the most troublesome sources of uncertainty in the Proposed Regulations is the definition of persons who "ordinarily would know or be in a position to know the identity of the party that makes the sale and the nature of the transaction potentially giving rise to gross proceeds from the sale." This "position to know" standard is met, according to the Proposed Regulations, if the person "maintains sufficient control or influence over the facilitative services provided" such that they have "the ability to change the fees charged for facilitative services." Several issues arise from this standard.

First, the purported ability to change the fees charged for facilitative services does not translate into actually knowing or being in a position to know identifying customer information. Practically speaking, to be in a position to know the identities of customers, therefore, DeFi participants would need to put into place sophisticated systems for collecting and storing DeFi user data—which, as discussed above, would fundamentally change the very nature of DeFi.

Second, the concept of "sufficient control or influence" to change the fees charged is also hopelessly vague. With respect to "sufficient control," it is unclear whether and to what extent holders of governance tokens would be viewed as having "sufficient control or influence" under the regulations. Would any group of governance token holders with over 50% of the voting share have "sufficient control" in the aggregate—even if these token holders do not know each other, or do not generally act in concert? What about a governance holder with veto power over protocol changes but not the power to initiate a change?

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[22] The Preamble specifically requests comments regarding "the extent to which holders of governance tokens should be treated as operating a digital asset trading platform business as an unincorporated group or organization."

The "sufficient influence" standard is equally, if not more, problematic. Practical ability to "influence" a protocol—e.g., through social media—should never subject a party to "broker" status (assuming this is even what is meant, which is unclear from the text of the Proposed Regulations). It is also unclear how this would be measured – if an individual (be it a founder, celebrity, or otherwise) believes that their voice would carry weight with holders of governance tokens, would this then make them a broker? How would a taxpayer ever know the true motivations of governance token holders for voting on a certain matter, and how would the government confirm or challenge that determination? Regardless of such "influence," such a party would not have access to customer information and thus never actually be in a "position to know." However, the Proposed Regulations would require parties to determine whether they have "sufficient" "influence" in the absence of any guidance regarding what level of influence could subject that party to the reporting requirements, let alone how those parties could possibly comply. Simply put, the Proposed Regulations once again create great uncertainty about what DeFi entities would even be covered by the Proposed Regulations.

We note that in other areas of the tax law, when measuring "control" or "relatedness" for purposes of imposing particular tax consequences, objective percentage standards are used – be that for purposes of defining a "controlled foreign corporation" and/or a "United States shareholder" under Sections 951(b) and 957(a), for purposes of defining related parties under Sections 267 and 707, and for purposes of defining "control" under Section 304, among a myriad of other places. Providing the public with clear, measurable standards (rather than subjective standards of "influence", or undefined levels of "control") is an essential feature for workable rules. Tokenholders and other participants in DeFi systems should not be "brokers" in the first place for the reasons outlined above; the vagueness of the Proposed Regulations only compounds the problem.

VII. THE PROPOSED REGULATIONS OVERSTEP TREASURY'S LEGAL AUTHORITY.

The Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*, requires a reviewing court to set aside agency action that is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," "contrary to constitutional right," "in excess of statutory jurisdiction," or "unsupported by substantial evidence." 5 U.S.C. § 706(2)(A), (B), (C). The Proposed Regulations, if finalized, would fail each requirement.

First, the Proposed Regulations exceed Treasury's statutory authority because they expand the definition of "broker" far beyond the text of the IIJA. As discussed, the Proposed Regulations would accomplish by regulation what Congress explicitly considered, but rejected, by legislation. The Proposed Regulations expand the IRS's regulatory authority far beyond the bounds authorized by the IIJA. But the IRS "literally has no power to act … unless and until Congress confers power upon it," *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986), and Congress's use of the term "broker" did not authorize the IRS to impose onerous requirements on every person tangentially involved in cryptocurrency or other digital assets. The Major Questions Doctrine bolsters this argument: Absent clear Congressional authorization, Treasury acts in a way that would eliminate DeFi and fundamentally transform non-custodial wallet services. For good reason Congress withheld that authorization here.

Second, the Proposed Regulations violate the First, Fourth, and Fifth Amendment rights of regulated parties. The Proposed Regulations compel developers to write new code. That is expressive conduct that cuts to the heart of the DeFi and non-custodial wallet industries by eliminating certain features of anonymity designed to protect participants. The Proposed Regulations impose content-based compelled speech, and are not narrowly tailored; they are likely to be struck down as contrary to the First Amendment. The Proposed Regulations also violate the Due Process Clause's fair notice requirement, because they fail to clearly specify who must comply with the reporting requirements.

Third, Treasury has not supported the Proposed Regulations with substantial evidence. The Proposed Regulations fail to quantify the costs or the benefits of the Proposed Regulations. On the costs side, as discussed above, the Proposed Regulations (1) vastly underestimate the costs of compliance by centralized parties, and (2) fail to grapple altogether with the likelihood that the Proposed Regulations will force the shuttering of regulated DeFi participants, or the likelihood that those parties will move any activities overseas. Nor do the Proposed Regulations estimate the burden on Treasury to process potentially billions of new filings. On the benefits side, the Proposed Regulations do not quantify the supposed "tax gap" or the benefits that third-party reporting would bring in closing that gap.

Fourth, the Proposed Regulations are arbitrary and capricious because they treat digital and non-digital assets differently without justification. As the D.C. Circuit recently explained vacating an SEC order, "dissimilar treatment of evidently identical cases is the quintessence of arbitrariness and caprice." *Grayscale Invs., LLC v. SEC*, No. 22-1142, 2023 WL 5536704, at *3 (D.C. Cir. Aug. 29, 2023). The Proposed Regulations impose more onerous reporting requirements on DeFi participants than traditional finance entities by broadening the scope of reporting entities and requiring brokers in the digital assets ecosystem to report more transactions, and at greater specificity, than brokers in traditional finance.

A. The Proposed Regulations are in excess of statutory jurisdiction.

The Proposed Regulations' application to DeFi participants and non-custodial wallet software developers exceeds Treasury's statutory jurisdiction set out in the IIJA. The Proposed Regulations contravene the text of the IIJA, which defines "brokers" as entities that "regularly provid[e] any service effectuating transfers of digital assets." Through a set of cascading definitions, Treasury's Proposed Regulations sweep in as "brokers" entities that have the ability to influence transactions, even if they never exercise that ability at all. That is contrary to the text of the IIJA. Congress does not "hide elephants in mouseholes," *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001), and its use of the term "brokers" did not authorize the IRS to impose requirements on every participant who could potentially influence a transaction involving digital assets. Separately, the Major Questions Doctrine requires that the Proposed Regulations be struck down. The Proposed Regulations threaten to wipe out the DeFi and non-custodial wallet industries in the United States. Under the Major Questions Doctrine, that would require a clear Congressional authorization. Congress did not provide any such authorization here. In fact, Congress affirmatively considered, and ultimately rejected, legislation that would have extended the IRS's authority to require reporting to DeFi participants. Basic application of the Major Questions Doctrine would require setting aside these Proposed Regulations.

More specifically, the Proposed Regulations' roundabout definition of "broker" sweeps significantly more broadly than the IIJA's definition, exceeding Treasury's statutory authority in at least two ways. *First*, through nested definitions of "broker," "effect," and "digital asset middleman," the regulations define as brokers entities that do not effectuate transactions. The Proposed Regulations conflate the term "affect" (to influence or have an effect on) with "effect" or "effectuate" (to cause to happen, to bring about, to give effect to, or to bring into effect). *See*

Bryan A. Garner, A Dictionary of Modern Legal Usage 305-06 (2001). By using the term "effectuate," Congress sensibly limited the reporting requirement to parties who actually carry out transactions. But the Proposed Regulations sweep much broader, capturing all entities who might provide "facilitative services" related to transactions. Thus, the Proposed Regulations sweep in entities like internet service providers and app marketplaces who may "provid[e] access to digital asset trading platforms." *See supra* pp. 23–24. But internet service providers and app marketplaces are not "service[s] effectuating transfers of digital assets on behalf of another person," as required by the IIJA. 135 Stat. 1340. While the "facilitative service[s]" described in the Proposed Regulations may *influence* transactions, they do not *cause* or *bring about* transactions. Moreover, these entities are ill-suited or unable to comply with the reporting requirements, *see supra* p. 7, which contravenes Treasury's insistence that the regulations are not meant to extend to ancillary parties who cannot access information useful to the IRS, *see id.* Because the Proposed Regulations require reporting from a host of entities who do not carry out transactions, they exceed Treasury's statutory jurisdiction.

Second, the Proposed Regulations define as a broker an entity who "stands ready" to effect sales. Prop. Treas. Reg. § 1.6045-1(a)(1). But the IIJA defines a broker only to include entities who are "responsible for regularly providing" effectuating services. 135 Stat. 1340. While Congress sensibly limited the scope of Treasury's authority to include only entities that actually provide transactional services, the Proposed Regulations exceed that definitional limitation to include entities who have never effectuated transactions before, but because they possess the technical ability to do so, are subject to onerous reporting requirements. The "stands ready" provision stretches the reporting requirement beyond the IIJA.

Each of these arguments would lead a court to invalidate the Proposed Regulations based on ordinary principles of statutory construction and the APA. That's because the "starting point in any case involving the meaning of the statute is the language of the statute itself." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 210 (1979). The Proposed Regulations are inconsistent with the plain text of the IIJA, and there is no ambiguity in the term "brokers" that could authorize the sweeping approach that Treasury has taken to DeFi and non-custodial wallet entities.

What's more, the Major Questions Doctrine lends even more force to both of these arguments. In certain cases, "separation of powers principles and a practical understanding of legislative intent make [the Court] reluctant to read into ambiguous statutory text the delegation claimed to be lurking there." *West Virginia v. EPA*, 142 S. Ct. 2587, 2609 (2022). The Court has explained that the doctrine applies depending on the "economic and political significance" of the regulation, and that when it applies, the agency "must point to clear congressional authorization for the power it claims." *Id.*

Because Congress did not authorize Treasury to require DeFi entities or non-custodial wallet software developers to report, a court would invalidate the Proposed Regulations (if enacted). The Proposed Regulations would have the practical effect of driving many U.S.-based DeFi entities to cease activity or to restructure overseas. *See supra* pp. 21–22. In either event, the Proposed Regulations will eliminate innovation in decentralized technology in the United States. A result of that magnitude requires clear Congressional authorization. *See West Virginia*, 142 S. Ct. at 2612.

The Major Questions Doctrine would also apply for another reason: Congress considered, but ultimately rejected, the very authority now sought by Treasury. *See supra* pp. 5–6. Congress considered a draft of the IIJA that defined "broker" to include "any decentralized exchange or peer-to-peer marketplace," but rejected that provision. That fact, coupled with "[t]he importance of the issue" to DeFi, calls for the doctrine's application. *West Virginia*, 142 S. Ct. at 2614.

Applying the Major Questions Doctrine here would require setting aside the Proposed Regulations. Congress did not give clear congressional authorization to Treasury to require reporting from DeFi entities or non-custodial wallet software developers. Congress certainly did not do so in a definitional provision, especially when it considered and rejected the very definition that Treasury now seeks to impose. *See West Virginia*, 142 S. Ct. at 2613. If enacted, the Major Questions Doctrine would require vacatur of the Proposed Regulations' application to DeFi participants.

B. The Proposed Regulations are contrary to constitutional right.

The Proposed Regulations are also "contrary to constitutional right." 5 U.S.C. § 706(2)(B). The Proposed Regulations raise at least three significant constitutional issues: violations under the First, Fourth, and Fifth Amendments.

First, the Proposed Regulations violate the First Amendment right against compelled speech. The First Amendment protects the "right to speak and the right to refrain from speaking." *Wooley v. Maynard*, 430 U.S. 705, 713 (1977). "There is certainly some difference between compelled speech and compelled silence, but in the context of protected speech, the difference is without constitutional significance." *Riley v. Nat'l Fed'n of the Blind of N.C., Inc.*, 487 U.S. 781, 793 (1988). Computer code "must be viewed as expressive for First Amendment purposes." *Bernstein v. United States Dept. of Justice*, 176 F.3d 1132, 1141 (9th Cir. 1999); *see also Universal City Studios, Inc. v. Corley*, 273 F.3d 429, 448 n.22 (2d Cir. 2001). Computer code is, therefore, "protected speech," and programmers have the right to determine for themselves "what *not* to say." *Riley*, 487 U.S. at 797. Content-based compelled speech is subject to strict scrutiny, *see id.* at 797–98, and so may only be upheld if it is narrowly tailored to obtain a compelling state interest, *see Turner Broad. Sys., Inc. v. FCC*, 512 U.S. 622, 662 (1994).

The Proposed Regulations compel speech from DeFi developers and non-custodial wallet software developers. The Proposed Regulations require these developers to include code in their products that would reveal customer data. *See supra* pp. 19-21. That is expressive speech, *see Bernstein*, 176 F.3d, at 1141, and it is expressive speech that goes to the very heart of DeFi as well as the ability to self-custody one's assets: *see supra* pp. 22-23. Compelling coders to write new language that violates that core principle is, in every sense of the term, viewpoint discrimination that violates the First Amendment. *See Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789, 804 (1984).

The Proposed Regulations fail strict scrutiny. Even if tax reporting is a compelling state interest, the regulation is not narrowly tailored to achieve that end; compelling developers to write particular code is broader than imposing a reporting requirement on buyers and sellers of crypto products. Even if strict scrutiny did not apply, the Proposed Regulations would still violate the First Amendment because the breadth of the Proposed Regulations, which apply to *all* entities who have the capacity to influence a transaction, is not rationally related to the government's interest in collecting tax.

Second, the Proposed Regulations violate the Fourth Amendment. Government action violates the Fourth Amendment if it is (a) a search, and (b) is unreasonable. *See City of Los Angeles, Calif. v. Patel*, 576 U.S. 409, 419 (2015). A search under the Fourth Amendment occurs when the government invades a constitutionally protected privacy interest to gather information. *See Katz* *v. United States*, 389 U.S. 347, 360–61 (1967) (Harlan, J., concurring). The reasonableness of a search is context-specific, but outside of the criminal context, the reasonableness inquiry examines whether the search is "sufficiently limited in scope, relevant in purpose, and specific in directive so that compliance will not be unreasonably burdensome." *See v. City of Seattle*, 387 U.S. 541, 544 (1967).

The Proposed Regulations violate the Fourth Amendment rights of both individual participants to a transaction *and* the third parties required by the Proposed Regulations to report information to the IRS.

As to the *participants of a transaction*, the Proposed Regulations invade a constitutionally protected privacy interest to gather information. The Proposed Regulations require participants to a transaction to give up their private information to a third party, and ultimately to the government. That's a search. *See, e.g.*, *Chandler v. Miller*, 520 U.S. 305, 313 (1997) (Fourth Amendment right against laws requiring people to report information to the government). And the information that must be disclosed requires linking personal identities to transactions that are the quintessential "privacies of life" entitled to protection. *See Carpenter v. United States*, 138 S. Ct. 2206, 2217 (2018). The reporting requirements include enough information for the government to identify addresses on a public ledger that would allow the government to access large quantities of data that date back years, and will continue into the future. The Fourth Amendment's protections are strongest when a search reveals not just isolated pieces of information, but a large quantity of information that can reveal information about a person's most intimate activities. *See Riley v. California*, 573 U.S. 373, 395 (2014).

While the Supreme Court has recognized that third-party reporting of tax information by a bank does not constitute a search, *see United States v. Miller*, 425 U.S. 435, 443 (1976), that was only because the parties to a transaction with a bank "voluntarily convey[]" their information, and thus lose their reasonable expectation of privacy. *Id.* at 442. But that's not the case for cryptocurrency users, who follow state-of-the-art protocols to protect privacy in transactions. Unlike transactions involving banks or financial institutions, for which third-party reporting may be constitutionally permissible, cryptocurrency users do not voluntarily convey their personal information to any third parties, and for DeFi users, there is no third-party at all with whom information could be shared. The Proposed Regulations do not ask for information *already conveyed*, but rather require parties to collect, and then disclose to the government, vast swaths of sensitive information.

The search of participants to a transaction is unreasonable. The Proposed Regulations do not allow the participants "an opportunity to obtain precompliance review before a neutral decisionmaker." *City of Los Angeles, Calif. v. Patel*, 576 U.S. 409, 420 (2015). The Proposed Regulations are devoid of any tailoring at all and apply whether or not the government has any suspicion that the participants are evading IRS regulations. The Proposed Regulations' dragnet approach may aid the IRS in its mission, but "no Fourth Amendment precedent countenances this expedient"; the "test of reasonableness is not whether an investigative practice maximizes law enforcement efficacy." *Airbnb, Inc. v. City of New York*, 373 F. Supp. 3d 467, 492 (S.D.N.Y. 2019).

As to the *third parties* who must collect, and then report, vast quantities of information, the Proposed Regulations also constitute an unconstitutional search. The Proposed Regulations require third parties to collect and turn over to the government vast amounts of information. That is a search, as the Ninth Circuit explained in a case striking down an ordinance requiring hotels to report information about its guests: "The business records covered by [the challenged ordinance] are the hotel's private property, and the hotel therefore has both a possessory and an ownership interest in the records. By virtue of those property-based interests, the hotel has the right to exclude others from prying into the contents of its records, which is also the source of its expectation of privacy in the records." *Patel v. City of Los Angeles*, 738 F.3d 1058, 1061 (9th Cir. 2013) (en banc), *aff'd*, 576 U.S. 409 (2015); *see also Airbnb, Inc. v. City of New York*, 373 F. Supp. 3d 467, 484 (S.D.N.Y. 2019) (Fourth Amendment protects companies' privacy interest in data as to their users).

Like those of participants, these searches of third parties would also be unreasonable. Third parties have no opportunity to obtain precompliance review before a neutral decisionmaker. *Patel*, 576 U.S. at 420. The Proposed Regulations are not tailored at all to particular types of transactions or types of entities that raise suspicion. *Airbnb*, 373 F. Supp. 3d at 492. Further, the universality of the Proposed Regulations' production demand (covering *all* transactions involving digital assets, with no de minimis requirement), the sheer volume of records implicated, and the Proposed Regulations' infinite time horizon "all disfavor the [Regulations] when evaluated for reasonableness under the Fourth Amendment." *Airbnb*, 373 F. Supp. 3d at 491.

Third, the Proposed Regulations violate the Fifth Amendment's Due Process Clause. The Due Process Clause requires that Treasury "give fair notice of conduct that is forbidden" and establish adequate standards to prevent "seriously discriminatory enforcement." *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012); *see also Johnson v. United States*, 576 U.S. 591, 602 (2015) (while "[e]ach of [a provision's] uncertainties … may [have] be[en] tolerable in isolation, … their sum ma[de] a task … which at best could be only guesswork"). A regulation that "requires the doing of an act" (like the reporting requirements proposed here) "in terms so vague that [persons] of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process of law." *Connally v. Gen. Const. Co.*, 269 U.S. 385, 391 (1926).

The Proposed Regulations require regulated parties to "necessarily guess at its meaning." *Id.* Through the cascading definitions of broker, effect, and digital asset middleman, the Proposed Regulations require a regulated party to report if the person "ordinarily would know or be in a position to know the identity of the party that makes the sale." Prop. Treas. Reg. § 1.6045-1(a)(21)(i). And then the Proposed Regulations define "position to know" to sweep in a person who has "the ability" to require parties to provide their time, address, and taxpayer identification number upon request. *Id.* § (21)(ii). That definition does not give fair notice to regulated parties, and the Proposed Regulations do not offer any outer bounds to what it means to have the ability to require information—and indeed provide that some parties are deemed to have that ability when they do not, as discussed above. And this vagueness problem is heightened in this case because the Proposed Regulations compel speech. *Cmty. for Creative Non-Violence v. Turner*, 893 F.2d 1387, 1395 (D.C. Cir. 1990) (due process clause "applies with particular force in review of laws dealing with speech").

These due process concerns are heightened by the unreasonably short timeline for regulated parties to comment on the Proposed Regulations and by the unreasonably short timeline by which the Proposed Regulations will take effect. *See supra* pp. 3–4.

C. Treasury has not supported the Proposed Regulations with substantial evidence.

Treasury has not supported its Proposed Regulations with substantial evidence. The APA requires that an agency's findings and conclusions be supported by "substantial evidence," which requires a reviewing court to consider whether the record as a whole supports the agency's conclusions.

Universal Camera Corp. v. NLRB, 340 U.S. 474 (1951). An agency fails substantial evidence review if it ignores evidence that undercuts its judgment or discounts evidence without adequate explanation. *See Morall v. DEA*, 412 F.3d 165, 179-80 (D.C. Cir. 2005). The Proposed Regulations lack substantial evidence as to both the Proposed Regulations' benefits and costs.

Treasury's analysis is flawed from the start because it fails to accurately quantify any "tax gap" resulting from digital asset transactions. Treasury hypothesizes that digital assets "create[] a significant risk to tax administration," 88 Fed. Reg. 59,580, but Treasury does not attempt to quantify the tax gap. Nor does Treasury quantify the tax benefits that might result from enacting the reporting requirements.

Treasury's analysis about the burden on regulated parties is also flawed. Treasury estimates that the average party will incur an annual "425 hours of time burden" to comply with the regulations. 88 Fed. Reg. 59,619. That estimate significantly undercounts the burden on centralized entities, which as described above, will have to undertake much more significant efforts (and incur much more significant costs) to comply. The Proposed Regulations also fail to grapple with the result of the Proposed Regulations that DeFi developers will either shut down or quit serving the United States market because they can't reengineer their products to comply, because they do not want to suffer the First Amendment compelled speech injuries, or because their customers might simply stop using digital assets to avoid revealing sensitive personal information. As for non-custodial wallet software developers, the same concerns apply. The Proposed Regulations fail to consider the cost of developers of such software needing to fundamentally change their software in order to comply with the regulations or cease providing non-custodial wallet software altogether in the U.S. The Proposed Regulations purport to calculate the average and aggregate start-up costs for compliance, but fail to grapple with the effect that those costs will have on small entities, for whom the cost of compliance would likely be prohibitive.

Treasury's burden analysis is also flawed because it fails to consider the overlapping reporting requirements imposed on digital asset entities from various regimes. For instance, Treasury fails to analyze the benefits to a reporting regime that aligns with the Crypto Asset Reporting Framework (CARF) that govern parties in the European Union. Overlapping and inconsistent reporting requirements are an additional burden on regulated parties, but the Proposed Regulations fail to quantify that burden, or the corresponding benefits of aligning U.S. regulations with CARF.

Treasury also has not considered the administrative burden to regulated parties and to the agency that will result from the failure to exempt *de minimis* transactions – resulting in potentially billions of filings, including duplicative filings by numerous purported "brokers" that act within the same value chain of a given transaction, such as service providers, DeFi providers, tokenholders, developers, liquidity providers, and others. *See supra* pp. 16–17.

D. The Proposed Regulations are arbitrary and capricious.

The APA requires a reviewing court to set aside agency action that is "arbitrary [or] capricious." 5 U.S.C. § 706(2)(A). This provision of the APA requires agencies to treat like cases alike. *Westar Energy, Inc. v. FERC*, 473 F.3d 1239, 1241 (D.C. Cir. 2007) ("A fundamental norm of administrative procedure requires an agency to treat like cases alike."); *see also Grayscale*, 2023 WL 5536704, at *3.

In addition to the distorted cascading definitions that lead the IRS to classify entities as "brokers" that perform no function as a broker, *see supra* pp. 5–7, the Proposed Regulations violate this requirement because, in this tax context, they treat traditional finance and decentralized finance differently without justification. By way of example, the Proposed Regulations:

- Require reporting for broker-to-broker transactions, which is not a requirement for traditional finance, *see supra* pp. 17–18;

- Define broker in the decentralized context as one who "stands ready" to perform certain functions, while defining broker as one who "regularly acts as a middleman" in the traditional finance context, *see supra* p. 5.

- Require reporting of information far beyond what traditional finance brokers must require, including timestamps down to the second, *see supra* pp. 17–18.

- Require decentralized finance entities to track down non-covered assets that traditional finance entities do not have to, see supra p. 18.

These disparities are emblematic of the Proposed Regulations' differential treatment of traditional and decentralized finance. That broader problem – the failure to treat like issues alike – is definitionally arbitrary and capricious.

Further, the vagueness problems identified above also require that the Proposed Regulations, if passed in current form, be set aside under the APA. "[A]n agency's exercise of its statutory authority [must] be reasonable and reasonably explained." *Mfrs. Ry. Co. v. Surface Transp. Bd.*, 676 F.3d 1094, 109 (D.C. Cir. 2012). "[C]ryptic" explanations that "ha[ve] no content" or "offer[] no meaningful guidance" must be set aside. *USPS v. Postal Regulatory Comm'n*, 785 F.3d 740, 754 (D.C. Cir. 2015); *see also, e.g.*, *Tripoli Rocketry Ass'n v. BATF*, 437 F.3d 75, 81 (D.C. Cir. 2006). The Proposed Regulations offer "no meaningful guidance" to regulated parties about whether they are or are not subject to the Proposed Regulations' onerous reporting requirements and thus fail the APA's "requirement of reasoned decision making." *USPS*, 785 F.3d at 754.

VIII. CONCLUSION

For the reasons set forth above, the Proposed Regulations introduce overly burdensome or truly impossible requirements for numerous participants. We hope that our comments will help highlight why the Proposed Regulations, as currently drafted, cannot function appropriately. Moreover, the timeline afforded to those who are properly subject to the broker reporting regime must be extended to account for the significant lead time that will be required to build out the requisite systems. We encourage Treasury and the IRS to reconsider certain aspects of the Proposed Regulations and re-propose rules that would better account for practical considerations in the digital asset ecosystem, with ample time for implementation for those ultimately impacted.

*   *   *   *   *

We appreciate the opportunity to comment on these regulations and would be happy to discuss further any of the issues discussed here.

Respectfully submitted,

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EXHIBIT A

SEC. _______. ENHANCEMENT OF INFORMATION REPORTING FOR BROKERS AND DIGITAL ASSETS.

(a) EXPANSION OF DEFINITION OF BROKER.—Section 6045(c)(1) of the Internal Revenue Code of 1986 is amended—

(1) by striking "and" at the end of subparagraph (B),

(2) in subparagraph (C)—

(A) by striking "any other person who (for a consideration)" and inserting "any person who (for consideration)", and

(B) by striking the period at the end and inserting ", and", and

(3) by inserting after subparagraph (C) the following new subparagraph:

"(D) any person who (for consideration) regularly provides any service responsible for effectuating transfers of digital assets, including any decentralized exchange or peer-to-peer marketplace.".

(b) REPORTING OF DIGITAL ASSETS.—

(1) BROKERS.—

(A) TREATMENT AS SPECIFIED SECURITY.—Section 6045(g)(3)(B) of the Internal

Revenue Code of 1986 is amended by striking "and" at the end of clause (iii), by redesignating clause (iv) as clause (v), and by inserting after clause (iii) the following new clause:

"(iv) any digital asset, and".

(B) DEFINITION OF DIGITAL ASSET.—Section 6045(g)(3) of such Code is amended by adding at the end the following new subparagraph:

"(D) DIGITAL ASSET.—Except as otherwise provided by the Secretary, the term 'digital asset' means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.".

(C) APPLICABLE DATE.—Section 6045(g)(3)(C) of such Code is amended—

(i) in clause (ii), by striking "and" at the end,

(ii) by redesignating clause (iii) as clause (iv), and

(iii) by inserting after clause (ii) the following:

"(iii) January 1, 2023, in the case of any specified security which is a digital asset, and".

(2) FURNISHING OF INFORMATION.—

(A) IN GENERAL.—Section 6045A of such Code is amended—

(i) in subsection (a), by striking "a security which is", and

(ii) by adding at the end the following:

"(d) RETURN REQUIREMENT FOR CERTAIN TRANSFERS OF DIGITAL ASSETS NOT OTHERWISE SUBJECT TO REPORTING.—Any broker, with respect to any transfer of a covered security which is a digital asset during any calendar year and with respect to which such broker is not otherwise required to furnish a return under section 6045 or a written statement under subsection (a), shall make a return for such calendar year, in accordance with such regulations as the Secretary may prescribe, showing the information otherwise required to be furnished under subsection (a).".

(B) REPORTING PENALTIES.—Section 6724(d)(1)(B) of such Code is amended by striking "or" at the end of clause (xxv), by striking "and" at the end of clause (xxvi), and by inserting after clause (xxvi) the following new clause:

"(xxvii) section 6045A(d) (relating to returns for certain digital assets),".

(3) TREATMENT AS CASH FOR PURPOSES OF SECTION 6050I.—Section 6050I(d) of such Code is amended by striking "and" at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting ", and", and by inserting after paragraph (2) the following new paragraph:

"(3) any digital asset (as defined in section 6045(g)(3)(D)).".

(c) RULE OF CONSTRUCTION.—Nothing in this section or the amendments made by this section shall be construed to create any inference with respect to whether any digital asset is property which is a specified security under section 6045(g)(3)(B) of the Internal Revenue Code of 1986 for any period prior to the effective date of such amendments.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to returns required to be filed, and statements required to be furnished, after December 31, 2023.