Dear Chairman Wyden and Ranking Member Crapo,

We, at the Chamber of Digital Commerce (the "Chamber"), appreciate the opportunity to provide our insights and comments on the taxation of digital assets, as requested by the Senate Finance Committee. We recognize the complexities and unique challenges that the evolving digital asset landscape presents, particularly in relation to federal tax law and hope our responses serve as a useful resource.

The Chamber is the world's largest blockchain trade association. Our mission is to promote the acceptance and use of digital assets and blockchain technology, and we are supported by a diverse membership that represents the industry globally. We represent the world's leading innovators, operators, and investors in the blockchain ecosystem, including leading edge start-ups, software companies, global IT consultancies, financial institutions, insurance companies, law firms, accounting firms and investment firms. As a leading advocate for businesses across various sectors, we are committed to fostering an environment that encourages innovation while ensuring regulatory compliance.

Our responses are organized in response to each question in the request below. In the rapidly evolving landscape of blockchain and related technologies, various terms and terminologies are often used interchangeably in the market. For the purpose of clarity and consistency in these comments, we will be using the term "digital asset" to encompass the range of assets that exist in digital form. While we acknowledge and respect the diverse terminology preferences within the community, our choice to consistently use "digital asset" is to ensure uniformity and avoid potential confusion throughout our commentary.

We appreciate your consideration of these comments and welcome the opportunity to discuss them further with you and your staff. If you have any questions or would like to discuss further, please feel free to contact Cody Carbone, Vice President of Policy at Cody@digitalchamber.org.

1. Marking-to-Market for Traders and Dealers (IRC Section 475)

a. Should traders of digital assets be permitted to mark to market? Why?
Traders of digital assets should be permitted to mark-to-market. We view this as less of a policy question and more a technical one of determining what level of market activity is required for digital assets to be marked-to-market and what types of activities constitute trading activities.

IRC Section 475 was enacted in response to Congress' concern that securities dealers were understating their income by reporting income with respect to their inventory of securities on the lower of cost or market method, which allowed securities dealers to recognize unrealized losses

but not unrealized gain.[1] The mark-to-market method is considered a more accurate reflection of income for taxpayers who hold fungible assets as inventory for sale in the ordinary course. We see no reason why a taxpayer that regularly purchases and sells digital assets (for which there is a market) in the ordinary course of business should be treated differently from other assets for which mark-to-market is either permitted or required.

b. Should dealers of digital assets be permitted or required to mark to market? Why?
Consistent with the treatment of traders above, we see no reason why IRC Section 475 should apply differently to dealers in digital assets than to dealers in stocks and securities.

c. Should the answer depend on the type of digital asset? How should digital assets be determined to be actively traded (under IRC Section 475(e)(2)(A))?
In order to mark-to-market, there has to be a "market" and such market needs to establish the value that the taxpayer could pay or receive if the asset was purchased or sold on the reporting date. We see no reason why any digital asset for which there is a reasonable basis to determine fair market value should be treated differently than any security or commodity. The Treasury Regulations under IRC Section 1092(d) provide that actively traded personal property includes any property for which there is an established financial market.[2] While the same regulations define an established financial market with reference to regulated securities and commodities exchanges, they also include an "interdealer market," which is "characterized by a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers, or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations (including rates, yields, or other pricing information) of one or more identified brokers, dealers, or traders or actual prices (including rates, yields, or other pricing information) of recent transactions." We would expect any price-tracking service such as CoinMarketCap and similar platforms to meet the criteria to be considered an interdealer market described above and digital assets with values shown on such platforms to be considered as traded on an established financial market.

We see no reason to distinguish digital asset transactions from securities and commodities transactions as it relates to the scope of activities determined to be "trading."

2. <u>Trading Safe Harbor (IRC Section 864(b)(2))</u>

a. When should the policies behind the trading safe harbor (of encouraging foreign investment in U.S. investment assets) apply to digital assets? If those policies should apply to (at least some) digital assets, should digital assets fall under IRC Section 864(b)(2)(A) (trading safe harbor for securities), IRC Section 864(b)(2)(B) (trading safe

[1] H.R. Rep. 103-111, 103rd Cong., 1st Sess. (May 25, 1993).
[2] Treas. Reg. Section 1.1092(d)-1(a).

harbor for commodities), or should the answer depend on the regulatory status of the specific digital asset? Why?

In 2022, the U.S. alternative asset management industry had roughly $18 trillion of assets under management. A significant percentage of such assets come from foreign pension funds, sovereign wealth funds, foreign insurance companies and other foreign investors. Such investors have long relied on the securities, commodities and the proposed derivatives trading[3] safe harbors to avoid becoming subject to U.S. net taxation solely because of investing in U.S. stocks, bonds and other investment assets or as a result of being limited partners or other beneficial owners in U.S.-managed investment funds that hold such assets.

We are aware that many private market investment funds may buy, hold and sell digital assets as part of their investment program. Where such funds are managed by U.S. persons, there is significant uncertainty as to whether foreign investors in these funds can rely on the current safe harbors while the status of digital assets as securities or commodities (or both or neither in different contexts) remains uncertain.

The current safe harbors were enacted to encourage foreign investment in U.S. investment assets where ordinary income from such assets would generally be subject to Fixed Determinable, Annual, or Periodical (FDAP) income subject to withholding.[4] Without the safe harbors, foreign investors effecting transactions in stocks, securities or commodities, including stock, securities or commodities organized or located outside of the U.S., could be treated as engaged in a U.S. trade or business if they are using a U.S. agent, and the income from such investments could be subject to U.S. income tax, even though, in the case of foreign stocks or securities, ordinary income from such investments would generally be foreign-source income and not subject to U.S. tax.

We do not see a compelling policy reason to treat digital asset transactions effected, directly or indirectly, through an agent in the U.S. differently than stock, securities and commodities, regardless of the source of the income from the digital asset transactions. If effecting transactions in digital assets through an agent in the U.S. causes a foreign investor to be engaged in a U.S. trade or business, foreign investors that want to invest in digital assets may be incentivized to invest with agents located outside of the U.S., thereby having a chilling effect on the U.S. alternative asset management industry.

Given the unique characteristics of digital assets – sometimes functioning like a security, other times functioning as a commodity and at still other times, not functioning as either a security or a commodity – extending the existing safe harbors to digital assets is more likely to result in unintended consequences than would adopting a new safe harbor solely for trading in digital

[3] Prop. Reg. Section 1.864(b)-1

[4] See Notice of Proposed Rulemaking, Fed. Reg. Vol. 63, No. 113, p. 32164 (June 12, 1998).

assets. We do not express a view as to whether a dealer in digital assets should be permitted to avail itself of the securities or commodities safe harbor when trading in those assets for its own account.

b. Another possibility is that a new, separate trading safe harbor could apply to digital assets. In that case, should the additional limitation on commodities eligible for the trading safe harbor apply? Why?

The commodities trading safe harbor is limited to commodities that are of a kind customarily dealt with through an organized commodity exchange and to transactions of a kind customarily consummated on such exchanges.[5] The regulations define a "commodity" to exclude goods or merchandise in the ordinary channels of commerce.[6] Given the nature of fungible digital assets, which generally operate as a store of value, and not as goods or merchandise in commerce, we do not see any reason to limit such fungible digital assets to those of a kind traded on organized exchanges or to transactions of a kind effected on such exchanges.

We do not express a view on whether nonfungible digital assets eligible for the trading safe harbor should be subject to such limitation.

c. To the extent that the additional limitation on commodities for the trading safe harbor applies, how should the terms "an organized commodity exchange" and "transactions of a kind customarily consummated" (in IRC Section 864(b)(2)(B)(iii)) be interpreted in the context of different kinds of digital asset exchanges?

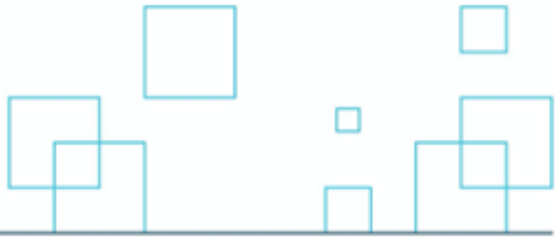
Because we think fungible digital assets generally do not operate as goods or merchandise in commerce, we do not see any reason to apply the limitation for the commodity trading safe harbor. Many if not most fungible digital assets that are subject to investment or trading will already be of the kind that are customarily consummated on a digital asset exchange or similar platform.

3. <u>Treatment of Loans of Digital Assets (IRC Section 1058)</u>

a. Please describe the different types of digital asset loans.

- **Collateralized Loans**:
  - Crypto-backed Loans: Borrowers use their cryptocurrencies (like bitcoin, ether) as collateral to secure a loan, typically in fiat money (like USD, EUR) or stablecoins (like

[5] 26 U.S. Code § 864
[6] 7 U.S.C. §§ 1-26.



USDC, USDT). If the borrower fails to repay, the lender can sell the collateral to recoup their funds.
    - Some platforms allow users to take loans against their staked assets (e.g., staked ether in Ethereum 2.0). The staked asset serves as collateral, and the borrower receives funds based on the staked asset's value.
    - Companies that provide fiat or stablecoin loans using digital assets as collateral. These platforms act as intermediaries, and they usually offer a more user-friendly experience compared to decentralized platforms but come with counterparty risk.
- **DeFi Lending Platforms**:
    - Peer-to-Peer (P2P) Loans: Platforms like Compound, Aave, and MakerDAO allow users to lend or borrow funds directly from other users or from a pooled fund. Interest rates can be set algorithmically based on supply and demand.
    - Liquidity Pools: Users can deposit their assets into a pool, and borrowers can take loans against this pool. Interest is earned by the liquidity providers.
    - Flash Loans: These are uncollateralized loans where borrowing and repayment happen within a single transaction. This is useful for arbitrage opportunities and other financial operations.
- **Staking Loans**: Undertaking staking on certain protocols requires an initial “stake” of the protocol’s native digital asset. Certain stakers will take a “loan” of the protocol’s native digital asset from third-party lenders. The third-party lenders will take a portion of the staking rewards as a fee for providing the digital assets to the staker.
- **NFT-backed Loans**: With the rise of non-fungible tokens (NFTs), some platforms allow users to collateralize their unique digital assets (like art, collectibles or virtual real estate) to secure loans.
- **Margin Lending**: This is prevalent in cryptocurrency exchanges. Users can borrow funds to leverage their trades. If the position moves against them, the exchange may issue a margin call, requiring the user to add more funds or sell assets to cover the loan.
- **Tokenized Loans**: Some platforms allow for the creation of tokenized debt agreements. These tokens represent a claim on the underlying debt and can be traded or used in other financial applications.
- **Revolving Credit Lines**: Like traditional credit lines, some platforms provide borrowers with a maximum limit they can borrow against. Borrowers can draw and repay funds as needed up to the limit and are charged interest only on the amount they draw.
- **B2B (Business-to-Business) Digital Asset Loans**: These are tailor-made solutions for businesses seeking liquidity or financing using their digital assets as collateral.
- **Parachain Loans**: This refers to receiving airdrops for locking up tokens for a period of time in support of projects’ securing a parachain slot on the Kusama or Polkadot networks.

b. If IRC Section 1058 expressly applied to digital assets, would companies allowing customers to lend digital assets institute a standard loan agreement to comply with the requirements of that section? What challenges would compliance present?

It is our understanding that some market participants are already structuring digital asset lending arrangements to comply with IRC Section 1058 by meeting the following requirements:

1. The borrower is required to return to the lender digital assets that are identical to those which were lent to the borrower;
2. The lending transaction does not limit the lenders "risk of loss." Essentially, the agreement must provide that the lender may terminate the loan upon notice of not more than 5 business days;[7] and
3. Any airdrops or hardforks that occur during the loan period should be considered owned by the lender and not the borrower even though the borrower has possession.

A standard agreement would likely only be appropriate for certain types of lending arrangements. In the digital asset space, the types of arrangements involving the lending or leasing of digital assets is varied and driven by different economic, commercial and/or technical requirements. For example, the fact patterns are as varied as:

1. Digital assets are provided as collateral for a cash or stablecoin loan, which automatically executes if the collateral-to-loan value drops below a certain percentage;
2. A native digital asset loan to a market maker to enable the market maker to trade the native digital asset in order to create a market in the digital asset;
3. Loans of a native digital asset to a staker, who has the equipment and software but not the cash to purchase the native asset or the native asset itself, to begin staking; or
4. A holder of a digital asset that is passively looking to earn a yield by providing the asset to a centralized broker for further lending to a third party.

In each case, it will be useful to a have safe harbor such as IRC Section 1058, ideally updated to reflect the technical and economic features of digital assets. Congress may consider updating the criteria to evidence "risk of loss" to reflect the technology and industry practices.

For example, it is common in the digital asset industry for there to be multiple approvers to release the digital asset from a self-hosted hardware or software wallet (e.g., multi-sig wallets), and getting all required approvers to approve a transaction may take longer than expected; thus, 7 days or 10 days to deliver tokens may be more practical than 5 days. Another example is in staking protocols, where the bad behavior of stakers (whether it be intentional or unintentional, or the result of unreliable infrastructure or software) is penalized by having the staked tokens "slashed," which means that the tokens are confiscated and destroyed by the protocol. Thus, Congress may consider an update to IRC Section 1058 that allows the party who bears the risk of loss in a slashing event to be viewed as the digital asset owner for purposes of the IRC Section 1058 safe harbor.

[7] See Prop. Treas. Reg. Section 1.1058-1(b)(3)

c. Should IRC Section 1058 include all digital assets or only a subset of digital assets? Why?

IRC Section 1058 should apply to all digital assets, per the original the scope of pre-IRC Section 1058 law, which IRC Section 1058 was intended to clarify, not change.

The legislative history of IRC Section 1058 illustrates that Congress encouraged stable markets by providing confidence to securities owners to engage in lending transactions. Congress stated that "[u]nder present law, uncertainty has developed as to the correct income tax treatment of certain securities lending transactions. As a result, some owners of securities are reluctant to enter into such transactions."[8] Congress further stated that "[i]t is generally thought to be desirable to encourage organizations and individuals with securities holdings to make the securities available for such loans since the greater the volume of securities available for loan the less frequently will brokers fail to deliver a security to a purchaser within the time required by the relevant market rules."[9]

Additionally, the administrative law prior to the issuance of IRC Section 1058 provides relevant dicta that digital asset lending arrangements may be respected as loans. General Counsel Memorandum (G.C.M.) 36948 provided that if property is exchanged for property differing in neither kind nor extent then no taxable event occurs.

This G.C.M. relies on Treas. Reg. Section 1.1001-1(a), which states that gain or loss from the exchange of property for other property differing materially either in kind or in extent is treated as income or loss. This regulation has been interpreted to mean that an exchange of property that is not differing materially either in kind or in extent, such as lending in property, should not give rise to gain or loss.

Utilizing a lending transaction may prevent potential sale/buy-back treatment or contribution/distribution treatment on the transfer of the digital asset for multiple investment purposes (e.g., accessing new markets or short selling). Pursuant to IRS guidance, lending in digital assets should be considered a loan of property. When a borrower repays a digital asset loan, the asset received is technically different from the asset that was lent (i.e., different block on the chain), even if the repayment is made in the same asset type. As outlined above, however, the IRS has issued guidance concluding that securities loans are not taxable exchanges, because the securities do not differ materially in kind or extent. IRC Section 1058 provides a safe harbor under which securities lending will not result in income tax recognition if certain requirements are met.

[8] Senate Report at 3; 1978-2 C.B. 359.
[9] Senate Report at 5; 1978-2 C.B 360.

Unlike securities, some digital assets are derived from and, thus, interoperable within a particular network. Congress may consider treating these digital assets are being the same for purposes of the requirements for a digital asset loan safe harbor.

Although we believe IRC Section 1058 should generally apply to all digital assets, as defined in IRC Section 6045. However, some rule may need to be adopted to prevent tokenization from being used to arbitrage a safe harbor.

d. If a digital asset is lent to a third party and the digital asset incurs a hard fork, protocol change, or air drop during the term of the loan, is it more appropriate for there to be a recognition of income for the borrower upon such transaction or subsequently by the lender when the asset is returned? Please explain.

a. Are there any other transactions similar to a hard fork, protocol change, or air drop that may occur during the term of a loan? If so, please explain whether it is more appropriate for the borrower or the lender to recognize income upon such transaction.

We believe it is appropriate for the lender to recognize income from any of these events (e.g., forks, airdrops and certain protocol changes) that occur during the terms of the loan as ordinary income at the conclusion of the loan. Numerous protocols have native vesting or locking mechanisms, and while the digital asset may be allocated during a loan, it may not be delivered until vesting occurs or the asset becomes unlocked. The programmable nature of lending contracts and nascent state of the industry provides a growing range of cases. As a result, the rule must remain flexible to accommodate future use cases.

4. <u>Wash Sales (IRC Section 1091)</u>

a. In what situations do taxpayers take the position that economic substance (IRC Section 7701(o)) applies to wash sales with regards to digital assets?

Generally, the wash sale rule of IRC Section 1091 prohibits a taxpayer from claiming a loss on the sale of a stock or security if the taxpayer repurchases a substantially identical stock or security within a 30-day window before or after the sale. We do not know of any situations in which taxpayers who trade in digital assets take the position that the economic substance doctrine applies to wash sales with regards to digital assets.

Under IRC Section 7701(o), a transaction shall be considered to have economic substance if both the (1) the transaction changes a taxpayer's economic position in a meaningful way without regard to tax effects, and (2) the taxpayer had a substantial non-tax purpose for entering the transaction.

As a general matter, we doubt these two prongs can easily be applied generally to transactions that might otherwise be prohibited by the wash sale prohibition of IRC Section 1091. Any given

investor who sells and repurchases a substantially identical digital asset within a 30-day period could very well have economically objective and subjective non-tax reasons for doing so. If a taxpayer were to sell bitcoin at a loss on December 1 of any given year and then he or she repurchased the same amount of bitcoin on December 5, he or she might be trying to simply harvest a loss, thus not satisfying the second prong of the economic substance test. Depending on how much the price of bitcoin changed during those five days (which could be significant given the 24-7 trading cycle), the first prong may also not be satisfied, resulting in application of the economic substance doctrine. However, if a taxpayer sells the same amount of bitcoin on December 1 because he or she might need cash liquidity on December 3 for any given reason, but ends up not needing that liquidity on December 3 and ultimately buys back the same amount of bitcoin on December 5, then that taxpayer may very well have both an objective economic reason for the December 1 bitcoin sale/December 5 repurchase and a subjective non-tax reason for it as well. The same issue could apply to securities trading.

b. Are there existing best practices for reporting transactions in digital assets that are economically equivalent to wash sales?

We are not aware of any best practices for reporting transactions in digital assets that may be economically equivalent to wash sales. IRC Section 1091 by its terms does not apply to digital asset sales today.

c. Should IRC Section 1091 apply to digital assets? Why or why not?

If Congress chooses to apply the wash sale rule to the trading of digital assets, it should keep in mind that such a change would likely make even more difficult the already cumbersome process of calculating tax liabilities from trades in digital assets. For that reason, we suggest reducing the window for what constitutes a wash sale. It is not uncommon for investors in digital assets to have hundreds, or even thousands of trades in any given year, and the tracking of all the relevant information can be daunting for those trying to honestly comply with the tax laws. As one industry publication described it, "[The] categories for how cryptocurrencies are taxed in the U.S. may sound relatively simple: pay taxes on capital gains and deduct losses while counting other forms of crypto earned as regular income. But the challenge isn't knowing how cryptocurrency transactions are taxed – it's keeping track of all transactions."[10] Applying IRC Section 1091 to the trading of digital assets would make that challenging effort even more difficult.

This challenge can be compounded by the fact that many investors hold and move their digital assets across different wallets or engage them with different exchanges or protocols for various non-tax reasons, such as purchasing any given asset on one exchange for a certain price,

[10] Shawn Douglass, *Why Crypto Taxes Get Complicated (Especially for Institutions)*, CoinDesk (Nov. 18 2022), *at* https://www.coindesk.com/layer2/2022/11/18/crypto-accounting-tax-requirement-challenges.

staking those assets on a DeFi protocol for a period of time, and then selling the assets on a different exchange thereafter.

An unlimited number of scenarios like this are possible with digital assets. Under a wash sale rule applied to digital assets, taxpayers would have to comprehend the universe of their holdings to ensure that one sale of an asset on an exchange might not constitute a wash sale under the statute because of a timely purchase of a substantially identical asset on another exchange a few days later, even without an intent to harvest a tax loss. Under current IRS rules, tax-reporting entities such as stockbrokers, which must report tax information on IRS Form 1099-B, only must report to their customers wash sales taking place within an account and not across different accounts.[11]

Under recently proposed Treasury regulations, hosted wallets may be considered brokers for tax-reporting purposes.[12] Regardless of the final disposition of that specific rulemaking, however, U.S. taxpayers are likely to continue using a variety of wallets that will not be tax-reporting entities, and the burden of accounting for such wash sales in digital assets would largely remain on individual investors. For those investors in digital assets who do use a variety of wallets and transfer their assets across multiple platforms and exchanges, complying with an amendment IRC Section 1091 with a 30-day window for what constitutes a wash sale could be a significant burden. We therefore suggest minimizing that burden by reducing the window from 30 days to 15 days. Given the volatility of digital asset markets, we think such a reduction would have a minimal effect on preventing tax-loss harvesting as compared to 30 days.

d. Should IRC Section 1091 apply to other assets beyond digital assets? If so, what assets and why or why not?

We do not know of the tax implications for further applying the IRC Section 1091 to other assets beyond digital assets.

5. <u>Constructive Sales (IRC Section 1259)</u>

a. In what situations do taxpayers take the position that economic substance (IRC Section 7701(o)) applies to constructive sales with regards to digital assets?

Generally, the constructive sale rule of IRC Section 1259 prohibits a taxpayer from locking in a gain on an asset while deferring a taxable realization event by entering into an offsetting short position, a practice sometimes referred to as shorting against the box. We do not know of any situations in which taxpayers who trade in digital assets take the position that the economic

[11] Internal Revenue Service, Instructions for Form 1099-B, Box 1g (2023), *at* https://www.irs.gov/instructions/i1099b#en_US_2023_publink100014780.

[12] Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, 88 Fed. Reg. 59,576 (Aug. 29, 2023).

substance doctrine applies to constructive sales with regards to digital assets, and for the same reasons discussed above in the discussion of wash sales, we doubt the economic substance doctrine could be applied to a generalized fact pattern involving digital assets without analyzing any given transaction's objective economic conditions or a taxpayer's subjective motivation behind the transaction.

b. Are there existing best practices for reporting transactions in digital assets that are economically equivalent to constructive sales?

We are not aware of any best practices for reporting transactions in digital assets that may be economically equivalent to constructive sales.

c. Should IRC Section 1259 apply to digital assets? Why?

Similar to our discussion of how a wash sale application to digital assets would affect taxpayers, if Congress chooses to apply the constructive sale rule to the trading of digital assets, it will likely make tax compliance more difficult than it already is for those investors. However, the nature of constructive sales is generally more of a deliberate process than that of wash sales, meaning an investor who engages in a constructive sale is much more likely to know he or she is doing so, as opposed to investors who might engage in wash sales without realizing he or she is doing so or intending to do so.

d. Should IRC Section 1259 apply to other assets beyond digital assets? If so, what assets and why?

Furthermore, we have no expertise on whether a prohibition on constructive sales of digital assets should apply to other assets.

6. <u>Timing and Source of Income Earned from Staking and Mining</u>

a. Please describe the various types of rewards provided for mining and staking.

Proof-of-work (POW) mining rewards consist of two components – (1) transaction fees that miners collect for minting new blocks on the network chain, and (2) preset subsidies that are attached to each block that is mined according to a specified issuance schedule maintained by the network's algorithm.

Proof-of-stake (POS) rewards generally consist of one or two components - (1) transaction fees that validators collect for minting new blocks on the network chain, and/or (2) algorithmically programmed rewards based on a validator's participation in a staking pool.

b. How should returns and rewards received for validating (mining, staking, etc.) be treated for tax purposes? Why? Should different validation mechanisms be treated differently? Why?

When individuals mine or stake, there are two views as to the appropriate characterization of the received rewards. One view is that these rewards are ordinary income received in exchange for providing services to the network. This is the view taken by the Service in Revenue Ruling 2023-14. The other view considers the rewards as acquired property. Importantly, unless the rewards are pre-mined, the recipient of the rewards may be the first owner. In this view, the rewards are not yet "clearly realized" until they are used or disposed.

Policymakers have reached a consensus that certain digital assets, including bitcoin, are digital commodities.[13] Typically, commodities are taxed when rewards are realized at the point of sale. This is how mining rewards should be treated—consistent with the way other commodities are treated. However, in the absence of legislation on this subject, the IRS has issued guidance, Notice 2014-21, which requires mining companies to recognize rewards as taxable income upon receipt, which is a departure from the way that other commodities are treated.

Taxing mining rewards at the point of sale would provide a consistent approach, aligning with how other capital assets are often treated. This consistency would simplify the tax code and make compliance easier for individuals and businesses.

c. Should the character and timing of income from mining and staking be the same? Why or why not?

Staking differs from mining in that the staked assets have an embedded right to staking rewards if the owner (or a delegate) engages in certain actions associated with the protocol. By contrast, a miner has no property with embedded rights to the rewards. Some view both staking and mining activities as similar to services offered to the network. In addition, as discussed above, there are contradictory views as to whether the newly created property is "clearly realized" as income until used or disposed.

d. What factors should be most important when determining when an individual is participating in mining in the trade or business of mining?

There is a lack of alignment among industry participants as to the characterization of mining actions and resulting rewards. This may be analogous to other transaction types, or alternatively, it could be something entirely new. It is pre-mature to make determinations on the factors that would be relevant to a trade or business until there is alignment on the characterization and then the underlying tax treatment of the transactions.

e. What factors should be most important when determining when an individual is participating in staking in the trade or business of staking?

There is a lack of alignment among industry participants as to the characterization of staking actions and resulting rewards. This may be analogous to other transaction types, or

[13] See, i.e. SEC.gov | Funds Trading in Bitcoin Futures – Investor Bulletin; Bitcoin Basics (cftc.gov).

alternatively, it could be something entirely new. It is pre-mature to make determinations on the factors that would be relevant to a trade or business until there is alignment on the characterization and then the underlying tax treatment of the transactions.

f. Please describe examples of the arrangements for those participating in staking pool protocols.

The staking supply chain requires three main components: the native digital asset, the infrastructure and the software. Often, the provider of infrastructure is also the provider of the software. Each of these components can be provided as an owner to the staking endeavor or as a service provider, with the distinction based on risk of loss. Based on this blueprint for the staking supply chain, there are arrangements where:

1. The owners of digital assets provide (or make available for use) the digital assets to infrastructure owners or operators to stake in exchange for a fixed return with the infrastructure owner bearing the risk of loss;
2. The owners of digital assets engaging infrastructure providers to provide the technical expertise and equipment in exchange for a fixed fee, but where the owner of the digital assets bears the risk of loss, and;
3. Where the risk of loss and the staking rewards are both shared between the parties.

g. Please describe the appropriate treatment for the various types of income and rewards individuals staking for others or in a pool receive.

There is a lack of alignment among industry participants as to the characterization of staking actions and resulting rewards. This may be analogous to other transaction types, or alternatively, it could be something entirely new. It is pre-mature to make determinations on tax treatment until there is alignment on the characterization.

h. What is the proper source of staking rewards? Why?

There is a lack of alignment among industry participants as to the characterization of staking actions and resulting rewards. This may be analogous to other transaction types, or alternatively, it could be something entirely new. It is pre-mature to make determinations on the sourcing until there is alignment on the characterization and then the underlying tax treatment of the transactions.

i. Please provide feedback on the Biden Administration's proposal to impose an excise tax on mining.

We oppose the Administration's proposal to impose an excise tax on mining. Miners are an end-user of power purchased in fair and open markets, much like electric vehicles, and if imposed, this tax would be uniquely picking winners and losers in the market and determining which Americans may purchase and use energy resources for business operations.

The proposed tax singles out the digital asset mining industry that lawfully purchases electricity, holding the electricity buyers responsible for the carbon emissions of the underlying generation. No other industry is faced with this sort of burden.

Moreover, mining digital assets in the United States ensures that Americans capture the value of these assets, rather than our adversaries, and the mining occurs in the cleanest and most diverse power grids in the world. The proposed excise tax would place Americans as a competitive disadvantage and push mining operations to dirtier energy grids in hostile parts of the world, including China and Russia.

Instead of penalizing digital asset mining companies, policymakers can work with industry leaders on innovative solutions that will reduce energy consumption while allowing for continued growth and development of the industry. The industry is shifting away from energy intensive consensus protocols like Proof of Work to less energy intensive ones.

7. Nonfunctional Currency (IRC Section 988(e))

a. Should a de minimis nonrecognition rule like the rule in IRC Section 988(e) apply to digital assets? Why?
   a. What threshold is appropriate and why?

While there are relatively few US taxpayers that use digital assets as a form of payment, it would seem to be within the spirit of IRC Section 988(e) to exclude small gains on digital assets if recognized for transactions not associated with a business or trading activity.

The most cited example associated with this de minimis nonrecognition rule highlights the use of digital assets with unrealized gain to buy a cup of coffee. This situation is similar to the US individual who excludes gain recognized on their use of British pounds resulting from exchange rate fluctuations during a UK vacation in Example 2 of Treasury Regulations Section 1.988-1(a)(9)(ii). To the extent that an individual recognizes gain on the use of digital assets used in their business or resulting from trading activity, these gains may fall outside of the de minimis exception, much like the treatment of exchange gain on foreign currency from business or trading purposes in IRC Section 988(e)(3).

From an administrability perspective, an exchange (broker) may not have insight into whether the transaction is for business/investment rather than personal purposes and, thus, may still report the transaction on a Form 1099. It may make sense to include a new line on Form 1040 to allow taxpayers to make their own determination about the application of a de minimis exclusion.

Without further rationale, it would make sense that the amount of a de minimis exclusion threshold track the same as that used for foreign currency.

8. FATCA and FBAR Reporting (IRC Sections 6038D, 1471-1474, 6050I, and 31 U.S.C. Section 5311 et seq.)

a. When do taxpayers report digital assets or digital asset transactions on FATCA forms (e.g., Form 8938), FBAR FinCEN Form 114, and/or Form 8300? If taxpayers report some categories and not others, please explain and identify which categories of digital assets are reported and not reported with respect to each of these forms.

a. Should FATCA, FBAR, and/or 8300 reporting requirements be clarified to eliminate ambiguity about whether they apply to all, and/or some categories of, digital assets? Why?

A U.S. taxpayer with interests in foreign financial assets or accounts is subject to certain information reporting requirements. First, "specified persons" (generally U.S. citizens or residents and domestic entities) that have an interest in "specified foreign financial assets" must attach IRS Form 8938, *Statement of Specified Foreign Assets*, to their U.S. federal income tax return if the value of those assets is more than the applicable reporting threshold.[14] Second, certain U.S. persons that have an interest in foreign "financial accounts" must file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* ("FBAR").

Many digital asset exchanges and other types of intermediaries, such as wallet providers and investment funds, are foreign, and thus the question arises as to whether digital assets held in an account or a wallet at a foreign intermediary is reportable on either Form 8938 or the FBAR (or both). Certain foreign intermediaries may also be considered "brokers" subject to transaction-by-transaction reporting on Form 1099-DA under IRC Section 6045.[15]

Existing FACTA and FBAR guidance does not, by its terms apply to digital assets. Nonetheless, certain key terms related to reporting on Form 8938[16] and FBAR[17] are broadly defined and could be interpreted to include digital asset investments held at foreign intermediaries.

---

[14] The Foreign Account Tax Compliance Act ("FATCA") generally requires foreign financial institutions ("FFIs") to register with the IRS and to comply with certain information reporting, withholding, and due diligence requirements with respect to "financial accounts" maintained by U.S. persons. The U.S. account holders are subject to certain reporting requirements under IRC Section 6038D, which requires the filing of Form 8938.

[15] See. Prop. Treas Reg. Section 1.6045-1(g)

[16] For example, FATCA reporting applies broadly to: (1) any "financial account" maintained by an FFI, which includes a depository account or a custodial account for holding a financial instrument, contract, or investment; and (2) certain assets not held in an account, including any interest in a foreign entity, any stock or security issued by a non-U.S. person, and any financial instrument or contract held for investment that has an issuer or counterparty that is a non-U.S. person. Treas. Reg. Section 1.1471-5(b)(1), (b)(3). An FFI includes any non-U.S. entity that is (1) a depository institution that accepts deposits in the ordinary course of a banking or a similar business, (2) a custodial institution that holds financial assets for the account of others as a substantial portion of its business, or (3) an entity that invests, reinvests, or trades in financial assets. Treas. Reg. Section 1.1471-5(e)(1).

[17] Similarly, the FBAR rules require reporting by U.S. persons having a financial interest in, or signature or other authority over, a bank, securities, or other financial account—including accounts with a depository institution, broker or dealer for futures, options, or commodities, or mutual or investment funds—in a foreign country if the aggregate value of all foreign financial accounts exceeds $10,000 at any time during the calendar year. 31 CFR §§ 1010.350(a), (b), (c), (e), (f) and 1010.306(c).

Whether a particular digital asset investment is a financial account or a custodian or intermediary is an FFI is a fact-intensive analysis and very uncertain, but the penalties for failure to make the required disclosures on Form 8938 or FBAR are significant.[18] FinCEN has indicated informally that the FBAR regulations do not currently define cryptocurrency held in an offshore account as a type of reportable account, but that FinCEN intends to issue regulations applying it to crypto assets.[19] The IRS has indicated that it believes the instructions for Form 8938 sufficiently explain the FATCA reporting requirements. However, those instructions do not mention cryptocurrency (or any other type of digital asset) nor do they explain how to interpret the relevant requirements in the context of digital assets.[20]

Guidance from the Treasury, IRS, and FinCEN is critical for taxpayers to eliminate ambiguity around the reporting of digital assets. Absent guidance, there is no consistency among taxpayers regarding the reporting of digital assets. Conservative taxpayers report such assets, while other taxpayers take the lack of guidance requiring it as confirmation that they do not need to report such assets. Any such guidance should be issued in proposed form to give the industry and taxpayers sufficient time to comment.

b. Given the policies behind FBAR and FATCA, should digital assets be more integrated into those reporting regimes? Are there barriers to doing so? What are they?

In general, FATCA and the OECD's Common Reporting Standard ("CRS") have generally been consistent regarding the scope of the financial institutions and accounts subject to reporting. This consistency is critical to fostering compliance that is administrable and effective globally. In October 2022, the OECD amended CRS to include certain digital financial products.[21] Specifically, CRS was expanded to cover certain electronic money products, Central Bank Digital Currencies, and derivatives that reference crypto assets, which are held in custodial accounts and investment entities. The CRS was also amended to eliminate duplicative reporting for accounts subject to CRS and the new crypto-asset reporting framework.

At the same time, it released amendments to CRS, the OECD introduced a whole new reporting and information exchange framework for crypto-assets.[22] The OECD's crypto-asset reporting framework is largely consistent with new digital asset reporting requirements added by the

[18] Specifically, the penalty for failure to file a Form 8938 for a taxable year is $10,000, and an additional $10,000 for each 30 days of non-filing after IRS notice of a failure to disclose, for a potential maximum penalty of $50,000. I.R.C. § 6038D(d). The penalty for failure to file an FBAR is up to $10,000 if non-willful, and up to the greater of $100,000 or 50 percent of account balance if willful (these amounts are adjusted for inflation).

[19] FinCEN Notice 2020-2.

[20] U.S. Government Accountability Office, "Virtual Currencies – Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance," GAO-20-188, February 2020, at p. 30.

[21] OECD, *Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard* (Oct. 2022), https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.htm.

[22] *Id.*

Infrastructure Investment and Jobs Act in Code sections 6045, 6045A, and 6050I. Like the OECD, Congress, Treasury, IRS, and FinCEN should integrate the reporting regimes and avoid requiring duplicate reporting under these provisions, on the one hand, and FACTA and FBAR, on the other.

c. How do stakeholders consider wallet custody when determining compliance requirements with FATCA, FBAR, and Form 8300? Please provide examples of wallet custody arrangements and identify which types of arrangements FATCA, FBAR, and/or Form 8300 reporting requirements should or should not apply to.

In general, FACTA and FBAR apply to financial assets held in financial accounts at financial institutions. If extended to digital assets, they should only apply to similar digital assets held in a similar manner, such as electronic money products and Central Bank Digital Currencies held in custodial wallets.

9. Valuation and Substantiation (IRC Section 170)

a. Digital assets do not currently qualify for the IRC Section 170(f)(11) exception for assets that have a readily available valuation on an exchange. Should the substantiation rules be modified to account for digital assets? If so, in what ways and for which types of digital assets? More specifically, would something different need to be done for those publicly traded digital assets?

In general, a taxpayer who claims a deduction of more than $5,000 for charitable contributions of property must obtain a qualified appraisal and attach an appraisal summary to the tax return.[23] A "qualified appraisal" must be conducted by a "qualified appraiser" in accordance with generally accepted appraisal standards and any regulations or other guidance.[24]

A qualified appraisal is not required for donations of certain readily valued property specifically set forth in the Code and regulations, namely: cash, stock in trade, inventory, property primarily held for sale to customers in the ordinary course of business, publicly traded securities, intellectual property, and certain vehicles.[25] The IRS has ruled informally that cryptocurrency does not fall within any of these exceptions, so it is subject to the qualified appraisal requirements.[26]

[23] I.R.C. § 170(f)(11)(C), (D).
[24] I.R.C. § 170(f)(11)(E)(i); Treas. Reg. Sections 1.170A-17 and 1.170A-13. A "qualified appraiser" is an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance. I.R.C. § 170(f)(11)(E)(ii): Treas. Reg. Section 1.170A-16(d)(2)(i).
[25] I.R.C. § 170(f)(11)(A)(ii)(I); Treas. Reg. Section 1.170A-16(d)(2)(i).
[26] CCA 202302012 (Jan. 10, 2023).

Not only are qualified appraisers for digital assets that are traded on exchanges hard to find but they can also charge a lot for appraising assets whose value is readily available to the public.

We recommend that the exception to the qualified appraisal requirement be extended to actively traded digital assets. This will likely require legislation, as digital assets are not enumerated in IRC Section 170(f)(11)(A)(ii)(I).

b. What are the characteristics of an exchange and the digital asset for which this exemption would appropriately apply and why?

Like publicly traded securities, many digital assets are traded on established digital asset exchanges and have a readily ascertainable fair market value. Similar to exchanges on which public securities are traded, exempt digital assets should be traded on an established market, such as that defined in IRC Section 1092(d) and/or their pricing displayed on a digital asset aggregator. Thus, Congress should grant Treasury the authority to designate any U.S.-based exchange or other price aggregator that reasonably reflects general market conditions for digital assets as suitable for purposes of the IRC Section 170(f)(11).

Conclusion

In conclusion, we would like to express our gratitude to the Senate Finance Committee, and staff, for initiating this important dialogue on digital asset taxation. We believe that our collective efforts can lead to a more comprehensive and effective regulatory framework that balances the need for innovation with the necessity of compliance and investor protection. The Chamber of Digital Commerce remains at your disposal as a resource for further discussions or clarifications on the points raised in our response. We look forward to continuing to engage with the Committee on this and other matters of importance to the business community.