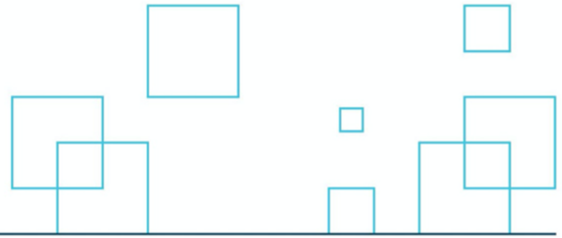


November 13, 2023

VIA Regulations.gov

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

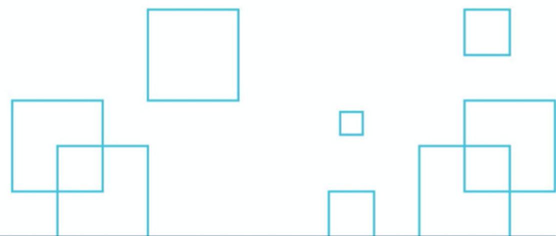
Re: Proposed Regulations Regarding Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions

Dear Ms. Cutrone:

The Chamber of Digital Commerce (the "Chamber") is pleased to submit these comments providing feedback on the proposed regulations regarding gross proceeds and basis reporting by digital asset brokers under section 6045[1] (the "Proposed Regulations"),[2] which were issued by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on August 25, 2023. We recognize the complexities and unique challenges that the evolving digital asset landscape presents, particularly in relation to federal tax law, and hope these comments 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 startups, software companies, global IT consultancies, financial institutions, insurance companies, law firms, accounting firms and investment firms.

[1] Unless otherwise indicated, references to a "section" are to a section of the Internal Revenue Code of 1986, as amended and all "Treas. Reg. §" references are to the Treasury regulations promulgated thereunder.
[2] 88 Fed. Reg. 59,576 (Aug. 29, 2023).

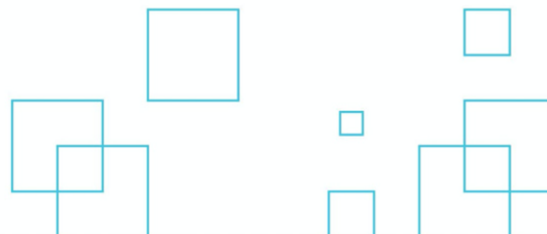


EXECUTIVE SUMMARY

With respect to centralized digital exchanges or other custodial intermediaries that effectuate transactions, the traditional broker regime generally provides an appropriate foundation for regulating such exchanges or intermediaries. When applied to decentralized or noncustodial arrangements, however, the breadth of the proposed definition of "digital asset middleman" creates several problems, which should ultimately be addressed in final regulations. First, participants at the front end of the protocol may have access to information about the customer, while participants at the back end of the protocol may have access to information about the transaction. These participants may not know one another's identity and thus have no way to share the customer's personally identifiable information ("PII") absent transmitting it on the blockchain. Second, the definition contemplates the front end, back end, and ancillary service providers all reporting on the same transaction. This results in multiple Forms 1099-DA for the same transaction, which creates confusion for taxpayers and adds complexity for the IRS which will have to address both returns that are redundant and returns that reflect an underreporting. It also increases the risk of data privacy and security breaches. To resolve these issues, we recommend the following:

- Phase in the implementation of the broker reporting rules first to centralized and custodial brokers and then to decentralized and noncustodial brokers to allow time to develop, test, and implement solutions to the problems.
- Narrow the definition of "digital asset middleman" to include only those who provide facilitative services that *directly* effectuate a sale of digital assets, which would generally cover custodial brokers.
- Adopt a multiple broker rule and consider options, such as allowing the designation of a third-party reporting entity or allowing technology-based solutions, to minimize the sharing of PII.
- Exclude digital asset payment processors that are also third-party settlement organizations ("TPSOs") (which are already required to report gross proceeds to merchants under section 6050W) from section 6045 broker reporting, as they otherwise duplicate reporting by the buyer's broker. If this recommendation is not adopted, we recommend at least excluding digital asset payment processors from the basis reporting requirement and adopting a reporting threshold.
- Provide further guidance to determine when a person has "sufficient control or influence" and what fees are relevant for purposes of making that determination.

We also believe that including all stablecoins and non-fungible tokens ("NFTs") in the definition of "digital asset" is too broad and will result in millions, or even billions, of transactions reported



on Forms 1099-DA. We recommend the following rules to limit the application of the broker reporting rules to these tokens:

- Exclude fiat-backed stablecoins from the broker reporting requirement. If this recommendation is not adopted, we recommend at least excluding fiat-backed stablecoins from the basis reporting requirement and adopting a reporting threshold.
- Include only NFTs that represent fungible tokens or other financial instruments in the definition of digital asset.
- Provide more detailed guidance on the treatment of governance tokens, wrapped tokens, and liquidity pool tokens.
- Expand examples of closed system virtual assets to include other walled garden type environments such as loyalty programs.

Finally, we recommend certain miscellaneous revisions to the Proposed Regulations, including (1) aligning the broker reporting rules with other reporting regimes, such as the OECD's Crypto-Asset Reporting Framework ("CARF") and the Foreign Account Tax Compliance Act ("FATCA"), (2) allocating transaction costs for exchanges of digital assets to either the buyer or seller as determined by the broker, (3) limiting the information required to be reported on Form 1099-DA, such as timestamps and digital asset addresses, (4) permitting brokers to designate a time zone for dating transactions, and (5) making certain improvements to the existing IRS Transcript Delivery System ("TDS") to accommodate the influx of Forms 1099-DA.

DISCUSSION

I. CONSIDERATIONS REGARDING THE BREADTH OF BROKER REPORTING RULES

A. Proposed Definition of Digital Asset Broker

Section 6045 defines a broker to include "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."[3] The Proposed Regulations, like the existing regulations, implement the language "for consideration" by limiting the definition of broker to a person who effects sales made by others "in the ordinary course of a trade or business."[4] However, the Proposed Regulations further

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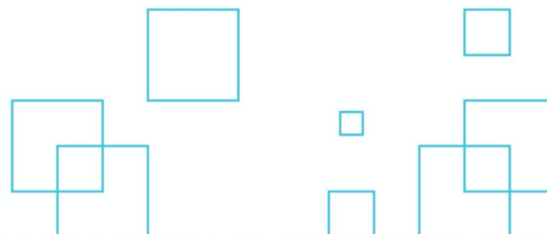
[3] I.R.C. § 6045(c)(1)(D).

[4] Prop. Treas. Reg. § 1.6045-1(a)(1); *see also* 88 Fed. Reg. at 59,587.



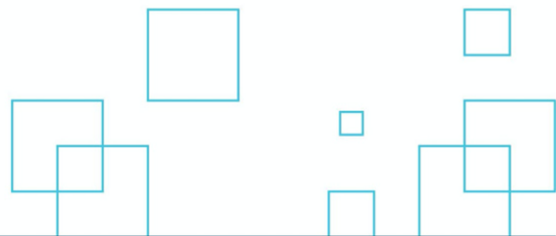
expand the definition of "effect" by including "digital asset middleman." A "digital asset middleman" means "any person who provides a facilitative service . . . with respect to a sale of digital assets wherein the nature of the service arrangement is such that the person ordinarily would know or be 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."[5]

A "facilitative service" is broadly defined to include a service that directly *or indirectly* effectuates a sale of digital assets.[6] This potentially includes many services that go well beyond effectuating sales of digital assets, such as providing certain unhosted wallets, web interfaces, market platforms, payment card networks, or price discovery services. The statutory language refers to "any person who (for consideration) is responsible for regularly providing any service *effectuating transfers* of digital assets on behalf of another person."[7] There is no reference to "indirectly" effectuating transfers. When Congress intends to include indirect activities, it generally states so.[8] Therefore, we recommend narrowing the definition of facilitative service to include only those directly effectuating sales of digital assets.

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 and the nature of the transaction if that person maintains sufficient control or influence over the facilitative services provided.[9] The Proposed Regulations note that, if the person has the ability to change the fees charged for the facilitative service, that person is considered to have sufficient control or influence over the facilitative services.[10] But the Proposed Regulations do not provide further guidance on the meaning of "sufficient control or influence."

The "sufficient control or influence" standard is consistent with Financial Action Task Force ("FATF") guidance on Anti-Money Laundering ("AML").[11] We appreciate the use of this

[5] Prop. Treas. Reg. § 1.6045-1(a)(21)(i).
[6] Prop. Treas. Reg. § 1.6045-1(a)(21)(iii).
[7] I.R.C. § 6045(c)(1)(D).
[8] *See, e.g.*, I.R.C. § 267(b)-(d) (referencing stock owned directly or indirectly); I.R.C. § 871(m)(2) (dividend equivalents defined with reference to transactions that are directly or indirectly contingent upon the payment of dividends from sources within the United States); I.R.C. § 4943(f)(4)(A)(v) (a disqualified person making direct or indirect contributions to an organization may also render the organization a disqualified person).
[9] Prop. Treas. Reg. § 1.6045-1(a)(21)(ii).
[10] *See* 88 Fed. Reg. at 59,587; Prop. Treas. Reg. § 1.6045-1(a)(21)(ii).
[11] *See* 88 Fed. Reg. at 59,586; Targeted Update on Implementation of the FATF Standards on Virtual Assets and Virtual Asset Service Providers at ¶ 41, FATF, https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/June2023-Targeted-Update-VA-VASP.pdf.coredownload.inline.pdf.



language to align the section 6045 regulations with other regulatory regimes. That being said, there are many questions regarding how broadly this standard reaches. Therefore, we recommend that final regulations provide information that will allow persons to better ascertain whether they fall under this standard. For example, what constitutes sufficient control or influence; should this be the person with substantial or primary control; and how should the rules apply in the context of governance tokens given that virtually any suggestion or action can be viewed as influencing an outcome?

With respect to the rule that the ability to change the fees charged indicates sufficient control or influence, we believe that further guidance is needed on the meaning of "fees." There are multiple types of fees charged for blockchain transactions, including transaction fees, gas fees, and fees paid to liquidity providers. Not all these fees are similar in nature to a brokerage fee. For example, gas fees paid to validators and fees paid to liquidity providers are paid for services that we think would be ancillary to brokerage services. We believe final regulations should clarify that only fees paid to a person for effectuating a transaction involving the sale or exchange of digital assets should be included.

B. Compliance by Noncustodial Service Providers and Others Providing Ancillary Services

The traditional broker information reporting regime under section 6045 imposes information reporting requirements on a single party who actually effectuates a transfer of the asset. This party has a relationship with the customer, custody of the asset, and visibility into all aspects of the transaction on which it is reporting. This regime translates well to centralized digital asset exchanges or other custodial intermediaries that facilitate transactions.

However, the Proposed Regulations extend this regime broadly to almost all participants in the digital asset ecosystem, including those who do not directly effectuate transactions, those who do not have any relationship with the customer or with the other participants involved in effectuating the transaction, those who do not have custody of the asset, and those who do not have visibility into all aspects of the transaction. The Explanation of Provisions in the Proposed Regulations ("Preamble") indicates that it is anticipated that these participants can amend their protocols to obtain the necessary information to comply with broker reporting.[12] While that assumption may be true in some circumstances, it is not without significant hurdles, nor is it true in all circumstances.

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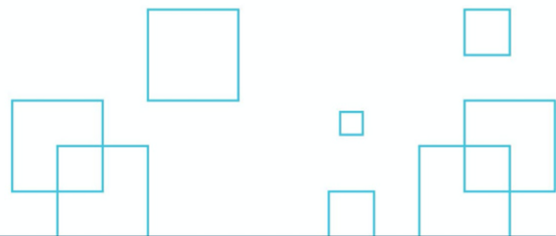
[12] 88 Fed. Reg. at 59,585.



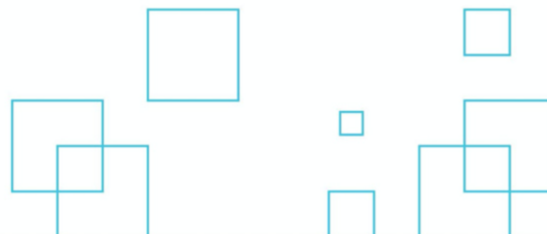
The proposed rules create an irrefutable presumption that any entity that has the ability to change the fees charged for a facilitative service maintains sufficient control to be in a position to know the identity of users of the services and the nature of the transaction. However, several currently deployed, non-custodial protocols are subject to variance in fees, based on the actions of certain administrators or token holders, but are for other practical purposes immutable, and the administrators, token holders, or other actors associated with such protocols could not modify the contracts deployed on chain to collect PII.

Noncustodial participants may have no practical ability to obtain the information to comply with the broker reporting rules. For example, the front-end of the protocol, which could be a web interface or a wallet with the ability to access the Application Programming Interface ("API") or decentralized protocol, may be able to obtain information about the customer, but does not effectuate the transaction and, thus, does not have visibility into the nature of the transaction. The back end of the protocol, which could be a smart contract routing transactions to the blockchain, effectuates the transaction, but does not know the customer or even the intermediate parties involved in the transaction. Even ancillary services, such as internet service providers could be considered to provide facilitative services.

Where a "digital asset middleman" under the Proposed Regulations could deploy new software, either on-chain or as part of a front-end, they may be unable to stop users from interacting with older versions of the software deployed on chain, or "front ends" that are frequently published to distributed file hosting protocols.

As a result, noncustodial participants could legitimately claim that they "ordinarily would not 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.[13] However, the Proposed Regulations, by extending the definition to persons who are "in a position to know" the identity of the customer and nature of the transaction due to their ability to amend the software running the protocol, potentially force the front-end, back-end, and all intermediary participants into the role of broker all of whom must report a given transaction. Each of these brokers must collect and report all the information required by form 1099-DA, even if they do not otherwise need it to perform their functions. Such a burden could create a barrier to entry for new participants in the industry. Further, as discussed in Section I.D., below, this could result in the sharing of large amounts of

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



sensitive PII (including social security numbers) across networks and platforms, placing customer PII at greater risk.

Additionally, some users may be harmed if, conscious of identity theft risks and unwilling to share PII with a decentralized organization, they instead continue to use deprecated smart contracts and front ends that are no longer being updated, and potentially subject to security vulnerabilities and other attacks. Conversely, developers may be disincentivized to develop more efficient and secure protocols if their distribution would carry with them a heavy burden of collecting and securing large amounts of sensitive PII.

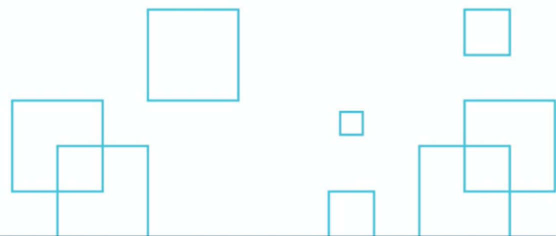
We believe the government has a legitimate interest in ensuring that taxpayers are provided with the information they need to report their digital asset transactions in order to increase tax compliance. However, we believe the government should balance those efforts with the compliance burden and additional risks its rules would impose on potential brokers and their customers.

C. Impact of Duplicate or Multiple Brokers

The implications of requiring parties to report information beyond what they need to perform their functions are significant and potentially damaging to the industry. First, it could force an industry, built on principles of operating without a centralized authority, to centralize.

Second, it could result in duplicate or multiple Forms 1099-DA being filed for the same transaction, which could, at best, confuse or, at worst, be unfair to taxpayers. Some taxpayers may simply report the information they receive on their Forms 1099-DA on their tax returns, which would result in over taxation. Other taxpayers may reconcile their Forms 1099-DA and report the transaction only once. In that case, it is possible that, through the IRS's automatic underreporting system, the taxpayer will be required to respond to an IRS notice identifying a reporting mismatch.

Third, requiring the collection of sensitive PII at multiple points within a transaction creates privacy and security concerns. For example, holding PII at multiple points within a transaction sequence exponentially increases the risk of such information being subject to a data breach. Many of the participants in the digital asset ecosystem are start-up companies with fewer resources to build a secure, compliant system, which may further increase the security risk. In addition, unscrupulous actors may set up decentralized platforms for identity theft, claiming they are a broker and collecting PII from customers for reporting purposes.



We understand the government's concern that providing a multiple-broker exception in the context of digital asset brokers might result in no broker reporting the transaction.[14] However, we believe that it is critical for final regulations to reduce or eliminate duplicate and multiple broker reporting. We offer some options in Section II.A., below, to reduce duplicative reporting and privacy concerns. However, these solutions will take time to develop, test, and implement.

D. Recommendation

While it is difficult to verify, it is estimated that 98% of digital asset transactions occur on centralized exchanges. Considering this and the above concerns, we urge Treasury and the IRS to phase in the implementation of the broker reporting rules to allow time to engage in this process of developing, testing, and implementing solutions. We recommend finalizing the regulations (with additional revisions recommended in these comments) with respect to centralized exchanges and custodial brokers as soon as possible, and then further detailing requirements that take into account nuanced characteristics of decentralized finance and other noncustodial participants when finally implementing the broker reporting regime for such noncustodial participants.

This is consistent with the implementation of other complex reporting regimes in which Treasury and the IRS realized that more time was needed to implement certain requirements. For example, basis reporting was phased in for debt instruments and options,[15] and the requirements under the FATCA were phased in.[16]

The IRS should also evaluate the applicability of withholding rules to noncustodial participants that may be impacted by any final reporting rules. It is unclear *when*, if at all, a noncustodial service provider or "broker" would be compelled to withhold. The existing rules under Treas. Reg. § 31.3406(a)-4 states that "the payor must withhold *at the time it makes the payment* to the payee or to the payee's account that is subject to withholding." But a noncustodial service provider never makes a payment; rather, in a decentralized automated market maker smart contract, the payments are peer-to-peer between the liquidity providers and the end user. The "broker" (in this example, governance token holders that have the ability to change the fee charged by the decentralized platform) does not make the payment.

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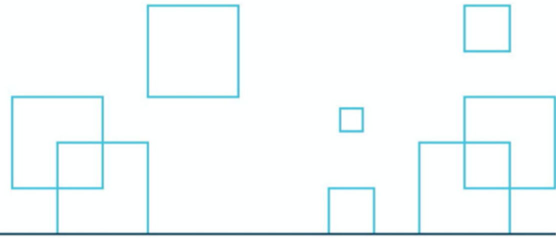
[14] 88 Fed. Reg. at 59,598.
[15] T.D. 9616, 78 Fed. Reg. 23,116 (Apr. 18, 2013).
[16] Notice 2011-53, 2011-32 I.R.B. 124.



In any case, for noncustodial service providers, obligations should be limited to furnishing information, and not withholding. Because most transactions will ultimately flow to a centralized exchange, for example, to convert cryptocurrency to fiat currency, avoiding these withholding obligations is necessary to avoid duplicative withholdings.[17]

We would be happy to work with Treasury and the IRS to develop more fully any of the approaches outlined in these comments.

II. DEFINITION OF DIGITAL ASSET MIDDLEMAN

A. The Proposed Definition of "Digital Asset Middleman" is Contrary to the Statutory Scope and Should be Narrowed

The Infrastructure Investment and Jobs Act created a digital asset reporting requirement by expanding the definition of "broker" to include "any person who (for consideration) is responsible for regularly providing any service *effectuating transfers* of digital assets on behalf of another person."[18] However, the proposed rules go beyond that scope, capturing, for example, noncustodial and ancillary service providers discussed above, by expanding the definition of broker to include those who provide "facilitative services … that … indirectly effectuate[] a sale of digital assets."[19] Inclusion of such indirect service providers would constitute an unprecedented expansion of tax reporting obligations, and nothing in the text of the statute indicates that Congress intended such an expansion.

To the contrary, the statute focuses on amending the reporting rules for custodial transactions. It expands the information furnishing requirements under section 6045A to include digital assets but retains the framework of the rule that only requires furnishing such information when the asset is "transfer[ed] to a broker," i.e., only custodial transactions. Likewise, the catch-all reporting requirement for "Digital Assets Not Otherwise Subject to Reporting" in the Act is limited to transactions "from an account maintained by [a] broker" and does not include unhosted, non-custodial accounts.[20] Similarly, statements made legislators during the consideration of the amendments to section 6045 indicate that they were targeting custodial arrangements. For example, Senator Warner described the targeted brokers to include "digital

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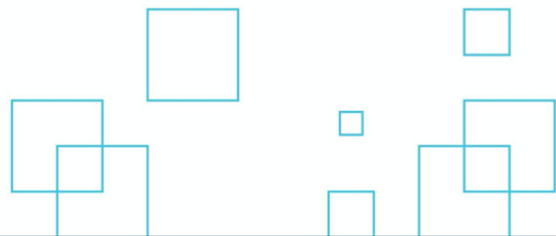
[18] Pub. L. No. 117-58 § 80603(a)(3), 135 Stat. 1339, 1340 (2021) (emphasis added).
[19] Prop. Treas. Reg. § 1.6045-1(a)(21)(iii).
[20] Pub. L. No. 117-58 § 80603(a)(3), 135 Stat. 1339, 1340 (2021).



asset exchanges or hosted wallet providers, *often called custodians*, or other agents involved in effectuating digital asset transactions."[21]

In addition, we believe that expanding the definition of "digital asset middleman" to include services that indirectly effectuate digital asset transactions, goes beyond the concept within the definition of "broker" of a person who effects sales made by others for consideration or "in the ordinary course of a trade or business." Final regulations should clarify that this concept likewise applies to digital asset middlemen.

We recommend that final regulations narrow the definition of "digital asset middleman" to include only those who provide facilitative services that *directly* effectuate a sale of digital assets, which would generally cover custodial brokers. We believe this is more consistent with the statutory language and Congressional intent.

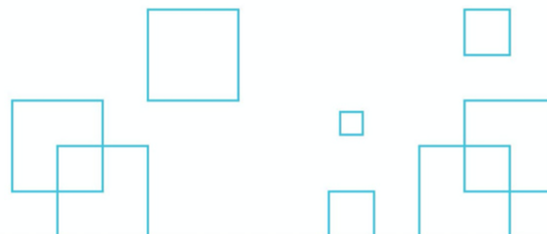
B. Reducing Duplicative or Multiple Brokers

As discussed above, the definition of digital asset middleman in the Proposed Regulations is broad enough to encompass most service providers in the industry, which will result in duplicative reporting and privacy and security concerns because of multiple parties collecting taxpayers' PII. In this section, we offer a few options to reduce these concerns.

1. Multiple Broker Rule

One option to address duplicative reporting is to select one entity within the transaction sequence as the default party to do the reporting. Under the current broker reporting regime, the multiple broker rule eliminates duplicative reporting by exempting brokers who sell on behalf of other brokers, so that only the broker that has the closest relationship to the customer is required to report the information.[22] In the context of noncustodial digital asset brokers, the broker that has the closest relationship to the customer will generally not be effectuating the transaction and, therefore, will not have any visibility into the nature of the transaction. That broker could obtain information about the transaction from the blockchain, but it might not know if and when the customer engages in a transaction to pull the information from the blockchain.

[21] 167 Cong. Rec. S6061-07 (2021).
[22] *See* Treas. Reg. § 1.6045-1(c)(3)(iii).



Alternatively, the last person in the transaction sequence could be required to report the transaction. This approach better implements the statutory language of effectuating transfers. This approach is also consistent with section 6050W involving multiple payment settlement entities.[23] On the other hand, the last person in line will not have access to the customer's data, so this approach presents the greatest risk to the security of the customer's PII.

For example, assume at the front end of the transaction that a customer uses a web interface to connect their wallet and access a decentralized protocol, and is required to provide their data for anti-money laundering and tax purposes when they log into the web interface. At the back end, an automated market maker (i.e., a smart contract) executes a token swap using tokens that have been provided by liquidity providers. There are also other participants in the transaction, including the block builders and validators, liquidity providers, the smart contract developers, and the protocol governors. As an initial matter, it may be difficult to determine who is technically the last person in line. More importantly, the persons at the back end do not have the customer data, and the front end, back end, and intermediate parties do not necessarily know each other and are not able to identify one another. Thus, the most logical way to transmit the information would be to use the blockchain to do so, thus making the customer's PII publicly available and creating significant privacy concerns.

We note that the two options described below in Sections II.A.2. and 3. can mitigate the privacy concerns, so these options may need to be considered in conjunction with a multiple broker rule.

2. <u>Designation of Third-Party Reporting Entity</u>

Another option to address duplicate reporting is to allow brokers to satisfy their reporting obligation by engaging a third party to collect data from customers and prepare information returns on their behalf. The delegation of the collection and reporting of customer data would permit consolidation of the reporting obligation and help address concerns of widespread access to customer PII.

If the designated person fails to satisfy the reporting obligation, the original broker will remain liable for any applicable penalties. To reduce the chances of inaccurate or incorrect reporting by the designated third party, the IRS could specify criteria that service providers must satisfy, implement a voluntary certification program, or subject the service providers to periodic audits.

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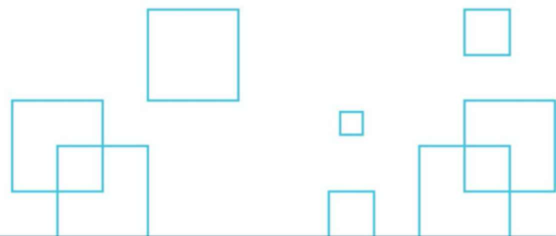
[23] Treas. Reg. § 1.6050W-1(a)(4).



Other reporting requirements permit the designation of a third-party reporting entity. For example, section 3511 permits a professional employer organization to obtain a certification and assume liability for federal employment tax reporting, withholding, and payment on behalf of the common law employer.[24] Similarly, under section 6050W, the payment settlement entity with the obligation to report may designate a different person to satisfy the reporting obligation.[25]

3. Technology Solutions

Given sufficient time, technology solutions will likely be developed to facilitate tax reporting while protecting customers' PII. Adopting a phased approach as recommended in Section I.E., above, would allow more time for the development of such solutions.

A couple of suggestions have already been proposed. For example, a tax attestation token could be issued by a trusted third party to the user's digital wallet containing the relevant customer information (taking the place of Forms W-8 or W-9). Users could allow the trusted third party to associate the onchain and offchain tokens and submit necessary information to the appropriate tax agency on their behalf.[26]

Another example is using zero knowledge proofs to verify identity. The idea is to allow users to publish a zero-knowledge proof, demonstrating that their identity has been verified without publicly revealing it.[27]

Healthcare companies are currently looking at ways to use decentralized ledger technology to allow patients to store data on the blockchain and release it according to their own instructions. Thus, there is broader demand to develop technology solutions to protect PII.

C. Digital Asset Payment Processors

We believe that the Proposed Regulations, as applied to digital asset payment processors, present a couple issues, and as discussed above in Section II.A., we believe that the definition of

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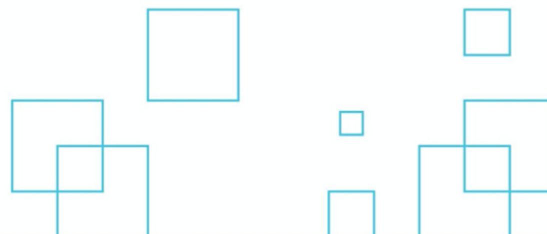
[24] *See* Treas. Reg. § 31.3511-1(g)(1).
[25] *See* Treas. Reg. § 1.6050W-1(d)(3).
[26] *See* Coinbase, *Tax Tokens: A Potential Solution for DeFi*, available at: https://www.coinbase.com/public-policy/advocacy/documents/tax-tokens.
[27] *See* Vitalik Buterin et al., *Blockchain Privacy and Regulatory Compliance: Towards a Practica Equilibrium*, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4563364.



facilitative service should be narrowed to include only those directly effectuating sales of digital assets.

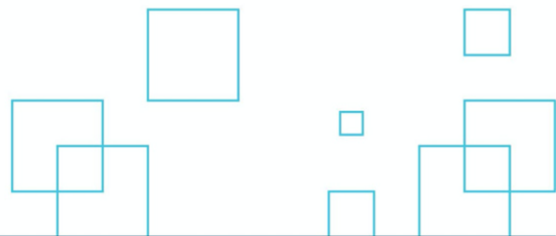
First, where the digital asset payment processor is also a TPSO under section 6050W(b)(3) and Treas. Reg. § 1.6050W-1(c)(2), we believe that section 6050W is a more appropriate reporting regime than section 6045 to govern digital asset payment processors. As explained in the Preamble, in situations in which a merchant accepts digital assets in exchange for merchandise, the digital asset payment processor that is also a TPSO is subject to reporting under section 6045 on behalf of the buyer *and* section 6050W on behalf of the merchant.[28] This subjects digital asset payment processors to two reporting obligations for only one transaction.

The proposed rules governing digital asset payment processors result in multiple brokers reporting the same transaction. The digital asset payment processor would be required to report the transaction on behalf of the customer, but the broker effectuating the transaction on behalf of the customer would also be required to report the transaction on the customer's behalf, and possibly indirect service providers such as the payment card network in a payment card transaction. In addition, the digital asset payment processor, if a TPSO, would report the transaction on the merchant's behalf.

Therefore, if only section 6050W reporting applied to the digital asset payment processor that is also a TPSO, and the definition of facilitative service was narrowed to include only directly effectuating a transfer of digital assets in a payment card transaction, there would be no gap in information reporting – the merchant's transaction would be reported by the digital asset payment processor, and the customer's transaction would be reported by its broker. This approach would relay all relevant information to the IRS about both parties to the transaction, as well as ease the burden imposed on digital asset payment processors and minimize duplicative reporting. Furthermore, a taxpayer's PII would pass to fewer persons under this approach because the digital asset payment processor would never need the buyer's information. To assist the IRS in better matching these transactions, a box could be added to the Form 1099-K to separately report the total gross proceeds from digital asset transactions.

If Treasury and the IRS reject this recommendation, they should consider eliminating the requirement for the digital asset payment processor to report the cost basis, because it will not have access to this information. In addition, Treasury and the IRS should consider imposing a

[28] 88 Fed. Reg. at 59,589; Prop. Treas. Reg. § 1.6045-1(b)(14), Ex. 14.



reporting threshold. This approach aligns with the OECD CARF,[29] which has a reporting threshold of $50,000 for retail payment transactions, and with section 6050I, which has a reporting threshold of $10,000 for retail transactions. The Preamble states that Treasury and the IRS considered but rejected a *de minimis* threshold because reporting entities in other contexts have elected not to take advantage of *de minimis* thresholds and because taxpayers still need the information to compute their taxes.[30] Without a threshold, however, the broker reporting requirement will discourage customers from using digital assets for retail purchases, as customers will be reluctant to turn over their PII to make relatively small purchases. We believe the thresholds provided in the CARF and section 6050I reflect a consideration of the administrative difficulty in requiring the collection of customer data in relatively small retail transactions, which likewise apply in the context of digital asset payment processor transactions.

III. DEFINITION OF DIGITAL ASSETS

The Proposed Regulations define "digital asset" as "a digital representation of value that is recorded on a cryptographically secured distributed ledger (or similar technology), without regard to whether each individual transaction involving that digital asset is actually recorded on that ledger, and that is not cash."[31] The Preamble explains that stablecoins and NFTs are considered digital assets under section 6045.[32] We recommend that Treasury and the IRS limit the scope of reporting for these tokens under section 6045, as discussed below. In addition, we recommend that Treasury and the IRS provide guidance on whether and how other types of tokens are subject to reporting.

A. Stablecoins

The Proposed Regulations treat all stablecoins as digital assets, even those that are backed by the U.S. dollar or other fiat currency, because not all stablecoins pegged to the value of currency are consistently linked and "a broker may not be able to identify which stablecoins will perfectly and consistently reflect the value of the currencies to which they are linked."[33]

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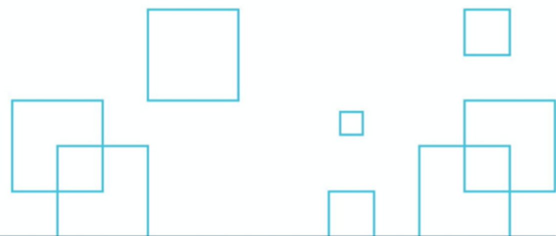
[29] Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standards at § IV.C.3., OECD (Oct. 10, 2022), https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf.
[30] 88 Fed. Reg. at 59,590.
[31] Prop. Treas. Reg. § 1.6045-1(a)(19)(i).
[32] 88 Fed. Reg. at 59,582.
[33] 88 Fed. Reg. at 59,608.



We believe that a comprehensive reporting requirement for all fiat-pegged stablecoin sales would be overly burdensome and would provide very little useful information to the IRS and to taxpayers. We are concerned that the sheer number of stablecoin transactions to be reported would be unmanageable. In this regard, we note that when one digital asset is exchanged for another, this is typically accomplished by converting the one digital asset into stablecoins and then from the stablecoins into the other digital asset. These transactions alone could result in millions, or even billions, of transactions reported on Forms 1099-DA.

Under similar circumstances, Treasury and the IRS reasonably concluded that broker reporting should not be required for dispositions of money market fund shares, notwithstanding that the Securities Exchange Commission modified its rules to allow money market funds to have a floating net asset value.[34] The preamble to Prop. Treas. Reg. § 1.6045-1(c)(3)(vi) explained that "The Treasury Department and the IRS believe that imposing broker reporting requirements on floating-NAV MMFs would result in *administrative burdens that are not justified in light of the expected relative stability of floating-NAV MMF share prices."*[35]

To ensure "relative stability" for a similar exclusion for fiat-backed stablecoins, final regulations could impose certain conditions on the exclusion. Specifically, we recommend that stablecoins that are denominated on a 1:1 basis by reference to fiat currency, backed on a 1:1 basis by short-term, liquid assets denominated in the same fiat currency, and redeemable upon demand at par be excluded from the definition of digital assets.

If Treasury and the IRS remain concerned that such stablecoins may still significantly break their peg, final regulations could limit the exception to situations where the value of the stablecoin falls within a certain dollar range (e.g., +/- $.02, or $0.98 – $1.02). We do not believe that value ranges within which popular stablecoins pegged to the U.S. dollar generally fall significantly vary from one dollar. For example, from November 2019 to present, the value of Tether reached a high of $1.02 and a low of $0.98, and at most times, the difference between the value of Tether and the U.S. dollar was mere fractions of pennies.

Alternatively, if Treasury and the IRS do not adopt an exclusion for fiat-backed stablecoins, we recommend a couple of simplifications to reporting fiat-backed stablecoins. First, because fiat-

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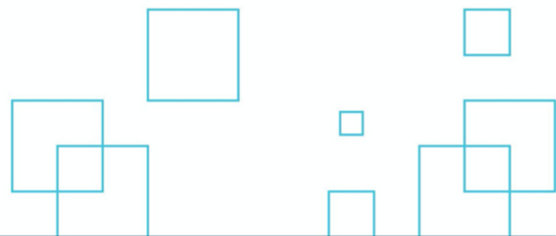
[34] Treas. Reg. § 1.6045-1(c)(3)(vi)(A).

[35] 79 Fed. Reg. 43,694, 43,696 (Jul. 28, 2014) (emphasis added). These same regulations adopted a simplified accounting method for taxpayers to report gains and losses on their floating net asset value money market funds. Although beyond the scope of the Proposed Regulations, a similar simplified accounting method could be adopted for U.S. dollar-backed stablecoins to reduce the burden on taxpayers.



backed stablecoins are almost always acquired for one unit of the fiat currency (e.g., one U.S. dollar), we recommend that digital asset middlemen be allowed to simplify basis reporting for fiat-backed stablecoins by treating the basis as equal to one unit of the fiat currency. Second, we recommend that final regulations adopt an annual threshold gain amount for reporting such stablecoin transactions. The amount of the threshold could be based on other reporting regimes—for example: (1) $600 reporting threshold for payment settlement entities under section 6050W; (2) $200 threshold for exclusion of foreign currency gains under section 988(e)(2); or (3) $10 reporting threshold for interest payments under section 6049.

B. NFTs

The Proposed Regulations treat all NFTs as digital assets, even if they represent ownership or other rights to assets that would not otherwise be reportable under the broker reporting regime (such as an interest in artwork or sports memorabilia), and even if they do not represent assets at all, such as gift cards or loyalty programs. The Preamble explained that it was treating such NFTs as digital assets because they raise tax administration concerns in that they can be transferred easily and give rise to gain or loss.[36]

We believe that the inclusion of all NFTs in the definition of digital asset is too broad. Instead, we recommend that only NFTs that represent fungible financial instruments be included in the definition of digital asset. For example, an NFT may have a serial number like a stock certificate making it technically non-fungible, but it represents a fungible equity interest in a venture. Where NFTs are like certain types of financial instruments – such as publicly traded stocks – they are generally regularly traded and have an ascertainable fair market value. In contrast, NFTs represent a right to some other type of underlying asset, which itself may have value, but the NFT is not a representation *of* that value. The NFT's price is not fixed according to market drivers and is not necessarily the same for each copy of that specific NFT (e.g., the first image in a collection can be more valuable than duplicates the seller later makes available). That means an NFT's fair market value is determined only once sold, and even then, if an NFT is exchanged for another NFT, it may be impossible to ascertain those NFTs' worth.

The value of an NFT may be difficult to ascertain where that NFT is ancillary to another product, such as a physical good. For example, many luxury brands have started issuing NFTs with their product, often including a serial number and access to metadata matching the watch, handbag, jewelry, etc. purchased by the consumer. Although they may enhance the value of the physical

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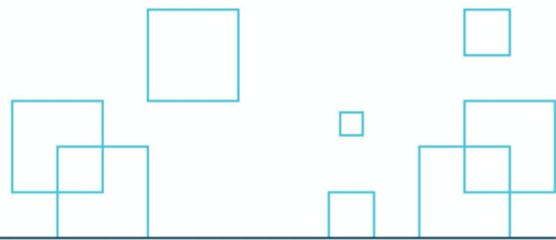
[36] 88 Fed. Reg. at 59,582.



good, similar to how software manufacturers have long relied on difficult-to-forge holograms or registration programs to distinguish their authentic goods from knockoffs, such NFTs may have only indeterminate and marginal value alone on the secondary market.

The value of NFTs may also be difficult to ascertain–and inconsistent–when it is closely tied to an event. For example, NFTs may be used as admission tickets for concerts, shows, or other events. Other NFTs may be part of a time-bound contest, where a user that can collect, the right is entitled to a physical prize, but holding the NFTs outside of the contest period is of no benefit, like the annual McDonald's Monopoly game. These tokens would persist on the blockchain after the event but would trade for a fraction of its original value, worth keeping primarily as a memento (although reselling it would result in the holder recognizing a paper loss).

Limiting digital assets to NFTs that represent fungible financial instruments is consistent with the look-through rule proposed in Notice 2023-27.[37] This rule looks to the nature of the asset or right represented by the NFT to determine how it should be treated for tax purposes, rather than indiscriminately treating all NFTs the same. This approach is appropriate when one considers that tokenizing assets may just be beginning, which could lead to numerous types of assets becoming subject to broker reporting.

Limiting digital assets to NFTs that represent fungible financial instruments is also consistent with regulatory regimes for AML. For example, the FATF defines "virtual asset" as any digital representation of value that can be digitally traded, transferred, or used for payment or investment purposes. FATF guidance provides that NFTs that are unique (rather than interchangeable) and are in practice used as collectibles, rather than as payment or investment instruments, generally are not virtual assets under the FATF definition.[38]

We believe that NFTs used as collectibles and other unique NFTs whose values are not readily ascertainable are more appropriately reported under section 6050W, which provides for aggregate gross proceeds reporting by payment settlement entities. Marketplaces listing this type of NFT resemble marketplaces such as Etsy and eBay, which are subject to section 6050W reporting.

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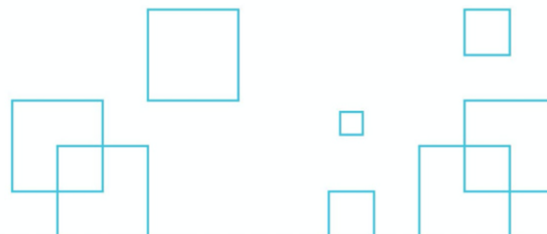
[37] 2023-15 I.R.B. 634. The Chamber filed comments on Notice 2023-27 expressing support for the look-through approach, available at: https://downloads.regulations.gov/IRS-2023-0011-0029/attachment_1.pdf .

[38] Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers at ¶ 55, FATF (Oct. 2021), https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Updated-Guidance-VA-VASP.pdf.coredownload.inline.pdf.



If Treasury and the IRS reject this recommendation and include all NFTs in the definition of digital asset in the final regulations, we recommend that exchanges of NFTs for other NFTs be excluded from the requirement to report gross proceeds and basis, as in this instance, it will be difficult for a broker to determine the appropriate amounts to report. We also recommend that NFTs that are ancillary to events or physical goods be excluded from the reporting obligations.

C. Miscellaneous Tokens

The Proposed Regulations do not provide any guidance on governance tokens, wrapped tokens, or liquidity tokens. As a result, it is extremely difficult for brokers to report on these transactions.

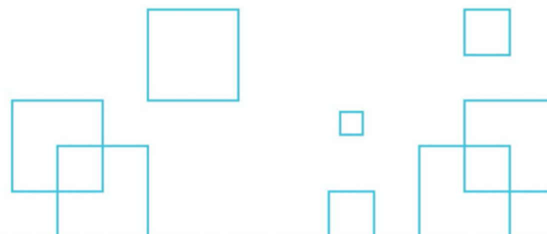
- Governance tokens give holders the right to propose and vote on key changes to an underlying protocol. They have differing rights and obligations, some of which have attributes resembling equity in a partnership or corporation, which could be subject to broker reporting for traditional equity.
- A wrapped token is a tokenized representation of a particular cryptocurrency, with the exact same value, that is operable on another blockchain. These transactions may look like transfers of the wrapped token, but taxpayers and advisors generally take the position that many of these actions are non-realization events.
- Liquidity pool tokens act as a receipt for the liquidity provider, who will use them to claim their original stake and interest earned. These tokens represent the liquidity provider's share of the fees earned by the liquidity pool.

We believe that clarification is needed on the tax treatment of actions involving these tokens to provide clear guidance to brokers and their reporting obligations. In addition, similar to our comments on NFTs, we are concerned that the difficulty in ascertaining the value of these tokens will prove burdensome to brokers and recommend that exchanges of these tokens for other such tokens be excluded from the requirement to report gross proceeds and basis.

D. Option Transactions

As described in the Preamble, the Proposed Regulations expand the type of option transactions that are subject to reporting to include options on digital assets and options on derivatives with a digital asset as an underlying property.[39] The Preamble states that, because Treasury and the IRS

[39] 88 Fed. Reg. at 59,584.



are unaware of any digital asset options that are also section 1256 contracts, the Proposed Regulations do not provide rules for such options, but request comments on whether such options are common.[40]

Bitcoin options and section 1256 contracts on bitcoin are already traded on the Chicago Mercantile Exchange. Accordingly, final regulations should address how these transactions should be reported under Prop. Treas. Reg. § 1.6045-1(a)(9)(i) or (ii), depending on whether the option is itself a digital asset.

E. Closed System Virtual Assets

The Preamble states that the definition of digital assets does not include certain types of virtual assets that exist only in a closed system (such as video game tokens that can be purchased with U.S. dollars or other fiat currency but can be used only in-game and that cannot be sold or exchanged outside the game or sold for fiat currency). While the provided video game example is helpful, we encourage Treasury and the IRS to consider broader examples of closed system virtual assets that may be contained in other "walled garden"-type environments (i.e., enclosed environments that control the end user's access to certain services or functions).

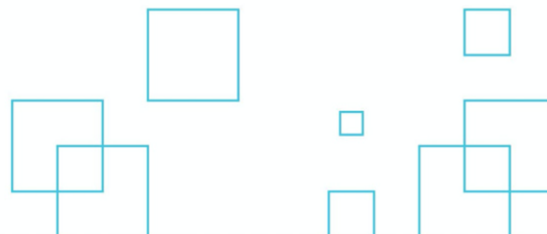
An example of a walled garden environment is a loyalty program that could be represented with an NFT, where a customer would buy a blockchain token for fiat currency and receive exclusive access to events or discounts on apparel, among other things. If the customer is unable to transfer the token outside of the program's walled garden in any manner (by sale or gift) or if the utility of the token is limited to a particular timeframe or event, it is in substance no different from the closed system video game tokens mentioned in the Preamble. Accordingly, we recommend that such tokens likewise be excluded from the definition of digital asset.

IV. MISCELLANEOUS COMMENTS

A. Non-U.S. Brokers

We anticipate that, within three to five years, most digital asset service providers will need to comply with the OECD CARF, so to the extent the U.S.'s rules are aligned with CARF, brokers need only report relevant information once, and will not have to obtain a separate certification

[40] *Id.*



for U.S. purposes.[41] Similarly, under FATCA, financial institutions can obtain an Intergovernmental Agency self-certification in lieu of an applicable Form W-8.

We believe it is less burdensome on brokers and better for tax administration for the United States to align itself globally and benefit from intergovernmental cooperation rather than requiring analyses and certifications that only serve a U.S. reporting regime. Therefore, we recommend continued consideration of the rules relating to non-U.S. brokers until they can be better coordinated with these other global information reporting regimes.

B. Treatment of Transaction Costs

With regard to the allocation of costs for determining the amount realized and basis, the Proposed Regulations provide that, in the case of an exchange of digital assets, one-half of the total transaction costs are allocable to the disposition and one-half are allocable to the acquisition ("50/50 Rule").[42] While it is theoretically true the transaction costs are for both transactions, splitting the costs adds unneeded complexity and makes it difficult to later reconcile validation.

We believe that an allocation of 100% of the costs to either the digital asset acquired or disposed of is more administrable than the 50/50 Rule. We believe it should be left to the discretion of the broker which side of the transaction receives the allocation of the costs and such practice should be made clear in its terms of service. Such an approach would also be more consistent with the economics imposed by the fees charged by the broker.

C. Information Reportable on Form 1099-DA

The Proposed Regulations provide that digital asset middlemen must report the information required by Form 1099-B, plus the following information unique to digital assets: the sale time (in addition to the date); the transaction ID; the digital asset address from which the digital asset was transferred in connection with the sale; and whether the sale was for cash stored-value cards, or in exchange for services, or other property.[43]

We believe that the requirement to provide timestamps and digital asset addresses is overly broad in an information reporting context, as they are not necessary for purposes of permitting

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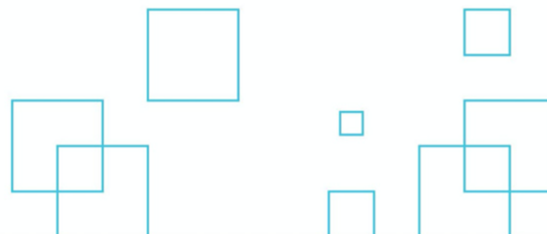
[41] *See, e.g.,* European Council directive amending directive 2011/16/EU on administrative cooperation in the field of taxation (DAC8) implementing CARF.
[42] Prop. Treas. Reg. § 1.1001-7(b)(2)(ii).
[43] *See* Prop. Treas. Reg. § 1.6045-1(d)(2(i)(B).



taxpayers to report their digital asset transactions. In addition, digital asset addresses raise the privacy and security concerns discussed above. We believe brokers could be instructed to retain this information rather than report it on Form 1099-DA, which is more appropriate to provide in the examination context.

D. Reporting of Date and Time of Transaction

The Proposed Regulations provide that the reported date and time should generally be set forth in hours, minutes, and seconds using Coordinated Universal Time ("UTC").[44] We recommend that brokers be permitted to designate a time zone for dating transactions, as opposed to requiring all brokers to use UTC. We believe such an approach would be more understandable for customers and would be more consistent with how this is done in the traditional brokerage space.

E. Suggested Improvements for Transcripts

Although outside the scope of the Proposed Regulations, we note that the sheer volume of digital asset transactions to be reported under section 6045 will highlight limitations in the existing IRS TDS. We recommend that the IRS consider improvements to its TDS system to address the considerations discussed below.

Assuming Forms 1099-DA are recorded similarly to Forms 1099-B, each covered transaction is entered as a separate Form 1099 entry in the TDS system. Thus, for example, 1,000 digital asset trades (which may be relatively small for some digital asset users) would appear as 1,000 Form 1099 entries in a TDS wage and income transcript. Currently, the TDS system can electronically transmit a maximum of 300 wage and income records. To obtain the entries exceeding 300, the practitioner must call the Priority Practitioner System, which will fax all the records. Because only two and a half Form 1099 records can be listed on a fax page due to how it is presented, to get 1,000 records, practitioners would receive a 400-page fax.

In addition, while paper Forms 1099-B display the total proceeds, basis, and gain in addition to each covered transaction detail record, the TDS system does not retain the totals, only the detailed records. Therefore, practitioners must manually add the 1,000 detail records to determine the total income.

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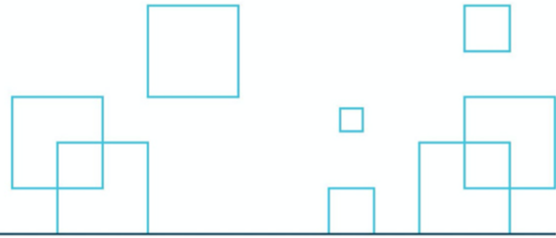
[44] Prop. Treas. Reg. § 1.6045-1(d)(4)(ii).



Finally, we anticipate that taxpayers engaging in multiple digital asset transactions may have greater need to access their transcripts. Accordingly, we recommend expanding the TDS to support self-service by all users for wage, income, and deposit records.

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.

Sincerely,

Cody Carbone

Cody Carbone
Vice President of Policy
The Chamber of Digital Commerce

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Encl.

cc: Hon. Lily Batchelder, Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
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