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, DC 20044

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

Dear Sir or Madam:

The Crypto Council for Innovation ("CCI") appreciates the opportunity to submit comments on the Notice of Proposed Rulemaking on gross proceeds and basis reporting by brokers and determination of amount realized and basis for digital asset transactions (REG-122793-19) (the "Proposed Regulations").[1]

CCI is an alliance of industry leaders in the digital assets space with a mission to communicate the benefits of digital assets and demonstrate its transformational promise. CCI members span the digital asset ecosystem and share the goal of encouraging the responsible global regulation of digital assets to unlock economic potential, improve lives, foster financial inclusion, protect national security, and disrupt illicit activity. CCI believes that achieving these goals requires informed, evidence-based policy decisions realized through collaborative engagement.

CCI is concerned that certain aspects of the Proposed Regulations do not adequately take into account the unique nature of digital assets and the digital asset industry, especially to the extent that they impose obligations on individuals, technologies, or entities that practically cannot comply with tax reporting obligations. Such entities or persons' inability to comply is not because they do not want to, but because they do not have–and in many cases, cannot get–the requisite information to do so. Among other concerns, the overbroad proposed definitions of "broker" and "digital assets" would include certain decentralized finance ("DeFi") protocols, self-hosted wallet products, non-fungible tokens ("NFTs"), and also does not differentiate between digital assets used as payments and digital assets used as investments. On this latter point, the Proposed Regulations' imposition of novel reporting requirements on payment

[1] Notice of Proposed Rulemaking, *Gross proceeds and basis reporting by brokers and determination of amount realized and basis for digital asset transactions* (REG-122793-19), published August 29, 2023, 88 Fed. Reg. 59576.

processors and facilitators would mark a dramatic and troubling expansion of such rules to the payments space. Such requirements would also create an unfair and unlevel playing field for payments activities leveraging digital assets as compared to traditional payments technologies.

The information contemplated to be collected under the Proposed Regulations further presents significant privacy concerns. CCI is concerned that certain provisions contained in the Proposed Regulations are overly broad and inconsistent with Congressional intent under the Infrastructure Act's (defined herein) amendments to Section 6045 of the Internal Revenue Code.[2] CCI's comments (as contained within this letter) are intended to address these areas. While CCI agrees with the Department of Treasury ("Treasury") and the Internal Revenue Service (the "IRS") that the goal of these rules should be to provide clarity as to information reporting obligations, we respectfully submit that the Proposed Regulations, as currently drafted, do not achieve this goal.

CCI's specific comments and recommendations regarding each of these areas are addressed below in more detail.

Discussion and Recommendations

1. *Definition of Digital Assets Subject to Reporting*

a. *Overall Recommendation*

There are robust existing information reporting regimes that have proven effective to facilitate closing the tax gap with respect to sales, exchanges, and payments outside of the digital assets space.[3] CCI recommends that, where a transaction with respect to a digital asset may be reportable under more than one information reporting regime, the existing rules applicable to such reporting ought to control the reporting on the transaction. This simple rule will provide clarity to market participants and promote efficiency in reporting activities.

b. *Securities and Commodities*

As drafted, property that is both a digital asset and a security or commodity is required to be reported under the digital asset regulations. Where a digital asset (as defined under Prop. Treas. Reg. § 1.6045-1(a)(19)(i)) also constitutes a security or commodity for U.S. federal income tax purposes (i.e., a dual classification asset), a broker must comply with only the digital asset reporting requirements in the Proposed Regulations.[4]

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[2] Infrastructure Investment and Jobs Act ("Infrastructure Act"), Public Law No: 117-58, Section 80603(b)(1)(B) (amending 26 U.S. Code § 6045) (All references to "section 6045" are to the Internal Revenue Code of 1986, as amended (the "Code" or "I.R.C.")). *See also* discussion under Non-Fungible Tokens, referencing the aim of Section 80603 of the 2021 Infrastructure Act to amend Section 6045 of Internal Revenue Code of 1986.

[3] *See, e.g.*, existing Treas. Reg. § 1.6045-1.

[4] Preamble, 88 Fed. Reg. 59583 (Aug. 29, 2023); Prop. Treas. Reg. § 1.6045-1(c)(8)(i).

The preamble to the Proposed Regulations (the "Preamble") indicates that Treasury and the IRS considered various ways to address this overlap. The Preamble expressed concern that there is no substantive guidance on when a digital asset can be a "security" or "commodity," making this determination incredibly difficult for a digital asset broker.[5]

We understand the concern expressed in the Preamble. That said, in the case of securities or commodities that are tokenized (i.e., take the form of digital assets), there may be sufficient publicly available data to make this determination, including tax disclosures and other materials. Further, broker dealers in the securities industry have already built platforms for tax information reporting purposes that currently help achieve material tax compliance. For these reasons, we propose "flipping" this rule so that digital assets that are both securities or commodities and digital assets are reported under the existing section 6045 regulations for securities and commodities after the effective date of the Proposed Regulations when finalized.

c. *Non-Fungible Tokens ("NFTs")*

The Proposed Regulations define "digital asset" as "any digital representation of value that is recorded on a cryptographically secure distributed ledger (or any similar technology), without regard to whether each individual transaction involving that digital asset is actually recorded on that ledger, and that is not cash."[6] The Preamble expresses that the definition is intended to (1) be wide enough to cover transactions involving representations of value which have been traded on ledgers that are not widely or publicly distributed and (2) be broad enough to cover any advancements to the technology.[7]

The Proposed Regulations and the Preamble specifically provide that NFTs are treated as "digital assets" for this purpose, subject to an exception for NFTs created in a "closed loop" system (like a video game) that cannot be transferred off the platform or sold for fiat and would only be used in a closed system.[8] The Preamble defines NFTs as "digital assets that are bought, sold, and traded on digital asset trading platforms similar to other digital assets" and notes that such disposition may give rise to gain or loss.[9]

Treasury and the IRS had previously addressed the definition of an NFT. Specifically, in Notice 2023-27, an NFT is defined as "a unique digital identifier that is recorded using distributed ledger technology and may be used to certify authenticity and ownership of an

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[5] *Id.*, at 59582. The Preamble notes that treatment of an asset as a reportable security, commodity, digital asset, or otherwise should apply only for purposes of sections 1001, 1012, 3406, 6045, 6045A, 6045B, 6050W, 6721, and 6722, and not for other purposes of the Internal Revenue Code of 1986 (the "Code").
[6] Prop. Treas. Reg. § 1.6045-1(a)(19)(i).
[7] Preamble, 88 Fed. Reg. 59581.
[8] *See, e.g.,* Prop. Treas. Reg. § 1.6045-1(b)(20) (example indicating that an NFT is a digital asset in addressing which parties to the transaction represent brokers); 88 Fed. Reg. 59576, 59582.
[9] Preamble, 88 Fed. Reg. 59618.

associated right or asset."[10] The Notice also states that "[o]wnership of an NFT may provide the holder a right with respect to a digital file (such as a digital image, digital music, a digital trading card, or a digital sports moment) that typically is separate from the NFT."[11] In footnote 1, the Notice elaborates, stating, "[a] digital file is not the same as a digital asset, as defined in section 6045(g)."[12] We agree with this description and the conclusion reached in the footnote.[13]

Accordingly, we recommend updating the Proposed Regulations to provide that an NFT that offers the holder a right to or authenticates a digital file (i.e., to an asset that is not a financial asset) is not subject to broker reporting under section 6045 because such an NFT would be characterized as a digital file under the look-through approach, and digital files are not digital assets within the meaning of section 6045(g).

If Treasury and the IRS were not to provide this clarification for these types of NFTs, then we request an exception for transactions with a fair market value of less than $50,000 from reporting (similar to the reportable retail payment exception under the OECD's Crypto-Asset Reporting Framework[14]) and delay of the effective date for an additional 18 months after other digital asset reporting is commenced (based on the systems enhancements needed beyond the digital asset exchanges to prepare systems and procedures for reporting).

This recommendation aligns with the statutory language that NFTs have to be "representations of value" to be within the scope of the new reporting requirements. In contrast, NFTs that do not represent or serve as financial instruments – such as those that provide the holder with access to things like digital files – fall outside of this scope. Congress also defined "specified security" in section 6045(g)(3)(B) in a manner that indicates that "digital assets" as defined in section 6045(g)(3)(D) is properly understood as a financial instrument.[15] Specifically, Congress inserted "digital asset" in 6045(g)(3)(D) after commodities, securities, and debt notes, but before "any other financial instruments."[16]

d. *Stablecoins*

The Proposed Regulations specifically include stablecoins, and their issuers, within the scope of reporting. The Preamble defines a stablecoin as "a form of digital asset that is intended

[10] I.R.B. 2023-15, March 21, 2023. The NFT Notice addressed the treatment of NFTs as "collectibles" under section 408(m), and solicited comments on the treatment of NFTs for other U.S. federal tax purposes.
[11] *Id.*
[12] *Id.*
[13] We had previously requested guidance on this question. *See* CCI, Response for Requests for Comments on Notice 2023-27 (June 19, 2023), available at https://perma.cc/WF5A-RYQR.
[14] Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard, published October 10, 2022, 50-51; Regulation (EU) 2023/1114, Article 3(1)(15) (May 31, 2023) (hereinafter "CARF"), available at: https://perma.cc/S8T4-G7MR.
[15] *See* Infrastructure Act *supra* note 2.
[16] *Id.*

to have a stable value relative to another asset or assets, typically a fiat currency."[17] Treasury and the IRS propose to include stablecoins in the definition of "digital asset," and their issuers in the definition of "broker," because "notwithstanding the nomenclature 'stablecoin,' the value of a stablecoin may not always be stable and therefore may give rise to gain or loss."[18]

The Preamble indicates that Treasury and the IRS considered excluding transactions involving the disposition of stablecoins that are linked to the U.S. dollar or to other foreign currencies from the definition of a sale for which reporting is required. Such an exclusion would parallel the manner in which dispositions of U.S. dollars or other foreign currencies are treated for purposes of section 6045–that is, as dispositions that are generally not subject to reporting.[19] Treasury and the IRS requested comments on these points.[20]

Stablecoins (i.e., digital assets whose value is pegged to a particular fiat currency, like the U.S. dollar) generally do not pose the same risk of tax avoidance as other digital assets that have the capacity for meaningful appreciation because the value stays closely linked to the U.S. dollar. The potential for use of stablecoins in retail transactions means that reporting the gross proceeds on sales could be massively burdensome for reporting brokers, undermine the payments use case, and be non-administrable for the IRS. Further, it is expected that any backup withholding imposed on gross proceeds from stablecoin sales or dispositions would greatly exceed the potential gain (if any) on such transactions.

In addition, the Preamble to the Proposed Regulations indicates that Treasury and the IRS are now considering how the U.S. can implement its crypto-asset reporting under the OECD's CARF.[21] CARF generally does not require digital asset brokers and crypto exchanges to report the sale of stablecoins if treated as "specified electronic money products" under CARF reporting rules.[22]

Accordingly, we recommend excluding stablecoins from the definition of digital assets subject to reporting, given the minimal reporting value of such transactions compared with the taxpayer burden from complying with such rules.

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[17] Preamble, 88 Fed. Reg. 59590.

[18] *Id*.

[19] *See, e.g.,* Treas. Reg. § 1.6045-1(a)(11) and (12) (the term cash includes the U.S. dollar and foreign currency); *Id*. at -1(c)(3)(viii)(no reporting required on foreign currency); *Id*. at -1(c)(3)(vi) (no reporting on certain money market funds); *Id*. at -1(c)(3)(vii)(A) (no reporting required on non-transferable obligations like savings accounts).

[20] Preamble, 88 Fed. Reg. 59608, Section K. Additional Definitions and Definitional Changes; *Id*. at 59616, Question 37 and 38.

[21] *See* CARF *supra* note 14. CARF would require the U.S. government to exchange information on crypto-asset transactions by residents of participating jurisdictions and entities controlled by residents of a participating jurisdiction. It is anticipated that implementation of CARF by the U.S. would require the modification of the Proposed Regulations to ensure that U.S. brokers collect the information required to be exchanged under the framework.

[22] *Id*.

2. *Definition of Brokers Required to Report*

a. *Overview*

The Proposed Regulations do not modify the definition of "broker" under existing Tres. Reg. § 1.6045-1(a)(1), which provides that the term means any person who in the ordinary course of a trade or business stands ready to "effect" sales to be made by others.[23] The Proposed Regulations modify the definition of "effect" as found in existing Treas. Reg. § 1.6045-1(a)(10)(i) and (ii), which provides the various roles which a broker may transact on behalf of customers. Such modification requires any person providing "facilitative services" that effectuate digital asset sales by customers to be considered a broker if such person would know or is in a position to know the identity of the customer and the nature of the transaction which potentially gives rise to gross proceeds.[24] The Preamble provides that this rule is intended to bring digital asset trading platforms that provide facilitative services within scope of the reporting rules where such platforms would also have access to the customer's identity and the nature of the transaction.[25]

This proposed definition of broker is overbroad and captures situations in which the activities are not "broker" activities. Under existing section 6045, a broker provides its services <u>for consideration</u> to customers that are not themselves brokers (because of the "multiple broker" rule).[26] From a policy standpoint, the current section 6045 standard reflects that a broker (other than an issuer redeeming its own stock or debt) must be engaged in the trade or business (i.e., compensated) for its activities <u>and</u> have a sufficiently direct relationship with its non-broker customer that it is in the position to report transactions to the customer.

The presence of a relationship between the broker and the customer is a hallmark of existing section 6045 and is a critical component of the definition of broker under section 6045(g) to avoid overly burdensome and duplicative reporting. This relationship requirement must be maintained to avoid unlevel, arbitrary, and disparate treatment of the digital asset space as compared to traditional financial service models. Our comments below highlight examples specific to the digital assets ecosystem that illustrate the overbreadth of the rules, and recommend changes intended to tailor the rules to the actual intent expressed by Congress.

b. *Expansion of the Term Broker to Include "Facilitative Services"*

The Proposed Regulations provide that a facilitative service "includes the provision of a service that directly or indirectly effectuates a sale of digital assets, such as providing a party in the sale with access to an automatically executing contract or protocol, providing access to

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[23] Preamble, 88 Fed. Reg. 59585.
[24] *Id*.
[25] *Id*. at 59586.
[26] 26 U.S. Code § 6045(c)(1)(C). *See also* the discussion of the "multiple broker" rule below.

digital asset trading platforms, providing an automated market maker system, providing order matching services, providing market maker functions, providing services to discover the most competitive buy and sell prices, or providing escrow or escrow-like services to ensure both parties to an exchange act in accordance with their obligations."[27] Where a person has "sufficient control or influence" over the service provided such that said person can set or change the terms of the arrangement, then that person should be said to be in a position to know the identity of the party making the sale.[28]

By definition, a facilitative service is a service that makes an action or process easier (here, effectuating the sale or exchange of a digital asset). The parties providing the facilitative service do not undertake the activity itself. For this reason, expanding the definition of broker to parties that do not, in fact, effectuate sales–but merely make it easier for others to do so–is not appropriate.

Many of the processes or activities identified by the IRS may not be ones in which the party is in the position to know the customer's identity and the nature of the transaction. In order to be a payor or withholding agent, the broker needs to be in a position to have knowledge as to the nature of the transaction. These may be situations in which the purported broker may be able to impose backup withholding but does not have sufficient information to report on the recipient. In many of the examples most concerning to CCI, the proposed "broker" does not have that information. Further, in many cases, there is no privity of contract between the purported "broker" and the "customer," limiting the basis on which the "broker" is able to collect the information required to be reported.

Limiting the exclusion to validators and certain providers of hardware and software (i.e., wallets) that engage in these activities is too narrow because it only captures a small part of the technology providers involved in creating a digital asset ecosystem.[29] There must also be parity with other information reporting regimes. For example, the OECD's CARF and the European Union's Eighth Directive on Administrative Cooperation in the field of taxation ("DAC8")[30] each

[27] Prop. Treas. Reg. § 1.6045-1(a)(21)(iii)(A).
[28] *Id*.
[29] See *id*.; *See also* Preamble at 59581 ("Explanation of Provisions").
[30] Regulation (EU) 2023/1114 of the European Parliament and the Council, on markets in crypto-assets, and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937, 2023 O.J. (L 150/40) 62 at Recital (10) (31 May 2023), available at: https://perma.cc/ZWY2-2VHU.

adopted more limited and appropriate definitions, which should be referenced and incorporated to create greater consistency across jurisdictions.[31]

The definition of "digital asset middleman" explicitly excludes persons who are solely engaged in the business of providing validation services to the distributed ledger as well as those that sell hardware or software that allow customers to use a digital wallet to store digital assets.[32] We believe that, to the extent that the concept of a "facilitative service" is retained in the final regulations, there should be similar exceptions for a variety of persons that do not provide activities that effectuate a sale.

We have provided specific examples below that we believe are representative of the need for changes to the scope of the definition of facilitative service.

- **Node operators** – Congress provided clear intent to exclude parties operating nodes because they do not have a contractual relationship with persons processing transactions through the node, they are not always in a position to know the identity of the party that makes the sale, and they do not know the nature of the transaction being processed.[33] The exception for validators needs to be broadened to include other functions within a particular blockchain ecosystem.

- **Self-hosted wallets** – The IRS and Treasury include hosted wallet providers within the definition of "broker" for reporting purposes, providing that they are "in the ordinary course of a trade or business to take custody of and electronically store the public and private keys to digital assets on behalf of others" and act as an agent when the customer transacts.[34] A wallet provider, as a software technology provider, does not have knowledge of the nature of the transactions processed, nor the identity of the parties to the transaction. This is because wallets do not 'hold' coins, but are a way for the user to securely hold their private keys, which, in turn, enable use of coins that exist on the

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[31] The rules provided in CARF exclude entities or individuals that are solely engaged in the validation of crypto-asset transactions, even where such validation is remunerated, from the definition of a reporting intermediary. Entities and individuals who solely provide hardware upon which to store digital assets will also not meet the definition provided in CARF, because a reporting intermediary (also called a "Reporting Crypto-Asset Service Provider") must indeed provide a service as part of a business that effectuates a crypto-transaction. Similarly, the DAC8 rules exclude validators and hardware providers from their definition of "Reporting Crypto-Asset Service Provider." *See supra* note 14.

[32] Prop. Treas. Reg. § 1.6045-1(a)(21)(iii)(A).

[33] 167 Cong. Rec. S6061, S6096 (daily ed. Aug. 9, 2021) ("The amendment memorializes the common understanding that the requirements are to apply only to persons who regularly, and for consideration, effectuate transfers of digital assets. Persons solely engaged in validating distributed ledger transactions will not be covered for those activities, whether they use proof of work, proof of stake or some other new consensus mechanisms. Nor will they apply to persons solely engaged in selling hardware or software with the sole function of permitting someone to control private keys used to access digital assets. Of course, if these entities provide additional services for consideration that would qualify as brokerage, the rules would apply to them as any other broker.")

[34] 88 Fed. Reg. 59576, 59589.

blockchain. A wallet provides a user interface and technical connections or links to third-party platforms, but does not itself "effectuate" such transactions and should not be categorized as a "broker."

- **DeFi protocols** – For illustration purposes, DeFi protocols can be compared to SMTP (Simple Mail Transfer Protocol), which is used for emails (i.e., this is the TCP/IP, which merely provides the underlying infrastructure used by email providers like Gmail, Yahoo, etc.). No ordinary person would suggest that SMTP protocols are "effectuating" the emails sent by these applications or email providers. The same is true for DeFi protocols, which provide the underlying infrastructure for decentralized applications. Specifically for DeFi protocols, the absence of a customer relationship, compensation, and privity of contract means that the protocol designer does not have a sufficient customer relationship to properly require reporting.

- **Price discovery services** – As detailed above, the Proposed Regulations' overly broad definitions of "broker," digital asset middleman," and "facilitative services" would result in any person providing any type of ancillary service for a digital asset transaction to be treated as a broker. Specifically, the Proposed Regulations proffer that "providing services to discover the most competitive buy and sell services" would constitute a facilitative service. It is hard to understand how such price discovery service providers (e.g., a website providing pricing information) would be effectuating digital asset transactions, requiring such entities to be treated as brokers for reporting purposes.

- **Transaction fees** – It is uncertain under the Proposed Regulations which party/parties may be responsible for reporting the exchange of digital assets to pay transactions fees such as gas fees. Where such transfers are made by operation of the protocol directly, broker reporting may be appropriate only where the broker is a party to the transaction. Alternatively, an exclusion for such fees or a de minimis threshold may be appropriate.

Accordingly, we propose limiting the definition of "broker" to taxpayers directly effecting sales of digital assets for its customers and reinstating the requirement that the broker must receive compensation for effecting the sales for customers.

c. *Digital Asset Payment Processors*

The Proposed Regulations include digital asset payment processor in the definition of digital asset broker.[35] The Proposed Regulations appropriately exclude a "merchant who is not otherwise required to make a return of information under section 6045 and who regularly sells goods or other property (other than digital assets) in return for digital assets."[36] Consistent with

[35] Prop. Treas. Reg. § 1.6045-1(b)(1)(vii).
[36] *Id*. at 1.6045-1(b)(2)(viii).

these rules, if a payment is made in settlement of a third party network transaction and such payment is either made in[37]–or made for[38]–a digital asset, the regulations require the digital asset processor to report under section 6045 as a broker.[39] In the sale of a non-digital asset good or service for a digital asset as payment, the digital asset payment processor has two reporting responsibilities: (1) section 6045 reporting on the sale of the buyer's digital asset to make the purchase and (2) section 6050W reporting for the merchant's sales transaction.

When a digital asset is used as payment (rather than held for investment purposes), transactional reporting under section 6050W, instead of gross proceeds reporting under section 6045, better reflects the actual relationship of the payment processor and its customer (as the customer is the merchant, not the buyer). The digital asset payment processor may have no relationship with the buyer. Conversely, the broker with a closer customer relationship with the buyer (such as a digital asset platform on which the buyer holds its digital asset) has the responsibility to report on the buyer's disposition. Dividing this responsibility for reporting also helps eliminate duplicative and unnecessary reporting on the same transaction.

We propose permitting digital asset payment processors that are also a payment settlement entity to report only to the merchant under existing section 6050W when a digital asset is used to settle a reportable payment transaction.

3. *Exceptions to Reporting*

a. *Multiple Broker Rule Needed for Digital Asset Brokers*

Existing regulations under section 6045 prevent duplicative reporting on the same transaction through the so-called "multiple broker" rule. This rule exempts brokers from reporting where they transact at the direction of another broker.[40] Under such a rule, only the broker that is closest to the customer has the reporting requirement.[41] To be exempt under this rule, the broker must qualify as an exempt recipient, which includes registered dealers in securities or commodities, registered futures commission merchants, and financial institutions.[42] Treasury and IRS did not extend such rules to transactions involving digital assets, citing possible gaps in information between brokers which would lead to underreporting of these transactions.[43]

The scope of the rule as proposed for digital assets creates adverse results for taxpayers, brokers, and the IRS. Multiple reporting on the same transactions means that information

[37] *Id*. at 1.6050W-1(c)(5)(ii)(A)(3), Example 1(3).
[38] *Id*. at 1.6050W-1(c)(5)(ii)(A)(4), Example 1(4).
[39] *Id*. at 1.6050W-1(c)(5)(i)(A) and (B).
[40] *Id*. at 1.6045-1(c)(3)(iii).
[41] *Id*.
[42] *Id*. at 1.6045-1(c)(3)(i)(B)(6), (7), and (11).
[43] 88 Fed. Reg. 59576, 59598.

received may be confusing for taxpayers (particularly when received from a reporting entity with which the taxpayer has never interacted). Information received by the taxpayer may be conflicting (e.g., inconsistent in the fair market value of the assets exchanged, basis, etc.), resulting in less accurate reporting by taxpayers. Duplicative reporting increases taxpayer burden through increased paperwork as well as time and effort verifying, reconciling, and remediating information. The proliferation of multiple brokers also brings in significant data security risks that are unique to the digital age. For example, user data linked to wallet addresses increase the risks of security breaches by exposing the history of transactions of identified individuals. This, in turn, would create 'honeypots' that risk incentivizing bad actors to attempt to breach such troves of information. The "multiple broker" rule addresses concerns in situations in which a "broker" with no direct relationship to the customer would have to solicit tax-relevant information in a transaction which it may not have privity of contract to do so.

Accordingly, we propose adding digital asset brokers to the list of exempt recipients so that in a transaction involving two or more "brokers," the broker with the direct customer relationship reports the transactions.

b. *De Minimis Rule for All Transactions*

We propose a de minimis threshold for digital asset reporting to reduce taxpayer burden without materially compromising the information the IRS receives on transactions. Specifically, we propose a de minimis exception for amounts less than $200 of gross proceeds, similar to the exclusion for gains on dispositions of foreign currency held for personal use.[44]

4. Amend the Reporting Obligations for Non-U.S. Persons and Sales Effected Outside of the United States

The Proposed Regulations depart significantly from traditional section 6045 information reporting principles as they relate to the burdens imposed on non-U.S. persons for reporting sales effected outside of the United States. Under the existing reporting rules, a U.S. payor or middleman will be considered a broker for any sales effected, regardless of whether the sale takes place at an office inside or outside the United States. However, a non-U.S. payor or middleman will only be considered a broker under Treas. Reg. § 1.6045-1(a)(1) if the sales are effectuated at an office inside the United States. Whether reporting is required on a particular transaction depends on the status of the seller, including whether certain U.S. indicia are present.

Under the Proposed Regulations, broker reporting is required for U.S. digital asset brokers and controlled foreign corporation ("CFC") digital asset brokers.[45] The proposed rules require the reporting unless the broker can treat the customer as an exempt foreign person or

[44] *See* 26 U.S. Code § 988(e).
[45] *See* Prop. Treas. Reg. § 1.6045-1(g)(4)(ii).

another exception applies.[46] The Proposed Regulations further provide explicit rules on the type of documentation on which a broker may rely rather than referring to regulations under sections 1441 and 6049.[47] This specification significantly alters the circumstances in which the broker has "reason to know" that they cannot rely on a withholding certificate (i.e., IRS Forms W-8) by including the new U.S. indicia. The presence of one of these non-U.S. indicia can require a non-U.S. person to report on a transaction that otherwise would not be subject to reporting. Under the Proposed Regulations, CFCs not conducting activities as money services businesses ("MSBs") are not required to treat a customer classified as an individual as a U.S. person unless the broker has information for the customer or a withholding certificate showing any of the U.S. indicia.[48] A non-U.S. digital asset broker that does not conduct activities as an MSB must treat a transaction as effected within the United States if any U.S. indicia are present.[49]

There are several "U.S. indicia" provided in Prop. Treas. Reg. § 1.6045-1(g)(4)(iv)(B)(1) through (5) which, if present, change the reporting requirements for non-U.S. digital asset brokers and provide that such sale will be considered effected at an office inside the United States if any are present. Such indicia are: (1) a U.S. IP address used when communicating with the broker; (2) a U.S. permanent residence or mailing address or U.S. telephone number; (3) cash paid by the customer from a bank maintained in the United States; (4) digital assets being transferred from a digital asset broker that the non-U.S. broker knows or has reason to know is organized in the U.S.; and (5) an unambiguous indication of the customer having a U.S. place of birth. Criteria (1) and (4) are new in the Proposed Regulations, and (3) is proposed to be amended.

The additional indicia added may require a digital asset broker to "cure" a single Form W-8 multiple times because the non-U.S. indicia below could arise on an individual transaction executed after the original tax form was solicited.

We recognize that blockchain technology makes digital assets sales and exchanges less tethered to specific geographic locations or markets. Accordingly, we recommend:

- **a.** Removing IP addresses as indicia of U.S. status. The use of a U.S. IP address as one point of contact for "U.S. indicia" purposes is unfounded and impractical. We propose its elimination or the establishment of a higher threshold (i.e., more than one contact).

- **b.** Removing the fact that cash is paid by a customer from a bank in the U.S. as U.S. indicia and reverting the language to the existing section 6045 language, because

[46] *See id*. at § 1.6045-1(c)(3) and -1(g)(1).
[47] *See id*. at § 1.6045-1(g)(4)(iv)(B).
[48] *See id*. at § 1.6045-1(g)(4)(iv)(C).
[49] *See id.*

the existence of a U.S. banking relationship, in and of itself, is an unreliable indicia of U.S. status, particularly for non-U.S. persons engaged in activities in the U.S. that do not give rise to a U.S. trade or business (like investing).[50]

c. Removing the U.S. criteria related to transferring from or through a U.S. digital asset broker. Similar to (b) above, the mere fact that a transfer occurs through a U.S. digital asset broker has little probative value on the tax status of a seller. Many non-U.S. persons utilize U.S. digital asset brokers for non-tax reasons, such as greater liquidity and security. Treating this as U.S. indicia may deter non-U.S. persons from transacting through U.S. digital asset brokers in a manner that increases risk to the seller.

We also recommend that Treasury provide a less burdensome way for CFC digital asset brokers to substantiate the non-U.S. tax status of their foreign customers. We propose that Treasury include in final regulations provisions that would allow CFC digital asset brokers to accept "substitute forms" similar to those described in IRS Notice 2011-71 with respect to payments made outside the U.S. Specifically, we recommend that final provisions adopt an approach similar to that of Section 6050W, where non-U.S. customers can submit a simple, prescribed written statement certifying their non-U.S. status under penalty of perjury, in lieu of a Form W-8 or other documentary evidence.

5. Contents of the Reporting

We are concerned that the information required to be collected and reported raises material privacy and administrability concerns. The requirements also arbitrarily treat the digital asset space differently from traditional financial services, and do not set out a compelling rationale for such disparate treatment.

To elaborate, the Proposed Regulations require a broker to report the following information for each digital asset sale where an information return is needed: the customer's name, address, and taxpayer ID; the name/type of digital asset sold and the number of units; digital asset address (i.e., a wallet address); the sale date and time; the gross proceeds of the sale; and any other information required by the form instructions.[51] Additionally, brokers are required to report the transaction ID, the digital asset address, and the consideration type received (e.g., cash, property, or other digital assets) be reported by the broker.[52]

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[50] As historical context, when bank deposit interest reporting first started, there was discussion about how many depositors originate in other jurisdictions. At that time, it was further noted that the security and quality of banking in those other jurisdictions was a driver for these banking relationships in the U.S. This is further indicia that the existence of a U.S. banking relationship alone is an unreliable status of U.S. status.
[51] Prop. Treas. Reg. § 1.6045-1(d)(2)(i)(B).
[52] *Id*. Furthermore, if the sale of the digital asset also constitutes a sale of a security or commodity, then the broker must also comply with certain reporting requirements for such assets.

The Proposed Regulations provide that brokers effecting sales of digital assets held by a broker in a hosted wallet must also report the date and time of the transfer of the digital asset into such hosted wallet, the transaction ID of the transfer-in, the digital asset address, and the number of units transferred into the hosted wallet.[53] When reporting the date and time of transactions, the Proposed Regulations provide that Coordinated Universal Time (UTC) should be used.[54]

With this backdrop, the proposed remediation and specific recommendations are provided in more detail below.

a. *Wallet Address and Transaction ID Reporting*

The proposal that wallet addresses be reported with respect to sales transactions raises material concerns. Privacy of wallet address information is a huge concern for both customers and the taxpayers trusted with this information. Transmission of wallet address information raises significant risk of interception of such information by parties other than the government and the customer. In many cases, taxpayers required to report may have legal obligations regarding the protection and safekeeping of customer data that may be difficult to square with the proposed reporting.

Information relating to a wallet address may not be available or appropriate when sales occur through an omnibus account or wallets. Further, wallet address information is not necessary for the IRS to appropriately audit a taxpayer with respect to the sales reported under the regulations, which require the reporting of sufficient information to inform the IRS's audit decisions. Specifically, reporting of wallet addresses from which the digital asset is sold or exchanged is not necessary to provide the IRS with sufficient information on the reported sale or exchange to audit the recipient of the form. Because the IRS has the personal identifying information for that taxpayer, they can open an individual tax audit to request information relevant to the audit of that taxpayer's liability. In this case, reporting wallet address information seems probative only to the extent that it can identify other transactions outside the scope of the reported sale or exchange–like providing a taxpayer's full checking account transactional record.

Finally, if such information is not necessary for achieving the goals of reporting (i.e., enhanced taxpayer compliance and sufficient information to enable orderly IRS audits), then it is incumbent on the IRS not to collect such information.

For these reasons, we propose removing wallet addresses from the fields required to be reported. Further, we request removing transaction IDs as well because they raise similar privacy concerns.

[53] *Id*.
[54] *Id*. at § 1.6045-1(d)(4)(ii).

b. *Time and Time Zone Conventions*

Including time information down to the second for each transaction increases the burden for the IRS by causing reconciliation differences. This is the result because a higher number of taxpayers will report gross proceeds on their tax returns that differs from the gross proceeds reported on an information return because of time zone and timestamp differences. These potential differences also reduce the usefulness of this reporting for taxpayers in completing their tax returns, thereby undermining one of the intended purposes of this reporting.

We recommend permitting brokers to report based on their time zone (rather than with respect to a single time zone) so long as the time zone on which the taxpayer is reporting is disclosed to the customer and such time zone convention is used consistently for all reporting years. We also recommend that reporting of sales by date (rather than hour, minute, second) is sufficient so long as valuation conventions applied to digital assets for digital asset exchanges are consistently applied.

c. *Need for Aggregate Reporting*

As drafted, the Proposed Regulations require reporting of each digital asset sale effected for the customer. The volume of such data is massive, and likely greater than the estimates for the analyses under the Paperwork Reduction Act[55] and the Regulatory Flexibility Act[56] (required to estimate the impact of these regulations on small businesses).[57] Reporting on individual transactions does little to enhance the IRS's ability to audit taxpayers on their transactions.

We recommend permitting the aggregation of certain sales to permit simplified reporting for affected customers. Specifically, we propose that aggregate sales of a single asset type into one form (e.g., one Form 1099 for all bitcoin sales during the course of a taxable year).

6. Delayed Effective Dates

The Proposed Regulations concerning computation of gain or loss apply on or after January 1 of the calendar year immediately following the finalization of the Proposed Regulations in the Federal Register. Taxpayers may rely on the Proposed Regulations under sections 1001 and 1012 on or after August 29, 2023, if such rules are applied consistently going forward.

[55] 44 U.S.C. 3507(d).
[56] 5 U.S.C. 603(a).
[57] Preamble, 88 Fed. Reg. 59619 (total estimated monetized annual burden to complete the forms is $136,350,000; total estimated monetized start-up burden is $749,925,000). Recent IRS official statements suggest that eight billion 1099 Forms are expected to be filed for digital assets, suggesting that the per form estimates used for these burden estimates are too low.

Gross proceeds of a sale of digital assets are required to be reported by brokers on sales effected on or after January 1, 2025.[58] Prop. Treas. Reg. § 1.6045-1(d)(2)(i)(C) requires brokers subject to the reporting rules to report the adjusted basis and the character of gain or loss for sales effected on or after January 1, 2026. Reporting for any digital assets that are also commodities are proposed to apply on or after January 1, 2025.

We are concerned that implementation of these final regulations will be a massive undertaking for impacted taxpayers, and accordingly requires more time for implementation than what is proposed by the IRS. Further, we believe additional time is needed to educate taxpayers on their obligations as recipients of these forms. Accordingly, we recommend deferring the effective dates for the following provisions in the Proposed Regulations.

a. ***Digital Assets Sales for Fiat***

We propose that taxpayers are provided an extension of the effective date until the start of the calendar year beginning one year from the finalization of the Proposed Regulations to give taxpayers adequate time to build and implement systems to capture the customer information and data fields required to be reported under the proposed rules.

b. ***Digital Assets Sales other than Sales for Fiat***

We propose that taxpayers are provided an extension of the effective date until the start of the calendar year beginning 18 months from the finalization of the Proposed Regulations to give taxpayers adequate time to build and implement systems to track the valuation information and other data points that must be reported. Current systems may not have the required information associated with, and retained specific to, customer accounts.

c. ***Backup Withholding***

Brokers will need additional time to develop systems, policies and processes to apply backup withholding. Backup withholding is particularly problematic on exchanges in which there is no fiat. For example, in the case of digital assets for digital asset exchanges where there is no fiat involved, brokers must retain a portion of the digital asset exchanged and then immediately convert it into fiat and then reconcile that for each deposit. Even in this case, the amount of fiat received on the exchange may differ from the amount of backup withholding required because of market movements during the time necessary for the exchange. Further, because certain digital assets, like NFTs, cannot be fractionalized, exchanges must develop a process to ensure backup withholding can occur if required.

We propose that the implementation date for backup withholding be 12 months after the date reporting on such transactions begins to permit brokers to prepare. We further propose that

[58] *Id*. at 59616.

brokers be permitted to remit backup withholding in digital asset form (or be permitted to remit the proceeds received from the disposition of the digital asset withheld, regardless of whether such amount of fiat corresponds to 24% of the fair market value of the digital asset exchanged at the time of the transaction).

d. *Basis Reporting for Acquisitions Made after 1/1/23*

We recommend that basis reporting effective dates match the effective dates of the final regulations when issued. Matching the effective dates is necessary because information required to be reported may not be currently associated with a specific customer's accounts. The various ways in which taxpayers may receive digital assets (e.g., via gift, airdrop, warrant exercise, as a reward for staking, giveaways, etc.) make reconstructing the basis for digital assets retroactively more difficult. Additionally, knowledge of a customer's basis (i.e., lot) relief method applied to its digital assets prior to the effective date of final regulations is necessary and will take time to acquire. Further, distinguishing within relevant systems transactions that are acquisitions versus transferred assets from other wallets requires additional systems implementation.

Aligning the effective date for tracking basis with the effective date of the final regulations creates parity with how the securities basis reporting regulations were implemented, and acknowledges the systems and data limitations presented to taxpayers attempting in good faith to comply. It is important that firms have time to build the tracking and information reporting.

We request guidance on the basis reporting for assets acquired during the period before the effective date of the section 1012 regulations when finalized. Guidance is necessary because some brokers may currently operate on a first-in-first-out method of tracking customer sales, while others may currently permit customers to designate which digital assets are sold (e.g., by how the assets are segregated, by identifying features of the digital assets, or another method).

We also recommend further guidance on the sharing of information between brokers to accurately track cost basis information in the event a customer transfers digital assets from one platform to another.

e. *Extended Transition for Documenting Customers*

Similar to the implementation of the reporting required by section 6050W and FATCA, we recommend a two-year transition period for documenting pre-existing customers, including U.S. persons, before backup withholding and FATCA withholding is required.[59]

[59] Treas. Reg. § 1.1471-1(b)(104) (essentially withholding agents were granted two years from the effective date of FATCA to perfect documentation for pre-existing accounts); Treas. Reg. § 1.6050W-1(j) and Notice 2011-88.

7. Transaction Cost Capitalization

We recommend eliminating the rule allocating costs associated with a digital asset for digital asset exchange 50%/50% between the sale and the acquisition. We believe that taxpayers should apply existing capitalization principles under section 263(a) to determine the capitalization of these costs in property for property transactions, and that digital asset brokers ought to be able to use any reasonable method to report such items as either a reduction of proceeds on the sale or increase of basis on the property acquired so long as such reporting is done consistently.

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CCI again appreciates the opportunity to provide these comments and your consideration of our recommendations. We would be pleased to further engage on the comments detailed in this letter or digital assets tax issues generally.

Sincerely,

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(section 6050W became effective for transactions starting Jan. 1, 2011, but backup withholding was not required until Jan. 1, 2012).