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November 7, 2023

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

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

Dear Ms. Batchelder,

CohenWilson LLP, a U.S. law firm doing business as DLx Law, respectfully submits this letter to convey concerns we have regarding the proposed Internal Revenue Service (the "Service") regulation titled "Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions" (the "Proposal").[1]

By way of background, DLx Law is a boutique law firm with offices in New York, NY, Wilmington, DE and Washington, DC. Our lawyers have expertise in federal and state securities laws, financial regulatory laws, general corporate matters, and start-up and venture financing. We advise a wide range of clients on the use of novel technologies and business models, including businesses that utilize digital assets and blockchain technology, and are honored to be ranked as a "Band 2" practice in the United States by independent ranking firm Chambers & Partners for FinTech Legal: Blockchain & Cryptocurrencies.

DLx Law has reviewed the Proposal in light of our more than five years of experience representing clients on matters involving the use of digital assets. As we are not tax practitioners, we comment more broadly on what we see as the likely adverse consequences of the Proposal on the U.S. economy. Specifically, DLx Law is concerned that the Proposal, in its current form, would dramatically stunt the development of the digital asset ecosystem in the United States without concomitant benefits in terms of serving the national interest or furthering the Service's mission of helping taxpayers understand and meet their tax responsibilities. It would also likely reduce the aggregate amount of tax collected by incentivizing economic activity in the digital asset space to move outside of U.S. jurisdiction.

Background

In 2021, with the passage of the Infrastructure Investment and Jobs Act (the "IIJA"), Congress clarified the definition of "broker" in Section 6045 of the Internal Revenue Code of 1986, as amended (the "Code") to include "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." Congress adopted the relevant provisions of the IIJA to clarify prior law and resolve uncertainty over whether certain market participants are "brokers". There is no suggestion that Congress intended direct peer-to-peer transactions to fall within the broker regulations.

[1] 88 Federal Register 59576 (Aug. 29, 2023).

In this light, we believe a cautious approach is required by the Service in that the Congressional mandate is one of "clarification" rather than a fundamental change to policy. Nevertheless, the Proposal states that one of the primary goals of the new regulations is to close a perceived gap between taxes legally owed and taxes actually paid. More specifically, the Proposal states:

> With third party information reporting that specifically identifies digital asset transactions, the Service could *more easily* identify taxpayers with digital asset transactions that are otherwise difficult to discover. An information reporting regime requiring reporting to the Service on digital asset transactions would benefit tax compliance by helping to close the information gap with respect to digital assets.[2]

However, the benefits of making tax collection *easier* for the Service based on what appears to be dramatically increased information reporting (as discussed below) must be weighed against the cost to the economy and the inevitable consequences of this enhanced information collection and reporting. A world in which the government has knowledge of each and every financial transaction a U.S. citizen entered into would undoubtedly increase tax collection but also create the type of surveillance state we typically associate with autocratic foreign regimes. As discussed below, we are concerned that the Proposal would paradoxically reduce tax collection by eliminating the practicability of legitimate peer-to-peer transactions in digital assets by U.S. taxpayers in a manner not intended by Congress, thus driving a substantial portion of legitimate digital asset activity outside of U.S. jurisdiction.

Key Issues

Overbroad Reading of Congressional Mandate

As the Congressional Joint Committee on Taxation made clear in its August 2021 report on the Section 80603 of the IIJA,[3] the statutory amendments were intended to ensure that the definition of "broker" expressly included any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person. This sensible clarification reasonably ensures that persons in the business of *actually brokering transactions* involving digital assets take appropriate steps to capture and report relevant information to the Service.[4]

However, the core change in the Proposal transcends this clarificatory mandate, stretching the meaning of "effectuate" to treat as brokers any persons who may be deemed to be "in a position to know" the identity of the parties to a peer-to-peer transaction involving digital assets. Thus, the Proposal would make these persons responsible for collecting, and ensuring the security of, extensive information from the parties engaging in peer-to-peer transactions and then reporting that information to the Service. The Proposal makes clear that this overly broad interpretation of the Congressional mandate is intended to capture activities well outside of any current understanding of the concept of "broker". "In a position to know" is also not a standard that is currently applied to securities, commodities or anything other than digital assets.

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[2] *Id*. (emphasis added).

[3] *See* Technical Explanation of Section 80603, "Information Reporting for Brokers and Digital Assets," of the Infrastructure Investment and Jobs Act, August 2021, available at, https://www.jct.gov/publications/2021/technical-explanation-of-section-80603,-information-reporting-for-brokers-and-digital-assets,-of-t/.

[4] In a Senate floor colloquy on August 9, 2021 on the scope of the relevant provisions in the IIJA, Senator Mark Warner noted: "We want to ensure that taxes legitimately owed are paid, and full and accurate transaction reporting is a proven way to make that happen. *We don't, however, want to place reporting requirements on individuals who shouldn't have them*" (emphasis added). *See* On Senate Floor, *Warner, Portman Conduct Colloquy Clarifying Cryptocurrency Provision in Infrastructure Investment & Jobs Act*, Aug. 2021, available at https://www.warner.senate.gov/public/index.cfm/2021/8/on-senate-floor-warner-portman-conduct-colloquy-clarifying-cryptocurrency-provision-in-infrastructure-investment-jobs-act.

In fact, if adopted as proposed, anyone maintaining a website that, for commercial purposes, provides information to individuals and companies about the data available within smart contract protocols,[5] which data allows those persons to exchange digital assets directly with each other on a peer-to-peer basis, will be treated as much as a broker as a giant financial services company that actually brokers securities or commodities transactions and holds itself out as doing the same. As such, those persons subject to U.S. jurisdiction that maintain informational front-end websites available to U.S. persons would be required to amass vast amounts of user data and other personally identifiable information about users in order to report sales transactions to the Service.

Under the Proposal, the Service expects that this "clarified" proposed broker definition will be used to require those maintaining front ends (*i.e.,* information aggregators) for decentralized exchanges to be treated as the "operators" of the exchange protocol itself. In fact, if adopted as proposed, this expansion would treat almost any arrangement through which peer-to-peer transactions are "facilitated" as being subject to wholly impractical information collection, retention, and reporting obligations. These obligations would be imposed either on entities simply making available public blockchain data and providing technology solutions through a website (*i.e.,* a front end) so that users themselves can directly effect their own peer-to-peer activity, or on ephemeral groups of digital asset owners, by treating these owners as some sort of "unincorporated association" with legal obligations that, as a group, they cannot meet.

Lack of Clarity

Even if the Service's reading of the term "effectuating" comported with Congressional intent in the IIJA, the development of the concept in the Proposal would leave participants in the digital asset ecosystem unsure about when and how to comply with the new information collection and reporting obligations. The Proposal acknowledges that "digital asset trading platforms operate with varying degrees of centralization and effective control by founders or others" but leaves open how any given digital asset market participant is to know whether reporting obligations apply to "platforms" that have one or more individuals or entities that can "update, amend, or otherwise cause the platform to carry out the diligence and reporting rules" in the Proposal. It seems clear that the Service believes that most, if not all, decentralized exchange "platforms" have an identifiable individual, company or group of persons who can, with just a bit of "elbow grease", meet the Proposal's extensive requirements.

However, in our experience, this perspective does not reflect the current vertiginous digital asset landscape. Peer-to-peer transactions in digital assets occur in a myriad of formats and circumstances and include "bridging" or "wrapping" transactions (where assets are moved from one blockchain network to another), transactions in which representations of digital assets being "staked" to secure a network are created to facilitate the liquidity of the underlying staked asset, and "re-staking" sidechains where owners of digital assets can participate in new consensus protocols while benefitting from the security of a more widely used network. Many new uses for digital assets are being developed. The Proposal does little to elucidate which market participants would need to capture information about third parties' activities. The inevitable result will be that activity will seek to avoid U.S. jurisdictional reach, reducing tax collection in the United States and driving this activity, and related technological innovation, overseas.

Compliance Burden

Even for those market participants who would clearly fall within the ambit of the Proposal as brokers, the introduction of Form 1099-DA and the associated costs of compliance will be highly burdensome. The requirement of persons deemed to be brokers to determine the fair market value of digital assets is impractical, given asset price volatility and the potential lack of readily available accurate, consistent and timely valuations from trading platforms. This approach does not consider the significant differences between digital assets and the more

[5] These websites are generally known as "front ends" and there typically are multiple front ends for any given smart contract protocol.

traditional securities and commodities currently covered by the broker reporting rules. As the Proposal acknowledges, many digital assets are illiquid and, unlike real estate, do not have obvious "comparables" to use for estimating fair market value. Digital assets trade on a 24/7 basis, frequently settling (and repricing) every few seconds. There can be significant price disparities between markets in different geographic locations. In addition, many persons appropriately deemed digital asset brokers under the IIJA are themselves start-ups. While a handful of large, centralized digital asset market participants have the capital to build out the systems needed to comply with the Proposal, the barriers to entry created by the new regulations will drive start-ups, capital, and jobs out of the U.S. as new entrants simply would not be able to compete. This will further centralize the digital asset ecosystem in the United States, decreasing user choice and potentially increasing risks for consumers and users of digital assets. Considering start-up costs, the Proposal estimates that the overall cost of compliance will exceed $700 million.[6]

However, there is no suggestion that implementing the Proposal will result in increased tax collections substantially in excess of, or even equal to, this amount. Moreover, this estimate is built up from assumptions that seem to us to be highly unrealistic based on our work with companies operating in the digital ecosystem. For example, the Proposal estimates that the "average broker" will incur $27,000 of monetized burden per year. Smart contract code is very different from traditional software and developing and auditing blockchain code can run many multiples of the cost of developing software in other areas. More information from potentially affected parties is needed to develop accurate information about actual costs so that the true costs and benefits of the rulemaking can be weighed by Congress and the General Accounting Office under the Congressional Review Act.[7]

Conclusion

In light of these concerns, we strongly urge the Service, through a more fulsome collaboration with a broad cross-section of digital asset ecosystem participants, to reconsider and refine the overbroad and counterproductive approach taken in the Proposal in order to find a more balanced solution — one that better aligns with Congressional intent without stifling innovation, growth, and investment in the United States. Only then will the U.S. continue to be a technological leader in the global economy.

Sincerely,

Lewis Rinaudo Cohen, Co-founder
CohenWilson LLP

cc: U.S. Senator Cynthia Lummis
U.S. Senator Kirsten Gillibrand

[6] The specific estimate is $749,925,000. Some commentators have estimated that the burden would be much higher, reporting that the IRS itself expects to receive close to 8 billion information returns if the new proposals are enacted. *See* Jonathan Curry, "IRS Prepping for at Least 8 Billion Crypto Information Returns", *Tax Notes*, Oct. 26, 2023, available at https://www.taxnotes.com/featured-news/irs-prepping-least-8-billion-crypto-information-returns/2023/10/25/7hhdp.
[7] 5 U.S.C.§ 801(a)(1)(A).