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Internal Revenue Service
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Room 5203
P.O. Box 7604
Ben Franklin Station, Washington, DC 20044

Dear Sir or Madam:

Andreessen Horowitz (“a16z”) appreciates the opportunity to respond to the request for comments included in the proposed regulations addressing gross proceeds and cost basis reporting by brokers in the context of digital asset transactions, which the Internal Revenue Service (“IRS”) published on the federal register on August 29, 2023 (the “Proposal”).¹ We welcome an opportunity to meet with IRS staff and answer any questions that the agency may have and to discuss our comments below in more detail.

A16z is a venture capital firm that invests in seed, venture, and late-stage technology companies, focused on bio and healthcare, consumer, crypto, enterprise, fintech, and games. A16z currently has more than \$35 billion in committed capital under management across multiple funds, with more than \$7.6 billion in crypto funds. In crypto, we primarily invest in companies using blockchain technology to develop protocols that people will be able to build upon to launch Internet businesses. Our funds typically have a 10-year time horizon, as we take a long-term view of our investments, and we do not speculate in short-term crypto-asset price fluctuations.

At a16z, we believe we need an Internet that can foster competition and mitigate the dominance of large technology companies, unlock opportunities in the innovation economy, and enable people to take control of their digital information. The solution is web3 — the third generation of the Internet — a group of technologies that encompasses blockchains, digital assets, decentralized applications and finance, and decentralized autonomous organizations. Together, these tools enable new forms of human collaboration that can help communities make better collective decisions about critical issues, such as how networks will evolve and how economic benefits will be distributed. We are optimistic about the potential of web3 to restore trust in institutions and expand access to opportunity.

¹ Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions, 88 FR 59576 (proposed Aug. 29, 2023), <https://www.regulations.gov/document/IRS-2023-0041-0001>.

TABLE OF CONTENTS

I. Summary	3
II. Definitions of “Broker” and “Digital Asset Middleman”	4
A. Congress has not authorized Treasury and the IRS to extend broker reporting requirements in the manner proposed.....	4
i. Persons that do not “effectuate” transactions are not “brokers” under the Infrastructure Act.....	4
ii. Congress considered — and rejected — a broader definition of “broker” before the passage of the Infrastructure Act.....	10
iii. The Proposal includes other vague and indeterminate language that deprives market participants of fair notice of what the rules require of them.....	11
B. Expanding the information reporting regime creates significant privacy, safety, and national security concerns and could violate the Fourth Amendment.....	13
i. Privacy, Safety, and National Security Concerns.....	13
ii. Fourth Amendment.....	15
C. The Proposal’s requirements will result in reporting that is cumbersome, duplicative, and confusing for taxpayers.....	16
D. The Proposal would eliminate or reduce the meaningful benefits that DeFi provides to U.S. citizens.....	17
III. Digital Asset Payment Processors	18
A. Digital Asset Payment Processors have a customer or business relationship with sellers — rather than buyers — of goods and services.....	18
B. Volume and Impacted Taxpayers.....	18
C. Privacy Considerations and Duplicative Reporting.....	19
IV. Scope of the term “Digital Asset”	19
A. NFTs and Tokenized Securities.....	20
B. Stablecoins.....	21
V. Scope of the term “Sale”	23
A. NFT-for-NFT exchanges.....	23
B. Wrapped digital assets.....	24
VI. The Proposal treats digital assets differently from non-digital assets	24
VII. The Proposal should include a de minimis threshold and transactions should be aggregated for reporting purposes	25
VIII. <i>Chevron U.S.A., Inc. v. Natural Resource Defense Council, Inc.</i>	26
IX. The IRS should delay the effective date of the regulations	27

I. Summary

If enacted as written, the Proposal would treat new classes of persons as “brokers” effecting “sales” of digital assets and require them to report those sales to both the Internal Revenue Service (“IRS”) and U.S. customers (that are not otherwise exempt from reporting). It expands the scope of reporting brokers and the definition of a “sale” to include digital asset transactions that are not conducted for cash, e.g., exchanges of a digital asset for a different digital asset. These changes are intended to serve two primary purposes: (i) to provide taxpayers with the information they need to complete their tax returns and comply with their tax obligations, and (ii) to provide the IRS with sufficient information to ensure that taxpayers are accurately reporting gains and losses from digital asset transactions.

We appreciate the importance of information reporting, i.e., Form 1099 reporting, to both the IRS and taxpayers, and we share the IRS’s desire for a stable tax regime for the blockchain industry. But, as written, the Proposal does not achieve this worthwhile goal. We believe the Proposal improperly applies tax reporting obligations — both as a matter of law and administrable tax policies — to a large swath of persons, software tools, and transactions. This overly broad application will confuse taxpayers, create unnecessary administrative burdens on the IRS, stymie innovation, and have unprecedented ramifications for the privacy of individual taxpayers, which will undermine U.S. competitiveness and potentially imperil national security and the safety of U.S. citizens.

Our recommendations are summarized as follows:

- Developers of blockchain-based protocols and applications (and the protocols and applications themselves), tokenholders, and self-hosted wallet software providers should not be considered “Digital Asset Middlemen” and should not be required to provide gross proceeds or cost basis reporting.
- Digital Asset Payment Processors should not be required to provide gross proceeds or cost basis reporting.
- The term “digital asset” should be interpreted to exclude non-fungible tokens (“NFTs”), and stablecoins should be exempted from broker reporting obligations.
- Future guidance should exclude NFT-for-NFT exchanges and wrapped tokens from the proposed requirements.
- Digital assets should be treated in the same manner as non-digital assets.
- The Department of the Treasury (“Treasury”) and the IRS should provide guidance and analysis regarding the Constitutional implications of the proposed regulations.
- The Proposal should be significantly revised to align more closely to the Infrastructure Act.
- The effective date of the proposed regulations should be delayed to allow for the underlying issues in its construction to be resolved and provide adequate time for taxpayers to comply with any final regulations.

II. Definitions of “Broker” and “Digital Asset Middleman”

A. Congress has not authorized Treasury and the IRS to extend broker reporting requirements in the manner proposed.

In traditional finance, centralized intermediaries with direct involvement in underlying transactions are required to obtain tax-relevant information and report it to taxpayers and the IRS. As written, the Proposal seeks to apply the same requirements broadly to the blockchain industry, including developers of decentralized blockchain-based protocols and applications, self-hosted wallet software providers, and others, through the expanded definition of “broker” and introduction of the term “Digital Asset Middleman.”² As discussed below, the expansion of broker reporting requirements, without due consideration of the differences between blockchain-based products and platforms and centralized intermediaries in traditional finance, will not result in the same efficient and informative reporting. Indeed, it will have a negative impact on the entire blockchain ecosystem, particularly decentralized finance (“DeFi”) protocols and applications, which will significantly impede core web3 technological breakthroughs such as the transfer of value nearly instantaneously in a disintermediated fashion, as well as the web3 industries that benefit from these advancements, including social media, gig economy protocols and applications, and gaming. Such a negative impact will curtail innovation in the U.S., complicate tax compliance and enforcement, and place undue burdens on certain segments of the blockchain industry in a manner that is not technology neutral.

We raise four main concerns with the Proposal’s extension of the broker reporting requirements in the manner proposed below. As written, the Proposal would (i) stretch the definition of broker beyond the statutory plain language of the Infrastructure Investment and Jobs Act³ (the “Infrastructure Act”), which only captures persons who “effectuate” transactions, (ii) contravene legislative history that expressly declined to include certain DeFi protocols and applications within the Infrastructure Act’s definition of “broker,” (iii) lead to confusion and significant administrative burdens for the blockchain industry given the many vague terms in the proposed regulatory provisions affecting industry participants; and (iv) eliminate or reduce the meaningful benefits that DeFi provides to U.S. citizens.

i. Persons that do not “effectuate” transactions are not “brokers” under the Infrastructure Act.

When interpreting a statute, we read the words in a statute in light of their ordinary, plain meaning.⁴ In essence, “[w]ords are to be understood in their ordinary, everyday meanings—unless

² The term “Digital Asset Middleman” means “any person who provides a facilitative service with respect to a sale wherein the nature of the arrangement is such that the person ordinarily would know or be in a position to know the identity of the party that makes the sale and the nature of the transaction potentially giving rise to gross proceeds from the sale.” Prop. Treas. Reg. § 1.6045-1(a)(21)(i).

³ Public Law 117-58, H.R. 3684, November 15, 2021, Infrastructure Investment and Jobs Act.

⁴ A. Scalia & B.A. Garner, *Reading Law: The Interpretation of Legal Texts* 69 (2012).

the context indicates that they bear a technical sense.”⁵ In this comment, our analysis begins with the Infrastructure Act’s definition of “broker.”

As amended in the Infrastructure Act, a “broker” is defined to include “any person who (for consideration) is responsible for regularly providing any service *effectuating* transfers of digital assets on behalf of another person.”⁶ Various dictionaries define “effectuate” as “to cause or bring about (something)” or “to put (something) into effect or operation.”⁷ These definitions suggest that persons must engage in some sort of *causal* conduct with respect to a transaction and actually carry it out. For example, in traditional finance, stockbrokers “effectuate” transactions involving the exchange of cash for stock because the stockbroker has direct, causal involvement in the transaction. A stock exchange, in contrast, is excluded from the definition of broker because it does not have the same direct involvement in a transaction. Accordingly, current Treasury regulations already reflect this causal requirement, and Congress has provided no indication that this term should be afforded a different meaning within the context of digital asset reporting.⁸

Nevertheless, the Proposal suggests that a broad swath of persons, technologies, and software providers in the blockchain industry that either cannot or do not “effectuate” transactions fall within the definition of “broker.” To do so, the Proposal deviates from the plain language in the Infrastructure Act and states that persons or entities that provide “facilitative services” fall within scope. More specifically, the Proposal introduces the term, “Digital Asset Middleman,” and defines it as 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 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.”⁹ The term “facilitative service” includes “the provision of a service that directly or indirectly effectuates a sale of digital assets.”¹⁰ This expansive, and we believe improper, reading of the Infrastructure Act allows the Proposal to potentially capture the following categories within its scope:

- **Developers of Decentralized Protocols:** Developers draft source code for the smart contracts (self-executing software deployed to a blockchain) that make up decentralized protocols. Common examples of decentralized protocols include borrowing and lending protocols, exchange protocols, and social media protocols. As a general matter, once developers launch smart contracts and decentralized protocols, the protocols function in an autonomous manner and self-execute user commands without the need for third parties.

⁵ *Id.*

⁶ I.R.C. Code Section 6045(c)(1)(D) as amended by the Infrastructure Act (emphasis added). Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations promulgated thereunder.

⁷ See, e.g., Effectuate, Merriam-Webster Online, <https://www.merriam-webster.com/dictionary/effectuate>.

⁸ See Treas. Reg. section 1.6045-1(a)(10) (“The term effect means, with respect to a sale, to act as: (i) [a]n agent for a party in the sale wherein the nature of the agency is such that the agent ordinarily would know the gross proceeds from the sale; or (ii) [a] principal in such sale...”).

⁹ Prop. Treas. Reg. § 1.6045-1(a)(21)(i).

¹⁰ Prop. Treas. Reg. § 1.6045-1(a)(21)(iii) (emphasis added). The preamble to the Proposal and examples contained therein indicate that the IRS expects that certain DeFi applications and self-hosted wallet software providers will be subject to the proposed regulations.

While developers might retain certain control over a protocol, at least in its earliest stages, the developers do not have the unilateral ability to alter a decentralized protocol, to reverse transactions, or to otherwise control the smart contracts. More importantly, developers do not interact with users or have access to their identifying information, so they are not in a position to know the parties in the transaction. For these reasons, protocol developers (including DeFi protocol developers) cannot “effectuate,” i.e., have a causal effect on transactions over a blockchain network that, in its optimal and most decentralized state, can operate without the need for developers at all.

Treasury and the IRS seem to acknowledge that protocol developers cannot “effectuate” transactions, as the Proposal suggests that protocol developers should program broker reporting requirements into the protocol code. The implicit admission in the government’s position is that developers cannot “effectuate” transactions once a protocol is launched, and therefore, preemptive measures must be taken to force the developer to become an intermediary. But this position is inconsistent with the Infrastructure Act’s plain language, which mandates that brokers be “responsible for *regularly* providing any service effectuating transfers of digital assets.”¹¹ Because protocol developers have little or no involvement in a protocol post launch, they do not “regularly” provide any services and thus should not be subject to the Proposal’s requirements. Further, extending such requirements to protocol developers would raise questions as to whether other software developers should be included, including developers that create websites and tools for securities brokers like Vanguard and Charles Schwab.

- **Decentralized Protocols**: Blockchain protocols are collections of smart contracts that enable self-executing and programmatic functioning on the blockchain pursuant to code and a set of rules established by the protocols. Such protocols establish the structure of the blockchain — the distributed database that allows users to exchange digital assets in a secure manner over the Internet.¹² As mentioned above, protocols are autonomous and capable of self-executing transactions without the involvement of third parties. Many protocols allow users to transfer digital assets in a peer-to-peer manner. However, enabling such functionality does not mean that protocols “effectuate” transactions. An illustrative example of this point is a comparison with the SMTP protocol that is used for email communications. Users send emails over the SMTP protocol, but no one would suggest that the SMTP protocol has a causal effect with respect to email communications. Rather, the SMTP protocol provides the baseline set of rules that allows users themselves to effectuate communications with one another. Likewise, blockchain protocols should be thought of in the same manner. In addition, we note that applying regulation to decentralized blockchain protocols could have a disastrous effect on the blockchain industry and is largely unnecessary. The technical reality is that autonomous software protocols cannot comply with evolving, subjective, and often-conflicting global regulatory obligations. If decentralized protocols are subject to regulation, like broker reporting requirements, it would be impossible to create cross-border protocols that are

¹¹ Section 6045(c)(1)(D) (emphasis added).

¹² See Coinbase, *What is a protocol?*, <https://www.coinbase.com/learn/crypto-basics/what-is-a-protocol>.

accessible all over the world. Therefore, at minimum, the broker reporting requirements should not target the protocol level of blockchain ecosystems.

- **Decentralized Applications**: Decentralized applications are software tools that provide users with an interface, typically a website, to interact with decentralized protocols. These applications enable users without technical expertise to navigate through various options in executing different types of transactions on a blockchain, including digital asset transactions with DeFi protocols. The applications generate a message for a user’s self-hosted wallet to send to the DeFi protocol which is deployed to a blockchain, and the blockchain self-executes the transaction in an autonomous manner. Users with technical expertise can alternatively circumvent the application and interact with the protocol directly by crafting their own message and sending it via a wallet to the protocol. But even in this case, the blockchain is still the sole layer where transactions occur and are immutably recorded. A similar example to the one provided above regarding the SMTP protocol is also applicable here, but rather with a focus on the applications that utilize the SMTP protocol. Email applications, like Gmail, Yahoo, and Hotmail, provide users with an access point to the SMTP protocol. As in the example above, while email applications provide users with a convenient method of receiving, sending, and storing email communications, no one would suggest that the application “effectuates” the email communications themselves — the user is clearly the party effectuating the email. Likewise, DeFi applications should also be thought of in the same manner and should therefore not be subject to the broker reporting requirements.
- **Self-Hosted Wallets**: Self-hosted wallets are software tools that enable users to interact with blockchain networks by allowing them to sign and send cryptographic messages to blockchains. They are operated on a user’s own device and do not rely on servers or any hosting by third parties. Individuals use self-hosted wallets as a convenient way to interact with blockchain networks, just as web users tend to use web browsers to access the Internet. With a self-hosted wallet, users are able to hold their private keys and digital assets, as well as send and receive digital assets in a peer-to-peer manner. Neither the provider of the self-hosted wallet software, nor the self-hosted wallet itself “effectuate” transactions on a user’s behalf.

We note that, while the Proposal states that self-hosted wallet software that provides connectivity to trading platforms triggers reporting for the provider, the IRS offers no explanation for why Internet web browsers that provide similar connectivity would not fall within the scope of “effectuating” transactions. As noted above, extending broker reporting requirements to self-hosted wallets raises questions as to whether web browsers that provide access to securities brokerage sites like Vanguard and Charles Schwab should be similarly covered. In essence, burdensome requirements are being proposed for one type of technical application over another. Self-hosted wallets could be scoped into reporting simply because they provide access to a node, which is the same technical function as performed by software applications like browsers or email protocols, which are presumably not scoped into the requirements. In a similar situation, the D.C. Circuit Court of Appeals overruled the

Securities and Exchange Commission (“SEC”) on the grounds that the SEC treated similar products in an inconsistent manner.¹³

- **Tokenholders:** Many digital assets (or “tokens”) convey rights to their holders, including, in the case of “governance tokens,” the right to vote on certain governance matters relating to a protocol. In general, holders of governance tokens typically do not have the power to materially change or alter a protocol or interfere with its operation. However, in many cases, voting rights do enable tokenholders to adjust certain minor parameters of the protocol or support an upgrade or implementation of a new protocol. The result of voting and making governance decisions is, therefore, limited, and tokenholders are never able to “effectuate” transactions over the blockchain network or protocol.

In addition, we note that applying broker requirements to tokenholders could have significant unintended consequences that could harm consumers. As tokenholders cannot possibly comply with such requirements, the most obvious solution for developers will be to design their tokens without any governance rights. However, that would be a grave mistake that would endanger the potential of web3. Governance tokens provide several critical benefits that underpin web3’s core value proposition, including (i) empowering web3 protocols to grow, evolve, and adapt in a decentralized manner as blockchain technology advances, (ii) enabling transparent risk mitigation, and (iii) empowering protocol stakeholders to participate in the governance of such systems. Without these benefits, users will paradoxically have greater exposure to harms and risks.

Importantly, one issue common to all the categories above is that web3 software tools cannot perform certain functions needed to remain in compliance with the broker reporting requirements, like backup withholding. For example, self-hosted wallet software providers do not hold users’ private keys, and therefore, providers have no ability to access customer funds or know the nature of particular transactions. But under the Proposal’s requirements, self-hosted wallet software providers would need access to the private key or the ability to alter the smart contract that is used for the transaction in order to conduct necessary backup withholding. Forcing wallet software providers to retain a private key would, in effect, convert those developers into providers of custodial wallets. The outcome of these requirements would, therefore, amount to a de facto ban on self-hosted wallets without Congressional authorization. The other categories mentioned above would suffer a similar fate.¹⁴

¹³ See *Grayscale Investments, LLC v. SEC*, No.22-1142 (D.C. Cir. 2023).

¹⁴ It is true that Treasury provides a limited exception from broker status for “the selling of hardware or the licensing of software for which the sole function is to permit persons to control private keys which are used for accessing digital assets on a distributed ledger if such functions are conducted by a person solely engaged in the business of selling such hardware or licensing such software.” Importantly, the exception does not extend to “[s]oftware that provides users with direct access to trading platforms from the wallet.” However, because most self-hosted wallets provide links to applications and protocols, including DeFi applications and protocols, most will remain “brokers” under the Proposal despite the exception. Further, even without such links, most self-hosted wallets contain in-app web browsers, which enable users to navigate to websites for various DeFi applications and protocols, and through which users can transact. As a result, the exception is unlikely to apply to most self-hosted wallets.

To summarize, none of the categories described above “effectuate” transactions. The IRS’s attempt to circumvent this plain language requirement to instead scope in “facilitative services” extends the reach of the broker reporting requirements far beyond persons that actually “effectuate” transactions, and read broadly, such language can be interpreted to scope in any number of layers of the current tech stack, from internet service providers (ISPs) to web browsers. Moreover, it is no surprise that existing regulations *already* recognize the difference between “effectuating” and “facilitating” services, given that the regulations already exclude from the class of traditional brokers any “person (such as a stock exchange) that *merely provides facilities* in which others effect sales.”¹⁵ As a result, the Proposal’s expansion of the reporting regime even exceeds what is regularly considered a broker in traditional financial services. Expanding the broker reporting requirements to include facilitative services — but only for digital assets — could not have been the intent of Congress and would directly contravene statements made by Treasury that “ancillary parties who cannot get access to information that is useful to the IRS are not intended to be captured by the reporting requirements for brokers.”¹⁶

We also note that the Proposal includes the following additional terms that deviate from the plain language of the Infrastructure Act:

- **“Indirectly.”** The term “facilitative service” includes “the provision of a service that directly or *indirectly* effectuates a sale of digital assets.”¹⁷ The modifier “indirectly” is at odds with the causal requirement in the Infrastructure Act, which suggests the need for a direct effect. If the definition of broker could bring into scope persons with an indirect effect over a transaction, it would have no limiting principles. For example, an ISP has an indirect effect on transactions entered into over the Internet, but Treasury and the IRS do not suggest that ISPs are within scope. Likewise, as described above, web browsers and email applications could also be seen as having an indirect effect. Without clear boundaries, this overbroad definition of broker would capture persons that *may* contribute to a transaction, even when those persons do not effectuate it.
- **“Stands Ready.”** The Proposal defines a broker as an entity that “stands ready” to effect sales.¹⁸ In contrast, the Infrastructure Act defines a broker to include entities that are “responsible for regularly providing” effectuating services.¹⁹ This notable difference allows the Proposal to scope in persons that possess the technical ability to provide broker services, but who do not necessarily do so on a regular basis, as required under the Infrastructure Act. While the “stands ready” language is part of existing Treasury regulations applying to broker sales of stock and securities, the difference in meaning impacts the diverse range of participants in the digital asset landscape differently.

¹⁵ Treas. Reg. § 1.6045-1(b), Example 2(ii) (emphasis added).

¹⁶ Letter from Jonathan C. Davidson, Department of the Treasury, Assistant Secretary for Legislative Affairs, to various Senators (Feb. 11, 2022), <https://www.stradley.com/insights/publications/2022/02/-/media/e295168ea3714c528af55eb44cad7e30.ashx>.

¹⁷ Prop. Treas. Reg. § 1.6045-1(a)(21)(iii) (emphasis added).

¹⁸ Prop. Treas. Reg. § 1.6045-1(a)(1).

¹⁹ 135 Stat. 1340.

- **“For consideration.”** The Proposal does not require that brokers effectuate sales “for consideration,” even though the statutory definition of a “broker” contains such a requirement. The Proposal instead defines a “broker” as a person who effects sales “in the ordinary course of a trade or business.” While the preamble to the Proposal suggests that persons engaged in a trade or business necessarily perform services for consideration, the regulation that Treasury cites for this conclusion states the opposite and includes “organizations the activities of which are not for the purpose of gain or profit.”²⁰ Without the “for consideration” requirement, the Proposal captures more entities than the Infrastructure Act allows. We note that, while this “ordinary course of a trade or business” language is in existing regulations that apply to sales of stock and securities, the difference in meaning between the statutory and regulatory language impacts blockchain protocols, applications, and platforms differently given that in a number of cases the developer or provider of the protocol itself may not receive consideration at all.

ii. Congress considered — and rejected — a broader definition of “broker” before the passage of the Infrastructure Act.

The Infrastructure Act amended section 6045(c)(1) of the Code to clarify the term “broker” as including: “any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.”²¹ Congress described the amendment as a “clarification” of the definition of “broker,” demonstrating that Congress did not intend a significant departure from the original regime.²²

Notably, Congress considered — and rejected — a broader definition of the term “broker” prior to the passage of the Infrastructure Act.²³ A proposed draft of the statutory language defined broker as, “any person who (for consideration) regularly provides any service responsible for effectuating transfers of digital assets, including *any decentralized exchange or peer-to-peer marketplace*.”²⁴ This language would have provided more support for the Proposal’s current scope,

²⁰ See Treas. Reg. § 1.6041-1(b)(1) (“all persons engaged in a trade or business” “includes not only those so engaged for gain or profit, but also organizations the activities of which are not for the purpose of gain or profit”).

²¹ Before the Infrastructure Act, section 6045(c)(1) defined the term “broker” to include a dealer, a barter exchange, and any other person who (for a consideration) regularly acts as a middleman with respect to property or services.

²² Infrastructure Act, Sec. 80603(a).

²³ The various iterations throughout the legislative process are indicative of what the legislature did not intend when compared to the content of the actual legislation enacted. *Immigration & Naturalization Serv. v. Cardoza-Fonseca*, 480 U.S. 421, 442-443 (1987) (“Few principles of statutory construction are more compelling than the proposition the Congress does not intend *sub silentio* to enact statutory language that is has earlier discarded in favor of other language.”).

²⁴ Enacting legislation at the scale of the Infrastructure Act is exceedingly complex and the relevant legislative history is somewhat obscured by there only being 7 recorded drafts from the introduction of the House Bill (*see* Text - H.R.3684 - 117th Congress (2021-2022): Infrastructure Investment and Jobs Act, <http://www.congress.gov/bill/117th-congress/house-bill/3684/text>). Although the draft language between that placed on the Senate calendar on July 13, 2021 and that which was amended and passed by the Senate on August 10, 2021 was not widely distributed, numerous news sources reported on the proposed language. *See* Jason Brett, *New Language For Crypto Tax Reporting Excludes Decentralized Exchanges, Miners Still Vulnerable*, Forbes (Aug. 2, 2021), <https://www.forbes.com/sites/jasonbrett/2021/08/02/new-language-for-crypto-tax-reporting-excludes-decentralized-exchanges-miners-still-vulnerable/?sh=41b5027b5f56>; Ella Beres, “*Crypto Tax Enforcement Update: The New Broker Definition in the Information Reporting Requirement Provision of the Infrastructure Bill Aims to Exclude Node Operators, Miners, and Validators*,” *Blockchain Law Center*, Davis Wright Tremaine LLP (Aug. 3, 2021), <https://www.dwt.com/insights/2021/08/crypto-tax-enforcement-update>.

and it is significant that Congress refused to include the emphasized language in the legislation’s final form. Because Congress rejected the broader definition, it is inappropriate for Treasury and the IRS to evade Congressional intentions and force persons and software tools that should not be covered into the proposed framework.

iii. The Proposal includes other vague and indeterminate language that deprives market participants of fair notice of what the rules require of them.

We also have significant concerns regarding other vague and ambiguous terms in the Proposal that are difficult for market participants to understand. Importantly, vague and indeterminate language undermines the effectiveness of the Proposal’s broker reporting regime and deprives market participants of fair notice of what the rules require of them. Below are examples of terms in the Proposal that require further attention.

- **“Ordinarily would know or be in a position to know.”** Under the Proposal, a prerequisite for falling into the definition of a Digital Asset Middleman is that a person must “ordinarily...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.”²⁵ The “position to know” standard is met if a person “maintains sufficient control or influence over the facilitative service provided,” such that the person has “the ability to change the fees charged for the facilitative service.”²⁶

As an initial matter, the Proposal provides limited guidance on what constitutes “sufficient control or influence.” It provides just one example of persons who meet the standard, i.e., a person who “has the ability to modify an automatically executing contract or protocol to which that person provides access.” This vague and expansive approach could have significant unintended consequences for users. For example, developers that program code into smart contracts that allows them to take emergency action in the event of a hack or other attack on a protocol, without otherwise retaining material control over a protocol, could fall within the definition. Such powers are typically limited to pausing the functionality of a blockchain or protocol smart contracts to protect user funds. In addition, developers who retain certain controls over DeFi protocols in their earliest stages, like holding “administration keys” for upgrades, emergency pauses, or governance changes, could also be in scope. To avoid falling within the broker reporting regime, developers may purposefully forgo retaining these very limited controls, which would paradoxically result in less protection for the protocol and users and prevent important upgrades. The government should incentivize, not discourage, smart contract developers to deploy code that results in safer outcomes.

The Proposal also states that the “ability to change the fees charged” suffices to meet the sufficient control or influence standard to be in a “position to know” both the identity of the party and the nature of the transaction. But simply having the ability to change fees does not

²⁵ Prop. Reg. § 1.6045-1(a)(21)(i).

²⁶ Prop. Reg. § 1.6045-1(a)(21)(ii)(A).

translate into having the ability to know each customer’s identity or the nature of a transaction. Fees can be based on multiple factors that are not associated with a transaction or the user’s identity (e.g. fixed fees or fees based on a balance). Fundamentally, fees associated with sales of digital assets are inherently different from fees associated with securities transactions as they do not necessitate and are not indicative of intermediation. The introduction of this entire method to approximate intermediation where none exists demands specific congressional language and is not a continuation of previous analysis or methods.

- **“Person.”** The preamble to the Proposal states that the term “person” “generally has the meaning provided by Section 7701(a)(1), which provides that the term generally includes an individual, a legal entity, and an unincorporated group or organization through which any business, financial operation, or venture is carried on.” This definition is problematic for participants in the blockchain industry, especially in decentralized contexts. For example, tokenholders in decentralized autonomous organizations might not know one another despite participating in a common ecosystem. In addition, certain governance tokens could be readily exchanged or traded, which could lead to a constantly shifting governance group. Without further guidance, it is not clear whether such distributed groups could potentially constitute a partnership or “unincorporated group” for U.S. federal income tax purposes and be “persons” for purposes of the Proposal, or whom among an unincorporated group would be responsible for the obligations set forth in the Proposal.
- **“Providing an automated market maker system.”** The Proposal states that a “facilitative service” includes “providing an automated market maker system.”²⁷ This definition is problematic because “providing” is vague without further explanation of the term. For example, it is unclear whether writing and publishing computer code for an automated market maker or deploying code to a blockchain would fall within the scope of “providing” a system to customers. It is also not clear whether an individual who publishes a website or wallet application that enables users to access a decentralized protocol and send messages to it would be considered to be “providing access to an automatically executing contract or protocol” or digital asset trading platform. Nor is it clear how or why the provision of internet services via an ISP or providing a web browser that enables users to access a DeFi protocol website should be treated differently from the foregoing activities.

We further note that such vague and indeterminate language could also raise Fifth Amendment concerns. It is axiomatic that fair notice is a fundamental aspect of Fifth Amendment due process and the rule of law, and there is no more “fundamental principle in our legal system” than the rule “that laws which regulate persons or entities must give fair notice of conduct that is forbidden.”²⁸ The numerous vague and indeterminate terms described above, as well as the vague definition of “Digital Asset Middleman” could violate these precepts. Without additional guidance as to these terms, the Proposal could force “persons of common intelligence,” like the regulated

²⁷ Prop. Reg. § 1.6045-1(a)(21)(iii)(A).

²⁸ *FCC v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012).

parties here, to guess at its meaning, which could violate the “first essential of due process of law.”²⁹ For that reason, we strongly recommend that Treasury and the IRS clarify all terms in the Proposal.

B. Expanding the information reporting regime creates significant privacy, safety, and national security concerns and could violate the Fourth Amendment.

i. Privacy, Safety, and National Security Concerns

We have significant concerns with respect to the private nature of information that the Proposal would require brokers to collect. For individual taxpayers, the Proposal requires that providers of certain software tools and others (as described in Section II(A)(i)) link wallet addresses with real-life identities, which would require obtaining highly personal information from users, and then remit that information to the IRS. Enacting the Proposal as written could result in significant privacy, safety, and national security concerns and could imperil U.S. citizens. As a result, to the extent that Treasury and the IRS finalize the Proposal, they should not require the reporting of wallet addresses and instead limit reporting requirements only to information necessary for purposes of section 6045.

The Proposal’s requirement that brokers remit information to the government linking user identities with wallet addresses would provide the IRS with far more information than it has ever required for information reporting purposes. While we understand the government’s need to obtain certain taxpayer information as a matter of efficient tax administration, in order to carry out the purposes of section 6045, the IRS needs to know only the sales proceeds, cost basis of the asset, the date on which the sale occurred, and the name, address, and the TIN of the party that sold the asset. There is no need to associate a wallet address or transaction hash with this data in order to meet the objectives of section 6045 either for the benefit of the taxpayer or to assist the IRS in validating the gains reported on tax returns. Requiring additional information beyond the purposes of section 6045 is inappropriate from a statutory perspective and would invade the privacy of individual users.

In addition, users are rightfully concerned about remitting information to the IRS that connects them to their wallet addresses.³⁰ Because transactions on most blockchain networks are transparent and viewable by anyone with access to a block explorer, a person or entity who knows the wallet address of another also has access not only to a user’s purchases and swaps on a blockchain network, but also the *entire* transaction history associated with that user’s wallet address. In effect, this regime would be the equivalent of the IRS and third parties having access to a person’s bank account, brokerage account, and credit card information, as well as visibility into all of the transactions associated with those accounts. Not only is such information *not required for broker reporting in traditional finance transactions* involving conventional securities, but expanding such requirements is a significant infringement of privacy and could provide intimate details of an

²⁹ *Connally v. Gen. Const. Co.*, 269 U.S. 385, 391 (1926).

³⁰ We are also concerned with the IRS’s ability to safeguard this information. See *Massive IRS data breach much bigger than first thought*, CBS News (Feb. 29, 2016), <https://www.cbsnews.com/news/irs-identity-theft-online-hackers-social-security-number-get-transcript/>; Juliana Kim, *The IRS says it mistakenly made public data for about 120,000 taxpayers*, NPR (Sept. 4, 2022), <https://www.npr.org/2022/09/04/1121061081/irs-data-mistake-public-congress>.

individual's economic activity and holdings which could also pose risks to their safety. Congress has not authorized Treasury and the IRS to have such unprecedented access into the transactions of ordinary citizens absent audit or other legal process.

Moreover, as the use of digital assets as a medium of payment increases, this type of reporting could create a dataset that will result in serious privacy and national security risks to the individual taxpayer, including threats to their personal safety. If the transactional data of a wallet address is leaked or otherwise exposed, as has happened to the IRS in the past with respect to information from traditional reporting, criminals and foreign state actors could know the identities of persons with digital asset wealth and may attempt to extort or otherwise gain access to their private keys.³¹ Indeed, the proliferation of multiple brokers poses significant additional data security risks. For example, personal taxpayer data linked to wallet addresses increases the risks of security breaches, which could expose the transaction history of identified individuals and create “honeypots” for cyber actors to hack and for foreign state actors to gather intelligence on U.S. citizens.

Notably, users of DeFi and self-hosted wallets frequently turn to these technologies precisely because they value privacy and not having to reveal highly personal information, like identification information and social security numbers, to third parties. In light of recent hacks of and attacks on large, centralized institutions, as well as the selling of big data, it is no surprise that users have become much more attentive to and protective of their private information. For the first time, decentralized protocols have allowed these users to maintain their privacy while still transacting with others by giving them the software tools to custody their own assets and interact in a peer-to-peer manner. If Treasury and the IRS implement the Proposal as written, these users will be more likely to turn to non-compliant or overseas DeFi platforms, which will discourage tax compliance and paradoxically increase risk for users. With respect to DeFi applications and self-hosted wallets, it is also important to stress that these software services do not provide an exclusive service (as discussed further in Section II(A)(i)); more than one DeFi application can provide access to the same DeFi protocol and more than one self-hosted wallet can provide access to the same blockchain network — just as there are multiple email service providers (e.g., Gmail, Yahoo, and Hotmail) that all provide access to the SMTP email protocol — so other businesses can develop applications for accessing the same protocol without requiring the same information disclosure.

What's more, the categories of persons and software tools mentioned in Section II(A)(i) do not have the infrastructure to collect private information on users. While traditional centralized intermediaries hold customer assets and effectuate transactions on their behalf, in decentralized systems, users themselves maintain control over their assets and transactions. There is generally no “account” relationship with a user as in traditional finance. The main, and limited, purpose of a DeFi application, for example, is to provide software interfaces that allow users to interact with DeFi protocols in a manner that is convenient and accessible for members of the public. Wallet providers similarly provide a software service for users to hold their own private keys and interact with blockchains, and sometimes links to interact with DeFi protocols. Centralized intermediaries, like

³¹ See also Zhiyuan Sun, *\$5 wrench attacks appear to be on the rise in the crypto community*, CoinTelegraph (Feb. 2, 2022), <https://cointelegraph.com/news/5-wrench-attacks-appear-to-be-on-the-rise-in-the-crypto-community>.

banks and brokerages, in contrast, custody significant customer assets, sometimes in the billions of dollars, and thus need robust infrastructure in place to protect both customer information and assets.

As written, the Proposal would require DeFi developers and self-hosted wallet software providers, whose expertise is in launching protocols and running internet applications, to build similar infrastructure, despite *never* holding customer assets. In addition, it would be economically prohibitive to build and maintain such infrastructure given that these services are typically offered at little cost when compared to similar services offered by traditional finance. Given the fundamental differences between the services of DeFi and centralized intermediaries in traditional finance, this outcome is unfair and inappropriate.

ii. Fourth Amendment

As described above, the Proposal seeks to require certain third parties to transmit private information about individuals to the government. As written, this requirement could violate the Fourth Amendment's protections against unlawful searches and seizures. As a general matter, the Fourth Amendment has largely been relegated to criminal cases. However, the novelties of blockchain technologies — as well as the government's proposals for regulating them — suggest that the Fourth Amendment could be an important limiting factor with respect to the Proposal, especially in regards to the private information of DeFi users.

The Fourth Amendment protects “[t]he right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures.”³² The reasonableness of a search is context-specific, but outside of the criminal context, the reasonableness inquiry examines whether the search is “sufficiently limited in scope, relevant in purpose, and specific in directive so that compliance will not be unreasonably burdensome.”³³ Because the Proposal requires information reporting that would link personal identities of DeFi users to their digital wallet addresses, it may amount to an unreasonable search due to the open and transparent nature of blockchain transactional activity. Providing the government with wallet addresses would give it insight into every transaction that a user engages in on a blockchain network.³⁴ Such a significant volume of information is far beyond anything that the government has ever required of U.S. citizens. It is all the more unreasonable because, as discussed in Section II(B)(i), taxpayers and the IRS do not need the wallet addresses or transaction hashes in order to report capital gains or audit taxpayers' returns of such gains under section 6045.

³² The “basic purpose of this Amendment is to safeguard the privacy and security of individuals against arbitrary invasions by governmental officials.” *Camara v. Municipal Court of City and County of San Francisco*, 387 U. S. 523, 528 (1967).

³³ *See v. City of Seattle*, 387 U.S. 541, 544 (1967).

³⁴ Note that, even if a user were to switch wallet addresses, modern blockchain analytics practices have shown that heuristic analysis of on-chain interactions can be used to pierce the pseudonymous characteristics of blockchains.

C. The Proposal’s requirements will result in reporting that is cumbersome, duplicative, and confusing for taxpayers.

As acknowledged in the preamble to the Proposal, the proposed requirements create a significant possibility of duplicative reporting where multiple persons could be responsible for reporting on the same transaction. Duplicative reporting will confuse and burden all parties, including the persons that are subject to reporting requirements, taxpayers, and the IRS itself.

How the Proposal would apply to self-hosted wallets is an important and illustrative example. Under the Proposal, wallet software providers could potentially be required to report the transactions of their users if the wallet enables users to connect to a decentralized exchange protocol.³⁵ As described above, wallets generally enable such activity by allowing users to sign and send cryptographic messages to blockchains, including any self-executing smart contract protocol deployed to a blockchain. Wallets generally do not have any way of knowing what the functionality of a given protocol is that the user interacts with, but are nevertheless a participant in any such use, similarly to how an ISP is a participant in transfers of data packets via the Internet.

In any transaction initiated using a wallet, there are at least two touchpoints with nominal involvement in the transactions: the wallet and a DeFi protocol. Importantly, the wallet does not itself provide or create an exchange where transactions occur; what it provides is a method for signing and sending messages to a decentralized protocol, such that a user can initiate a transaction on a protocol without having technical expertise. The crafting of these messages is generally undertaken via a DeFi application, in which case the DeFi application acts as a third touchpoint in the transaction. As written, the Proposal could potentially obligate the DeFi application, self-hosted wallet, and the DeFi protocol to report tax information — the DeFi application provides purchase and swap tabs on its user interface and creates the message with the details of the transaction; the wallet signs and sends the message; and the DeFi protocol is where the actual transactions occur in an autonomous manner and are recorded to the blockchain. Thus, despite the user being the only party that “effectuates” the transaction, the Proposal potentially scopes in three reporting parties. But as discussed above, the broad applicability of the Proposal could scope in many more, including ISPs, web browsers, and email applications, which can all perform similar roles to the parties identified.

Complicating potential tax reporting obligations even further, certain self-hosted wallets natively include functionality that enables the use of decentralized exchange aggregators. A decentralized aggregator is a service that aggregates liquidity from a number of different decentralized exchanges and market makers, which help users find better prices.³⁶ In practice, a decentralized aggregator scans multiple decentralized exchanges to provide users with the best

³⁵ See Prop. Treas. Reg. § 1.6045-1(a)(21)(iii)(A) (“A facilitative service also does not include the selling of hardware or the licensing of software for which the sole function is to permit persons to control private keys which are used for accessing digital assets on a distributed ledger if such functions are conducted by a person solely engaged in the business of selling such hardware or licensing such software. Software that provides users with direct access to trading platforms from the wallet platform is not an example of software with the sole function of providing users with the ability to control private keys to send and receive digital assets.”).

³⁶ *Fundamentals: What is a DEX aggregator?*, 0x (Apr. 19, 2023), <https://0x.org/post/what-is-a-dex-aggregator#:~:text=A%20DEX%20aggregator%20is%20a,price%20for%20a%20given%20trade>.

exchange for a given transaction. In these cases, there could also be *four* potential broker reporting obligations: the wallet, the decentralized aggregator, the application, and the protocol. This result would lead to a significant waste of resources for companies that seek to remain compliant and significant confusion for taxpayers. In effect, the Proposal potentially leads to an endless array of web3 participants that are all required to report on the same transaction, even though no participant has all the information necessary to make such reports. Indeed, it is worth emphasizing that *no web3 participant* has greater access to a person’s transaction information than any other person that has access to the distributed ledger of the blockchain on which such transactions are recorded.

Duplicative reporting also creates administrative issues. When taxpayers receive multiple Form 1099s relating to the same transaction, they could either incorrectly report more than actual gross proceeds for the transaction, not report duplicative Form 1099 proceeds, or offset additional proceeds. This reporting standard would inevitably lead to a complicated and time-consuming reconciliation exercise between the taxpayer’s return and the IRS dataset. Moreover, taxpayers will not be able to request that brokers amend their reporting. A more optimal regulatory solution would scale back these inefficiencies. Finally, the Proposal is unlikely to improve reporting generally because it will result in many U.S.-based platforms shutting down and a significant number of users flocking to non-U.S. and non-compliant platforms to avoid threats to privacy and burdensome fees (as discussed in Section II(B)(i)).

D. The Proposal would eliminate or reduce the meaningful benefits that DeFi provides to U.S. citizens.

The Proposal would impede the development of blockchain technology, including DeFi and self-hosted wallet software, and breach the traditional posture that tax policy remain technology neutral. In effect, many developers building blockchain-based financial software applications — which provide a software interface for interacting with decentralized protocols as discussed above — would be forced to collect and protect confidential private customer data to remain in compliance with the proposed requirements.

These new requirements would place significant costs on DeFi and self-hosted wallet software, at the expense of the current and potential benefits of decentralization, such as no conflicts of interest, best execution, lower fees, faster transaction times, enhanced personal information protection, and greater privacy. Those costs will be passed onto users, which could result in two foreseeable outcomes. First, non-compliant applications that do not have the same costs would be cheaper for users, thereby incentivizing users to use them, which would paradoxically expose them to greater risks. Second, certain applications could quickly establish their dominance from a compliance perspective and attract the most user transactions. The outcome could be that the network effects of the decentralized protocol end up accruing to the DeFi application, leading to a re-centralization risk. Once a loyal user base is established, the DeFi application could take advantage of its market position and provide access to protocols that are less decentralized, which would also potentially expose users to greater risks.

III. Digital Asset Payment Processors

Under the Proposal, persons classified as “Digital Asset Payment Processors” would be subject to the information reporting requirements.³⁷ The expansion of broker reporting obligations from traditional brokers to payment processors raises significant issues from both the perspective of taxpayer privacy and effective tax compliance. We believe this expansion of broker reporting to buyers on retail purchases is unwarranted for the reasons described below. Because of the low risk of tax avoidance, the limited benefits of reporting, and the potential privacy harm and tax burdens that would be involved with reporting on payment transactions, we respectfully request that broker reporting not be expanded to digital asset payments processors.

A. Digital Asset Payment Processors have a customer or business relationship with sellers — rather than buyers — of goods and services.

In existing payment processing frameworks, payment processors may have a business relationship with sellers or the marketplace or platforms that host unrelated sellers. Therefore, reporting, if any, is generally done for sellers with respect to aggregate annual payments (e.g., on a Form 1099-K). The shift to broker reporting under the Proposal’s expanded definition of broker will mean reporting with respect to *buyers* making purchases with a payment processor or on a marketplace. Because payment processor reporting in the past has only been with respect to sellers, there is no infrastructure for soliciting tax documentation from buyers. Moreover, for payment processors, there is often no customer relationship to leverage for collecting this information, and collecting tax documentation from buyers will be all the more challenging if the transactions are one-time purchases for small sums as happens in the retail context (e.g., a purchase of a jacket or a hat).³⁸ The traditional process of tax documentation, backup withholding, and tax reporting on the basis of account relationships does not apply where no business relationship exists between the payment processor and the purchaser. Even if a digital asset payment processor could report on the gross proceeds paid on a purchase (and thus the sales proceeds from the deemed disposition of digital assets that were used to pay for the purchase), it would generally not have cost basis information to report. Accordingly, reporting provides limited utility to both the taxpayer and the IRS because determining a gain or loss on each purchase would still involve a separate search for cost basis information.

B. Volume and Impacted Taxpayers

The use of digital assets for common commercial transactions is growing, and U.S. citizens and businesses could benefit from more widespread adoption. Using digital assets for payments has a variety of advantages over established payment mechanisms (e.g., cash, checks, credit cards), including generally lower fees and near-instantaneous settlement with certainty and immutability. In

³⁷ These rules appear to be intended to capture entities that facilitate payments in digital assets by converting the payments into fiat currency or another digital asset for merchants. They could also apply to certain payment intermediaries in the marketplace and gig platforms and certain payment card issuers that facilitate payments in digital assets.

³⁸ Moreover, section 6045(a) explicitly contemplates reporting only for customer-facing transactions. Because there is no customer relationship, Treasury and the IRS do not have the authority to require reporting.

addition, digital asset payments are generally more secure and lower the risk of fraud or identity theft for consumers.

We understand that Treasury and the IRS may be concerned that taxpayers might not have tax-relevant information to report gains realized in connection with commercial transactions absent an information reporting regime. Although we appreciate this concern, we note that most tax software programs are able to accurately track and report the gains and losses realized in connection with these transactions. Thus, for taxpayers already taking steps to comply with their tax obligations, an information reporting regime that only provides gross proceeds information with respect to these transactions would not produce particularly useful information. More significantly, the potential revenue loss for most purchases is extremely low and using digital assets to make everyday purchases is not a realistic means of tax avoidance. Digital assets that are used to purchase daily items often take the form of stablecoins that do not ordinarily fluctuate in value, as discussed below in Section IV(B). For these reasons, there are limited benefits to expanding the tax reporting regime in the manner proposed.

C. Privacy Considerations and Duplicative Reporting

As noted in Section II(B)(i), if a broker is tasked with associating digital asset payment transactions with the identity of the wallet holder, and the broker reports that information to the IRS and the payment processor, the IRS, in effect, has the person's full transactional history on that blockchain network. As mentioned above, Congress has not authorized Treasury and the IRS to have such unprecedented access into the transactions of ordinary citizens absent audit or other legal process. As also noted in Section II(C), the Proposal could result in duplicative reporting. Because digital asset payment processors assist in payments, such processors would also have broker reporting obligations, in addition to all of the other entities that might report on the same transaction.

IV. Scope of the term "Digital Asset"

Under the Proposal, Treasury and the IRS treat all NFTs and stablecoins as digital assets, which results in an overly broad scope of reporting. We recommend that Treasury and the IRS exclude NFTs from the scope of the proposed regulations for two reasons. First, most NFTs do not fall within the statutory definition of a "digital asset." Second, even assuming that NFTs do fall within this definition, Congress explicitly granted regulatory authority to Treasury and the IRS to exclude certain types of digital assets, and we believe excluding NFTs would be consistent with sound tax policy.

We also strongly recommend that Treasury exercise its discretionary statutory power to exclude stablecoins from the definition of "digital asset" for purposes of the broker reporting requirements. As a practical matter, there are no gains or losses from U.S. dollar stablecoin transactions, and therefore, the information reporting requirements would be unnecessarily burdensome for digital asset businesses, while providing little useful information to the IRS.

A. NFTs and Tokenized Securities

Section 6045(g)(3) of the Code defines “digital asset” as a “digital *representation of value* which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.”³⁹ While it is true that some NFTs could represent value, “most represent images, provenance, access passes, in-game items, licenses, and property titles.”⁴⁰ In other words, an NFT is a representation of ownership or authentication of a linked asset external to the blockchain. While the linked asset could represent value, the NFT itself is not a representation of value, and it reflects its own unique attributes. Nonetheless, the preamble to the Proposal presupposes that all NFTs are digital assets for purposes of the broker reporting requirements.⁴¹ Because it is not accurate to treat all NFTs as representations of value, the IRS does not have the statutory mandate to take this broad approach.

In addition, where an NFT represents ownership in an underlying asset, the NFT should, under general tax principles, be treated as the underlying asset for all U.S. federal income tax purposes. The fact that ownership is transferred through a blockchain transaction should not be determinative of whether the asset is a digital asset subject to reporting — in these situations, the NFT is merely a means of conveying ownership, similar to any other contract, such as a title document evidencing ownership of a residence.⁴² The transfer of an NFT evidencing ownership of an underlying asset should only be subject to broker reporting if the underlying asset itself is subject to broker reporting. An instructive example is the case of tokenized securities. If securities are held in token form, the IRS should treat ownership of the token as ownership of the underlying security for U.S. federal income tax purposes. In other words, the NFT is not the tax-relevant asset; the tax-relevant asset is the underlying security. It is likely that tokenized securities should be subject to the same rules as traditional securities and not treated as digital assets for purposes of section 6045. Looking to the underlying asset for NFTs, therefore, makes sense as a policy matter because it prevents tax reporting considerations from impeding the use of a more efficient and reliable transfer mechanism using blockchain technology.⁴³

We further respectfully suggest that the IRS’s countervailing reasons for including NFTs within the scope of the Proposal are not based on well-established tax principles. First, the government suggests that the Proposal’s reporting requirements should apply to all NFTs because NFTs can “readily be transferred.” But that is not a recognized standard under tax law. In general,

³⁹ Prop. Treas. Reg. § 1.6045-1(a)(19)(i) also states: “For purposes of this section, the term digital asset means any digital representation of value that is recorded on a cryptographically secured distributed ledger (or any similar technology), without regard to whether each individual transaction involving that digital asset is actually recorded on that ledger, and that is not cash.”

⁴⁰ Jason Schwartz, *Misconceptions Around NFTs*, 179 TAX NOTES FEDERAL 300 (Apr. 10, 2023).

⁴¹ See 88 FR 59576 (proposed Aug. 29, 2023) (“The Treasury Department and the IRS also considered whether newer forms of digital assets, such as those referred to as stablecoins or NFTs, should be subject to the section 6045 broker reporting rules. The proposed regulations would require broker reporting for all types of digital assets, for multiple reasons.”).

⁴² In other situations, the NFT might not represent legal ownership, but a beneficial interest in the underlying asset. For example, an American Depository Receipt holder is treated as holding the underlying stock for U.S. tax purposes, not a separate contract. See, e.g., Rev. Rul. 72-271, 1972-1 C.B. 369; Rev. Rul. 65-218, 1965-2 C.B. 566; PLR 8826049 (July 1, 1988); PLR 8546125 (Oct. 4, 1985); PLR 8537010 (June 4, 1985); GCM 33024 (June 8, 1965).

⁴³ We note the widespread interest in using blockchain technology to transfer ownership in traditional securities, given faster settlement times and lower transaction fees for on-chain transactions.

tax status applies based on the underlying type of asset,⁴⁴ not its ease of transferability.⁴⁵ Second, Treasury and the IRS suggest that the Infrastructure Act lends itself to an “expansive” interpretation of the term “digital asset.”⁴⁶ But there is no support in the text of the Infrastructure Act or its legislative history for such a position. In fact, the statute provides the Secretary with authority to exclude certain classes of assets, recognizing that Congress anticipated a narrow interpretation of the statute, absent explicit exemptive relief from Treasury.⁴⁷

If Treasury and the IRS nonetheless conclude that all NFTs are “digital assets” as defined in Section 6045, we respectfully suggest that Treasury exercise its statutory authority to exclude NFTs from reporting in light of the relevant policy considerations. One consideration is that it may be difficult in many cases to determine the value of an NFT accurately, particularly in NFT-for-NFT exchanges. Moreover, the costs of a value determination in an NFT-for-NFT exchange exceed the benefits to the IRS, given that NFT transactions generally result only in gross proceeds reporting and, even then, gross proceeds may be indeterminable. One additional consideration is that the majority of NFT transactions generally involve small dollar amounts. For example, the average price of NFTs was approximately \$150 per NFT for Q3 2022.⁴⁸ As such, the information obtained through potential broker reporting will be voluminous, but will likely provide the IRS with little actionable information.

B. Stablecoins

In the preamble to the Proposal, Treasury and the IRS state that one reason for including stablecoins in the definition of a digital asset is that sales of those assets could give rise to a gain or loss. However, for most U.S.-dollar-pegged stablecoin transactions, this is not the case.⁴⁹ As long as

⁴⁴ There is also a lack of clarity where an NFT exists as a standalone asset for tax purposes (i.e., where the NFT is not a means of conveying ownership in an underlying asset). In this regard, we note that the IRS’s previously released Notice 2023-27 espouses a “look-through approach” to NFT taxation. See Request for Comments: Treatment of certain nonfungible tokens as collectibles, Notice 2023-27 (Mar. 22, 2023), 2023-15 I.R.B. 634, <https://www.irs.gov/pub/irs-drop/n-23-27.pdf>. The more optimal regulatory outcome is to apply this type of approach for all purposes, rather than narrowly in the context of section 408(m)(2) (where it would generally be to the taxpayer’s detriment).

⁴⁵ See 88 FR 59576 (proposed Aug. 29, 2023) (“The Treasury Department and the IRS are aware of concerns that applying these proposed regulations to such NFTs would create disparate reporting of transactions involving the subject of the NFT (such as ownership or license interests in artwork or sports memorabilia) depending on whether those interests are transferred using an NFT or as a traditional sale or license contract. But given that NFTs are popular investments, the buying and selling of NFTs raise tax administration concerns similar to the concerns associated with other types of digital assets that the physical analogues of NFTs do not. For example, like other digital assets, NFTs can readily be transferred to a private wallet or an offshore account, while the transfer of a physical artwork or trading card may be more difficult or costly.”).

⁴⁶ See 88 FR 59576 (proposed Aug. 29, 2023) (“[T]he definition of digital assets in the Infrastructure Act is expansive.”).

⁴⁷ Section 6045(g)(3)(D) (“Except as otherwise provided by the Secretary, the term ‘digital asset’ means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.”) (emphasis added).

⁴⁸ See Koba Molenaar, *NFTs Statistics – Sales, Trends and More [2023]*, Influencer Marketing Hub (Aug. 3, 2023), <https://influencermarketinghub.com/nfts-statistics/>. In addition, more than one-third of NFT sales are priced below \$100, and a majority of them (53.6%) are sold for less than \$200. See also Eileen Kinsella, *Think Everyone Is Getting Rich Off NFTs? Most Sales Are Actually \$200 or Less, According to One Report*, ArtNet (Apr. 29, 2021), <https://news.artnet.com/market/think-artists-are-getting-rich-off-nfts-think-again-1962752>.

⁴⁹ More than 90% of the stablecoin market consists of stablecoins that are backed by cash and cash equivalents. The de-pegging that occurred for USDC (which went down in value) and Tether (which went up in value) in March 2023, two of the stablecoins backed by cash and cash equivalents, were related to the Silicon Valley Bank failure, and both returned to their pegged value shortly thereafter. See Cristina Polizu, Anoop Garg & Miguel de la Mata, *Stablecoins: A Deep Dive into Valuation and*

a stablecoin peg holds, there should be no gain or loss on disposition of the stablecoin because it would have been acquired in exchange for assets with a value equal to the value of assets received upon disposition. For example, in the case of a U.S. dollar-backed stablecoin, upon disposition the taxpayer would receive assets or services worth \$1. Because the taxpayer's basis in the stablecoin would equal the amount realized, the taxpayer does not realize a gain or loss. Accordingly, we believe that Treasury should use its discretionary authority to exempt stablecoins from the broker reporting requirements.

Money market funds provide an instructive example from current tax regulations. Under existing broker reporting regulations that are applicable to stock and securities, money market funds are excluded from broker reporting requirements.⁵⁰ Money market funds generally target a peg to the U.S. dollar. Because the value of money market funds rarely fluctuates in value, there is limited opportunity for gain or loss or tax avoidance in the holding and redeeming of such funds. Stablecoins are similarly pegged to the U.S. dollar and rarely fluctuate in value, so there is also limited opportunity for gain or loss or tax avoidance.⁵¹ Accordingly, Treasury and the IRS should treat stablecoins similarly to money market funds and exclude them from broker reporting requirements. In the limited times that taxpayers are able to realize a loss and gain from trading stablecoins, those persons should bear the responsibility of tax reporting as individuals. Therefore, the IRS should still receive relevant information for taxable stablecoin gains.

We further note that exempting stablecoins from broker reporting would encourage stablecoin development and be beneficial from a national security perspective. Although the U.S. dollar continues to dominate global financial markets, many of our adversaries, including Russia and China, have signaled an intention to move away from the dollar and encourage other countries to do the same.⁵² This potential move could pose a national security challenge, given that the power of U.S. government sanctions relies, in part, on freezing countries out of U.S. dollar-denominated trade. If countries have successfully opted out of the dollar, the threat of sanctions is less potent. Because stablecoins dramatically expand cross-border access to U.S. dollars, there is evidence that private stablecoins could help bolster the U.S. dollar worldwide. Given the nascent stage of stablecoin development, the government should allow efforts in this sector to continue with minimal interference.

Depegging, S&P Global (Sept. 2023),

<https://www.spglobal.com/en/research-insights/featured/special-editorial/stablecoins-a-deep-dive-into-valuation-and-depegging>.

⁵⁰ Treas. Reg. Sec. 1.6045-1(c)(3)(vi) provides that “[n]o return of information is required with respect to a sale of shares in a regulated investment company that is permitted to hold itself out to investors as a money market fund under Rule 2a-7 under the Investment Company Act of 1940.” Rule 2a-7 establishes criteria for when a regulated investment company (mutual fund) may hold itself out as a money market fund, including provisions providing for pricing and redemption, eligible securities that the fund can hold, and risk limiting restrictions such as portfolio duration. These criteria are intended to maintain the stability of the money market fund and its dollar peg. But the rationale for the broker reporting exclusion appears to be that any gain or loss on redemption of such funds would be limited and would therefore not warrant the burdens of broker reporting given the limited, if any, benefit from a tax collection perspective.

⁵¹ We note that the value of a stablecoin tends to go down in the limited times that their values fluctuate, so gains occur if the stablecoin re-establishes its peg, if at all.

⁵² Faryar Shirzad, *National Security in the Age of Digital Innovation: The Critical Role of Crypto*, Coinbase Blog (Jan. 20, 2023), <https://www.coinbase.com/blog/national-security-in-the-age-of-digital-innovation-the-critical-role-of-crypto>.

V. Scope of the term “Sale”

The preamble to the Proposal requests comments on whether Treasury and the IRS should revise the definition of sale or other parts of the proposed regulations that address specific transactions. We address this request below for the following categories: NFT-for-NFT exchanges and wrapped digital assets. For these transaction categories, it is not possible to determine whether reporting is required without additional guidance for assessing whether the transaction is a sale; and therefore, we respectfully request that Treasury and the IRS defer any applicable reporting with respect to these transactions until it provides such guidance.

A. NFT-for-NFT exchanges

As described in Section IV(A), we believe that NFTs should not be subject to the broker reporting requirements because these assets in general, are not “representation[s] of value.” In addition, we recommend that NFT-for-NFT exchanges be excluded from the definition of a “sale” (and therefore not be subject to reporting) because NFTs may not have a readily determinable market value. The proposal provides that an NFT-for-NFT exchange should be reported as having “an undeterminable value” if neither the value of the transferred NFT nor the value of the NFT that is received in the exchange can be determined with reasonable accuracy. The method for valuing a digital asset is reasonable if it “considers and appropriately weighs the pricing, trading volumes, market capitalization and other factors relevant to the valuation of digital assets traded through digital asset trading platforms.” A valuation method is not reasonable if, for example, it fails to give adequate effect to “exchange prices lying near the median price value” or places too much emphasis on prices from “digital asset trading platforms having low trading volume.” The clear implication of these rules is that digital assets can be valued with reasonable accuracy only if regularly traded on one or more exchanges, such that there is a readily determinable market price for the asset. NFTs are unique, non-fungible assets for which there is generally no readily determinable market price. Therefore, the Proposal will require brokers to report virtually all NFT-for-NFT exchanges as having an undeterminable value. This reporting will not provide useful information for taxpayers or the IRS, but it will place a significant burden on potentially in-scope NFT marketplaces and create confusion for taxpayers.

As discussed above, backup withholding is also problematic and currently impossible on decentralized exchanges. In addition, it is problematic for any exchange, whether decentralized or centralized, that enables trading and does not involve fiat. For example, where there is no fiat involved in an exchange of digital assets, brokers must retain a portion of the digital asset exchanged and then immediately convert it into fiat and then reconcile that for each deposit. Because certain digital assets, like NFTs, cannot be fractionalized, exchanges must develop a process, if even possible, to ensure backup withholding can occur if required.

B. Wrapped digital assets

Because the Proposal’s treatment of “wrapped token” transactions⁵³ is unclear, we suggest that future guidance provide that wrapping and unwrapping transactions are not taxable exchanges. Wrapped assets should be treated as a continuing interest in the underlying asset, similar to the treatment of American Depository Receipts (ADR) and grantor trusts. The IRS and courts have repeatedly found that an ADR is treated as the underlying stock (or qualified appreciated stock) for U.S. tax purposes in the following contexts: § 901 of the FTC rules and tax treaty purposes (Rev. Rul. 65-218), the interest equalization rules of the 1954 Code (Rev. Rul. 72-271), and § 170(e)(5) of the Code, contribution to a foundation (PLR 9825031). This is also consistent with the tax treatment of fixed investment trusts.⁵⁴ A trust will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. If there is no power to vary the investments, the entity will be treated as a trust for tax purposes. This will be the case where the trust has only a single class of ownership interests unless the existence of multiple classes of ownership interests exist to facilitate direct investment in the assets of the trust. This tax treatment is the basis of many fixed income trusts, securitizations, and pass-through certificates.

Similar treatment for wrapped tokens makes sense because, with few exceptions, such tokens represent direct ownership of the underlying asset (akin to a grantor trust in which the activities of the trust are limited to owning the underlying asset and cannot be varied). In addition, the ADR rulings discussed above support the same conclusion. For these reasons, we recommend that Treasury and the IRS issue specific guidance treating wrapped tokens as ownership of the underlying asset and excluding from broker reporting the exchange of a token for a wrapped token.

VI. The Proposal treats digital assets differently from non-digital assets.

The Proposal’s application to digital asset brokers deviates significantly from the way existing reporting standards apply to traditional finance and non-digital assets. We believe that differing standards are inappropriate absent good reason, and below, we have provided examples where such disparate treatment exists.

- Definition of “sale” and backup withholding.** The Proposal’s definition of “sale” differs from that used for non-digital assets. Specifically, Treas. Reg. § 1.6045-1(a)(9) provides that for non-digital assets, the term sale means any disposition of securities, commodities, options, regulated futures contracts, securities futures contracts, or forward contracts, but only to the extent any of these actions are conducted for cash. The Proposal, however, defines a sale to include dispositions for cash and *also* exchanges for other types of property, including different digital assets, as we discussed in Section V(A) and (B) in the contexts of NFT-for-NFT exchanges and wrapped digital assets. At a minimum, these types of

⁵³ Most wrapped tokens involve a custodian that holds the assets underlying the tokens and is involved in issuing the tokens. Very generally, wrapped tokens are minted when the asset underlying the token (e.g., bitcoin in the case of wrapped bitcoin) is transferred to the custodian and wrapped tokens are burned when they are redeemed for the underlying asset. *See* <https://wbtc.network/>.

⁵⁴ *See* Treas. Reg. Sec. 1.7701-4(c).

exchanges should be excluded from broker reporting until Treasury and the IRS clarify taxation of these transactions. Treasury does not require this type of backup withholding for non-digital assets.

- **Multiple broker rule.** As discussed in Section II(C), the Proposal’s requirements will result in cumbersome duplicative reporting for digital assets — an outcome in sharp contrast to non-digital assets, where the “multiple broker” rule applies to avoid duplicative reporting.⁵⁵ The Proposal states that “it may be difficult for a broker to determine whether a particular digital asset platform also qualifies as a broker for purposes of these proposed regulations.”⁵⁶ But the fact that the guidance is unclear as to who qualifies as a broker should not be sufficient reason to create burdensome and duplicative reporting requirements for other industry actors who should not be in scope. The onus instead is on Treasury and the IRS to develop more clear guidelines.

The Proposal also suggests that there is a lack of assurance that digital asset brokers will comply with tax reporting obligations.⁵⁷ But a lack of compliance among certain industry actors is not a sufficient reason to force entities that are ill-suited for broker reporting requirements into the regime. As discussed in Section VII, we note that compliance can be increased by introducing a threshold to the reporting requirements that focuses on higher value transactions.

- **Documentation requirements.** The Proposal requires digital asset brokers to report more information than is required for brokers of traditional assets. For example, reporting for digital assets would require reporting the exact time of a transaction, in addition to the date of a transaction, as opposed to traditional intermediaries that report just the date. Only the date is required to determine the tax treatment for long term capital gains. Also, as mentioned above in Section II(B)(i), digital asset brokers would be required to report wallet addresses and transaction hashes, tying individual transactions to entire financial histories, with no statutory basis for requesting information not required in order to satisfy the purposes of section 6045.

VII. The Proposal should include a de minimis threshold and transactions should be aggregated for reporting purposes.

While we await clarification on the implementation of safe harbor exceptions for de minimis errors on information returns and payee statements reserve in Section 1.6045-1(d)(6)(vii) and (ix), it should be noted that the Organisation for Economic Co-operation and Development (“OECD”) considered the tension between the tax information needs of various governments and the wider privacy and administrability concerns inherent in such reporting in its consideration of reporting on retail payment transactions. In that context, the OECD adopted a \$50,000 per transaction threshold before reporting would be triggered, and we believe that the same threshold would be appropriate for

⁵⁵ See Treas. Reg. § 1.6045-1(c)(3)(iii).

⁵⁶ Part. I.H. of the preamble to the Proposal.

⁵⁷ *Id.*

Form 1099 reporting for digital assets generally or, alternatively, if the recommendations in this letter are not adopted at least with respect to any non-custodial digital asset “brokers.” It will reduce the burden on reporting and lead to greater compliance, as well as simplify tax administration by focusing the IRS’s limited resources on larger taxpayers and higher-value transactions.

In addition, the Proposal requires reporting of *each* digital asset transaction effected for a customer. This will result in an enormous volume of data, and it will not enhance the IRS’s ability to audit taxpayers on their transactions. At a minimum, digital asset sales should be aggregated for reporting purposes.

VIII. *Chevron U.S.A., Inc. v. Natural Resource Defense Council, Inc.*⁵⁸

Historically, a distinction has been drawn between legislative rules (i.e., rules that carry the force of law) and interpretive rules (i.e., advice to the public on what the administering agency thinks the statute means), particularly in regard to the administrative process for notice-and-comment rules stemming from Section 553 of the Administrative Procedure Act (“APA”). The IRS contends in Internal Revenue Manual 32.1.1.2.6 that most Treasury regulations are interpretive rules, because the tax statute that the regulation implements “contains the necessary legal authority for the action taken and any effect of the regulation flows directly from that statute.” Although interpretive rules do not require compliance with the APA, in regard to tax matters, Treasury and the IRS have historically applied the more exacting notice-and-comment rulemaking in their regulations, which this Proposal included.

To be effective, following a notice-and-comment period, the IRS must demonstrate an understanding of the facts received, articulate the reasoning behind its choices, and provide a satisfactory explanation of how its choices rationally connect to the facts and statutory objectives. Although the response to the notice-and-comment period for this Proposal has yet to occur, the sheer number of responses and the seriousness of the issues raised would seem to place a substantial obligation on the IRS to provide either significant changes to the Proposal or address serious concerns raised through the comments.

In the event that these proposed regulations were challenged in court, it is worth considering what degree of judicial deference would apply. Until the IRS responds to the comments, the full extent of this question is unknown. Although the case history on this matter hangs on some fairly nuanced points – the likely test for judicial deference for both legislative rules or interpretive rules is the framework contained in *Chevron*.

⁵⁸ 467 U.S. 837 (1984).

Chevron dictates whether the regulations have the force and effect of law, thus binding the courts and has two steps for the court to consider.⁵⁹ At numerous times throughout this Proposal, the proposed regulations significantly extend beyond the plain language of the underlying statute. As such, many of the issues raised above could be framed as violative of the intent of Congress or rising to the level of arbitrary and capricious agency action.

IX. The IRS should delay the effective date of the regulations.

Implementing the proposed regulations will require a significant amount of time for the design, building, and testing of systems to accommodate the new rules. This is especially so with respect to market participants that have no account relationships with the potential recipients of the Proposal's new Form 1099s. For the reasons discussed below, we respectfully request that the IRS delay the effective date of any finalized broker digital asset reporting regulations for at least 24 months after the date the final regulations are published in the Federal Register with the effective date coinciding with the beginning of a calendar year. In addition, if the IRS does not adopt our proposals in the preceding paragraphs, we also request a deferral for further government studies relating to the concerns raised, consideration of alternative technological solutions, and, as applicable, adoption of a phased-in approach for certain market participants and reporting products for which substantive tax issues are as yet unresolved.

In the past, for any major information reporting framework implementations, Treasury and the IRS have always provided for an extended time frame for financial intermediaries to comply with new regulatory mandates. For example, the IRS provided a 5-year phased-in approach when it introduced cost basis reporting for brokers with respect to sales of stocks and securities.⁶⁰ The IRS did so even though, in that context, financial intermediaries had the infrastructure to report gross proceeds when the rules were enacted. Similarly, in implementing the Foreign Accounts Tax Compliance Act of 2010, the IRS provided special relief and accommodations to financial institutions for addressing compliance with respect to pre-existing accounts.

Businesses also need lead time to budget for these compliance obligations, supporting human resources infrastructure and ancillary needs. Where no existing tax onboarding, withholding, and reporting infrastructure exists (as is the case with decentralized organizations), broker reporting

⁵⁹ The first involves whether Congress “directly addressed the precise question at issue.” 467 U.S. at 843. A court would only proceed to step two if a statute is “silent or ambiguous with respect to the specific issue.” If the statute is unambiguous, a court must “give effect” to that congressional intent without deferring to the agency and is done as stated by the Supreme Court by “employing traditional tools of statutory construction.” *Id.* at 842-43.

The second involves whether the agency's construction of the statute is “reasonable.” *Id.* at 844. As such, “controlling weight” is only afforded by the courts to reasonable agency interpretations of a statutory ambiguity. Given the extensive case history of the *Chevron* framework, the manner of determining reasonableness is fairly diverse but often hinges on an analysis of the agency's reasoning and a review of the “arbitrary and capricious” standard contained in the APA. The Court has indicated that the analysis at *Chevron* step two can overlap with an arbitrary and capricious review under the APA. *Judulang v. Holder*, 565 U.S. 42, 52 n.7 (2011); *see also Arent v. Shalala*, 70 F.3d 610, 616 n.6 (“The *Chevron* analysis and the ‘arbitrary, capricious’ inquiry set forth in *State Farm* overlap in some circumstances, because whether an agency action is ‘manifestly contrary to the statute’ is important both under *Chevron* and under *State Farm*.”).

⁶⁰ There were multiple deferrals between initial proposed cost basis regulations issued in 2009 and implementation, which followed a phased-in approach with effective dates that began in 2011 for common stocks and continued until 2016 for more complex debt instruments.

contemplated by the regulations will likely require more than the usual amount of time. Lastly, as we have alluded to previously, we believe that blockchain technology creates novel opportunities with respect to tax reporting that are not present in other industries. For example, unlike in other industries, data on blockchains is transparent and readily available to those with access to a block explorer. Therefore, we suggest that Treasury and the IRS consider unique blockchain-based tracking solutions that would align with the decentralized nature of the blockchain industry, rather than expand traditional broker requirements as prescribed in the Proposal.⁶¹

⁶¹ For an example of one such solution, see Coinbase, *Gross Proceeds and Basis Reporting by Brokers for Digital Asset Transactions*, submitted electronically on October 12, 2023.

We greatly appreciate the opportunity to provide comments on these important matters, and we welcome engagement with the Department of the Treasury and the Internal Revenue Service on these issues.

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