November 11, 2023

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

*Submitted electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov)*

**RE: REG-122793-19 (IRS), Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions**

Dear Ms. Batchelder:

The North Carolina Blockchain Initiative (**NCBI**) appreciates the opportunity to comment on the proposed regulations (the **Proposed Regulations**)[1] on gross proceeds and basis reporting by brokers of digital assets under Section 6045[2], as amended by the Infrastructure Investment and Jobs Act of 2021 (**IIJA**). We recognize the considerable investment of resources by the Treasury Department (**Treasury**) and the IRS (the **Service**) in promulgating the Proposed Regulations and appreciate the Service's legitimate interest in addressing the digital assets tax gap. The Service's 'notice and comment' approach is certainly welcomed in light of the 'regulation by enforcement' approach taken by the Securities and Exchange Commission (**SEC**) and the Commodity Futures Trading Commission (**CFTC**), which has forced many Web3 developers and market participants to seek friendlier regimes abroad.

Digital assets and blockchain technology are transforming virtually every sector, particularly finance. Regulatory clarity and "fit for purpose" legislation is essential for digital assets and Web3 to thrive in the US. However, the Proposed Regulations, if finalized, would effectively decimate decentralized finance (**DeFi**) and render compliance by both centralized and DeFi platforms cost-prohibitive and overly burdensome (for taxpayers as well as the IRS).

The Proposed Regulations' generally expansive nature is concerning, particularly given that the perceived regulatory overreach represents a significant deviation from legislative intent (discussed in greater detail below). As drafted, the Proposed Regulations gratuitously interpret and expand key definitions under the existing Section 6045 regulations (**Existing Regulations**)

[1] 88 FR 59585-86 (August 29, 2023).
[2] Except as otherwise noted, all references to 'Section' or 'Sections' herein are to the Internal Revenue Code of 1986, as amended (the **Code**), and to proposed and final regulations promulgated thereunder.

such that a wide swath of market participants and transactions will be swept into the reporting net of Section 6045.

Moreover, the preamble to the Proposed Regulations (the **Preamble**) indicates that Treasury not only intends to cast a wide net to capture as many reportable transactions as possible, it also intends to cast that net (in various evolving configurations) indefinitely. Incremental rulemaking for digital asset transactions is promised under the phased approach described in the Preamble and Treasury's 2023-2024 Priority Guidance Plan.[3]

Additional unrestrained regulation over transactions that arguably do not constitute taxable events or merit reporting will further chill digital asset innovation in the U.S., compounding the mass exodus of Web3 development the U.S. has already experienced. Ironically, while the *lack* of meaningful regulatory clarity in the U.S. to date has hamstrung the digital asset industry, the heavy-handed overreach now proposed will finish it off.

This letter outlines three of the NCBI's chief concerns regarding implementation of the Proposed Regulations.

***About North Carolina Blockchain Initiative***

The NCBI was launched in 2019 as a nonpartisan, all-volunteer task force under the supervision of the Office of the Lieutenant Governor of North Carolina to serve as a primary resource on the emerging digital asset and blockchain ecosystem. The task force consists of experts from regions throughout the state who provide insights and opinions related to blockchain and digital assets in their respective fields which include education, cybersecurity, rural area development, blockchain in government, taxes, and more.

Since inception the NCBI has:

- Developed a series of policy and legislative recommendations designed to promote opportunities for economic growth and cost efficiencies;
- Collaborated with the American Legislative Exchange Council (**ALEC**) on developing a 'model policy' for anti-CBDC bills nationally;
- Played a central role in the development and passage of the bipartisan North Carolina Regulatory Sandbox Act of 2021, and creation of the North Carolina Innovation Council;
- Worked to strengthen North Carolina as a leader in technological innovation;
- Conducted two in-depth tours of North Carolina-based bitcoin mining facilities for state and federal officials;
- Hosted an informational blockchain webinar series

***Key Considerations***

[3] https://www.irs.gov/pub/irs-utl/2023-2024-priority-guidance-plan-initial-version.pdf.

NC BLOCKCHAIN INITIATIVE

I. Expansive Statutory Interpretation Contra to Legislative Intent and History

The IIJA modified the tax information reporting framework to apply to the digital asset industry such that regulation of digital asset "brokers" would be analogous to that of brokers in the traditional financial services industry. To address digital assets, Congress amended the definition of "broker" to include "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."[4] The plain language of the statute is clear – the modification of Section 6045(c) was not intended to encompass all persons and entities who facilitate or participate in the digital asset market.

Moreover, a Colloquy between Senators Mark Warner and Rob Portman on August 9, 2021 (the **Colloquy**), clarified that Congressional intent in adding Section 6045(c)(1)(D) was not to create a novel class of information reporters outside the traditional definition of "brokers."[5] Referencing Section 6045(c)(1)(D), Senator Portman states, "The purpose of this provision is not to impose new reporting requirements on people who do not meet the definition of brokers."

Treasury acknowledged that the Colloquy "constitutes part of the legislative history of the IIJA amendment to the definition of 'broker' in Section 6045(c)."[6] Further, Treasury has expressed its position 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."[7]

Nevertheless, the Proposed Regulations' unreasonably and untenably expand the term "broker" by introducing the concept of a "digital asset middleman" who constitutes a broker for reporting purposes.[8] The Proposed Regulations define "digital asset middleman" to mean "any person who provides a *facilitative service* … with respect to a sale of digital assets wherein the nature of the service arrangement is such that the person ordinarily *would know or be in a position to know* the identity of the party that makes the sale and the nature of the transaction potentially giving rise to gross proceeds from the sale."[9]

"Facilitative service" is defined as any "service that directly or *indirectly* effectuates a sale of digital assets." [10] The Proposed Regulations then cite examples of such services, including providing:

[4] Code § 6045(c)(1)(D).
[5] *Colloquy Among Senators Mark Warner and Rob Portman* (Aug. 9, 2021), at https://www.warner.senate.gov/public/index.cfm/2021/8/on-senate-floor-warner-portman-conduct-colloquy-clarifying-cryptocurrency-provision-in-infrastructure-investment-jobs-act.
[6] Letter by Jonathan C. Davidson, Assistant Secretary for Legislative Affairs, to Senators Portman, Warner, Crapo, Toomey, and Lummis (Feb. 11, 2022), at https://www.stradley.com/insights/publications/2022/02/-/media/e295168ea3714c528af55eb44cad7e30.ashx.
[7] *Id.*
[8] Prop. Treas. Reg. § 1.6045-1(a)(10)(i)(D).
[9] Prop. Treas. Reg. § 1.6045-1(a)(21)(i) (emphasis added).
[10] Prop. Treas. Reg. § 1.6045-1(a)(21)(iii) (emphasis added).

1. Access to a 'smart contract' or protocol[11]
2. Access to digital asset trading platforms[12]
3. An automated market maker system, order matching services, or market making functions[13]
4. Services to discover the most competitive buy and sell prices[14]
5. Non-custodial wallets that permit users to access trading platforms[15]

Moreover, "in a position to know" the identity of a party or the nature of the transaction (whether it gives rise to gross proceeds) is not the standard applied to securities under the Existing Regulations. The Existing Regulations apply the "ordinarily would know" standard to brokers.[16] The "position to know" standard is subjective, ambiguous, and involves modeling various scenarios and hypothetical situations under which a putative broker could theoretically request information from a customer or party.

This expansive interpretation thus encompasses market participants well beyond those who are actually brokering transactions, with seemingly no bounds on the extent to which the definitions apply. In this regard, the Proposed Regulations vastly overstep the statutory authority granted by Congress under the IIJA, and patently contradict legislative intent, as evidenced by the plain language of the statute, the Colloquy, and legislative history.

## II. Lack of Technology Neutrality and Detrimental Impact on Digital Asset Innovation

Global policymakers generally laud the principle of technology neutrality, which posits that regulation should avoid privileging or penalizing one set of technologies over another. The U.S. has historically been a leader in technological innovation. In July 1997, while the "read" version of the Internet was still in its infancy, in the 'Framework for Global Electronic Commerce' (the **1997 Framework**)[17], President Clinton confirmed the crucial importance of technology neutrality as related to regulation of Internet commerce, stating:

> "[R]ules should be technology-neutral (i.e., the rules should neither require nor assume a particular technology) and forward looking (i.e., the rules should not hinder the use or development of technologies in the future). Existing rules should be modified and new rules should be adopted *only as necessary or substantially desirable to support* the use of electronic technologies."

[11] *Id*.
[12] *Id*.
[13] *Id.*
[14] *Id.*
[15] Prop. Treas. Reg. §§ 1.6045-1 (a)(21 )(iii);-1 (b)(22).
[16] Treas. Reg. § 1.6045-1(a)(10)(i).
[17] A Framework For Global Electronic Commerce, at https://clintonwhitehouse4.archives.gov/WH/New/Commerce/read.html (emphasis added).

Parallels are often drawn between the relatively nascent digital asset industry and the early days of the Internet, a technology which has undoubtedly had a profound impact globally. While it can be argued that the Internet, or Web2, should have been more stringently regulated in its infancy, such regulation would likely have stifled the growth and innovation that afford its users so many opportunities today.

Interestingly, President Clinton expressed heightened concerns about the impact unduly burdensome regulation and taxation could have on fledgling Internet commerce. Specifically, he advised that taxation of Internet sales should adhere to the following principles[18]:

- It should *neither distort nor hinder* commerce. No tax system should *discriminate among types of commerce*, nor should it create incentives that will change the nature or location of transactions.

- The system should be *simple* and *transparent*. It should be capable of capturing the overwhelming *majority* of *appropriate* revenues, be *easy to implement*, and *minimize burdensome record keeping and costs for all parties*.

- The system should be able to *accommodate tax systems* used by the United States and our international partners today.

The 1997 Framework further stated,

> "Wherever feasible, we should look to *existing taxation concepts and principles* to achieve these goals. Any such taxation system will have to accomplish these goals *in the context of the Internet's special characteristics* -- the *potential anonymity* of buyer and seller, the capacity for *multiple small transactions*, and the *difficulty of associating online activities with physically defined locations*.[19]

The similarities between the two technologies (the early Internet and digital assets), and the potential for detrimental regulatory overreach, are readily apparent. Despite nearly a thirty-year time gap, the same problems plague the digital asset industry that plagued the early Internet. Notably, both President Biden[20] and Secretary of the Treasury, Janet Yellen[21], have echoed President Clinton's sentiment from the 1997 Framework in expressing that digital asset regulation should be "technology neutral" to the extent possible.

Technology neutrality does not necessarily require that the *exact* same rules apply to different technologies (in this instance, the traditional financial service industry and the digital asset

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[18] *Id* (emphasis added).
[19] *Id* (emphasis added).
[20] Executive Order 14067: Ensuring Responsible Development of Digital Assets, 87 FR 14143 (March 9, 2022) at https://www.federalregister.gov/d/2022-05471.
[21] Remarks from Secretary of the Treasury Janet L. Yellen on Digital Assets (April 7, 2022), at https://home.treasury.gov/news/press-releases/jy0706

ecosystem). However, the Proposed Regulations hold the digital asset industry to a reporting standard not imposed on the traditional financial services industry or other asset classes. As drafted, they unnecessarily and unjustifiably discriminate against blockchain technology and digital assets by imposing onerous reporting obligations that do not reflect the challenges (and ironically, the opportunities) inherent to the technology.

The Proposed Regulations deviate markedly from the principles of 'light touch' regulation and technology neutrality espoused in the 1997 Framework and championed by President Biden and Secretary Yellen. The 1997 Framework proposed application of existing rules to the novel Internet and electronic commerce, with modifications and entirely new rules promulgated only to the extent absolutely necessary. Moreover, the 1997 Framework advocated for the adoption of a system that would accomplish compliance goals while recognizing the nuances of the Internet that would allow it to thrive. Underlying the 1997 Framework was a sense that regulations (particularly taxation) and existing systems should adapt as much as possible to new technologies, not the inverse (which the Proposed Regulations mandate as related to digital assets). The focus on regulating while accommodating is reflected in the imperative that the system capture the "majority" (not all) of "appropriate revenues," be "easy to implement" and "minimize burdensome record keeping and costs for all parties."

The 1997 Framework also seemed to suggest that regulatory agencies would need to balance the tradeoff between the overwhelming benefits of the Internet and complete risk mitigation. For electronic commerce to thrive (and thus perpetuate increased tax revenues) regulatory agencies would need to live with less than full compliance and potentially tolerate some degree of unmitigated risk, a concept which the drafters of the Proposed Regulations ostensibly find untenable. The 1997 Framework cautioned that regulation should be drafted in the "context of the Internet's special characteristics" while being mindful of certain inherent risks associated with electronic commerce (i.e., potential anonymity of buyer and seller, the capacity for multiple small transactions, and the difficulty of associating online activities with physically defined locations). Clearly, as regulation of Internet commerce developed over time, those risks were incrementally addressed (through KYC and AML, transaction batching, and continued refinement of sales tax nexus laws).

Electronic commerce via the early Internet and digital asset transactions present remarkably similar compliance challenges. Regulation of both technologies must address anonymity of the parties, reporting for recurring de minimis transactions, and potential "nexus" issues (in the case of digital asset transactions, physical location and wallet identification are implicated).

However, the spirit of the Proposed Regulations is not one of practical regulation through mindful accommodation. Rather, the Proposed Regulations seemingly justify discriminating against digital asset technology due to a compulsion for complete reporting for reporting's sake. One is reminded of the lyrics of 'Hold On Loosely' by .38 Special:

… Just hold on loosely
But don't let go
If you cling too tightly
You're gonna lose control…

III. Overly Burdensome Compliance and Enforcement

Given the expansive definition of a broker, it is anticipated that several reporting entities will be required to file and provide a report for the same transaction. Redundant overlapping reports will undoubtedly require needless time-consuming reconciliation by taxpayers, service providers, and reporting parties.

In addition to the cumbersome compliance burden placed upon digital asset market participants, the Proposed Regulations will likely result in an unprecedented burden on the Service. At a recent Council for Electronic Revenue Communication Advancement meeting, Julie Foerster, IRS Director of Digital Assets, stated that implementation of proposed Form 1099-DA alone would result in at least 8 billion additional information returns annually, which is approximately double what the Service now receives for all other Forms 1099 combined.[22]

The mandate to report all U.S. dollar stablecoin transactions will certainly exacerbate duplicative overreporting. U.S. dollar-pegged stablecoins generally experience very little price volatility and function as a method of electronic payment. In digital asset transactions, they're essentially utilized as cash. As such, the transfer of stablecoins doesn't typically generate sizeable gain or loss. The requirement to report all stablecoin transactions is akin to reporting all cash transactions regardless of amount for everyday transactions. The reporting volume that will accompany such a rule is mind-boggling. Moreover, the reporting will be of minimal value-add given that reportable taxable gain or loss is unlikely to be significant.

***Recommendations***

The NCBI recommends the following non-exhaustive measures to mitigate the potential unintended consequences of the Proposed Regulations:

I. Multiple Broker Rule

The Existing Regulations contain a "multiple broker" rule which limits reporting of duplicative transactions to the broker that credits the gross proceeds (cash) to the customer's account.[23] This limits the reporting obligation to the broker that has the closest relationship to the customer. The Preamble to the Proposed Rules acknowledges the disparity in not extending

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[22] See Jonathan Curry, IRS Prepping for at Least 8 Billion Crypto Information Returns, Tax Notes (Oct. 26, 2023), https://www.taxnotes.com/featured-news/irs-prepping-least-8-billion-crypto-information-returns/2023/10/25/7hhdp (reporting statements by Julie Foerster, IRS director of digital assets).
[23] Treas. Reg. § 1.6045-1(c)(3)(iii).

the Multiple Broker Rule to digital asset brokers (while allowing the rule for securities reporting), and further acknowledges the potential for duplicative reporting but justifies the overreporting due to concerns of higher risk of complete failure to report with digital assets.

This logic exhibits a lack of technology neutrality, and subjects multiple parties (taxpayers, reporting parties, and the Service itself) to unreasonably burdensome rules, again due to the need to enforce maximum reporting regardless of value. The digital asset industry should not be subject to more onerous rules than those imposed upon traditional finance.

II. De Minimis and / or Combined Reporting Rules

In light of the proposed reporting of all stablecoin transactions under the Proposed Regulations, a 'de minimis' rule for transactions involving nominal amounts is needed. Final Regulations should exempt reporting for transactions involving gross proceeds of less than $200 in digital assets.[24]

Under the Proposed Regulations, each individual stablecoin transaction requires its own Form 1099. In practice, this means that if a taxpayer made several purchases of goods or services per day using stablecoins, each transaction (regardless of dollar amount) would mandate a separate Form 1099. Obviously, this would yield voluminous reporting per taxpayer in a relatively short amount of time. A combined reporting rule for all stablecoin transactions involving gross proceeds of less than $600[25] used to purchase goods or services (i.e., not digital assets) would reduce the number of reporting forms required.

III. Delayed Implementation

The proposed implementation deadline of January 1, 2025 places a significant burden on all parties (including the Service). Compliance will be particularly burdensome if not impossible for many digital asset market participants due to the need to design, purchase, and implement new reporting systems in a rapidly evolving ecosystem. As such, we recommend implementation of the Final Regulations be postponed for at least one year after finalization.

***Conclusion***

The concerns discussed herein are non-exhaustive; there are numerous other technical challenges posed by the Proposed Regulations. However, as discussed, of particular concern is the generally broad nature of the Proposed Regulations, in conjunction with their lack of technology neutrality and propensity to result in low-value overreporting. Ironically, the Proposed Regulations may actually reduce compliance and tax collection by further driving the digital asset market offshore.

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[24] This is the amount proposed in the Lummis-Gillibrand Responsible Financial Innovation Act, S. 2281, 118th Cong. § 801 (2023).

[25] This is the current payment threshold amount for payment settlement entities under Sections 6041 and 6050W.

We sincerely appreciate your consideration of our comments and welcome the opportunity to discuss these matters further if desired. We genuinely believe that blockchain technology and digital assets will have a transformative impact globally, and desire for the U.S. to maintain its status as a leader in technology and innovation through appropriate 'fit for purpose' regulation of digital assets.

Sincerely,

Kristin Stroud
North Carolina Blockchain Initiative – Tax Appointee