September 8, 2023

<u>VIA ELECTRONIC SUBMISSION</u> to responses@finance.senate.gov

United States Senate Committee on Finance
304 Dirksen Senate Office Building
Washington, D.C. 20510-6200

Re: ***Committee Open Letter to Members of the Digital Asset Community and Other Interested Parties***

To Whom It May Concern:

We respectfully submit this letter on behalf of the Wall Street Blockchain Alliance ("WSBA"), in response to the U.S. Senate Finance Committee's Open Letter to Members of the Digital Asset Community and Other Interested Parties regarding the appropriate treatment of digital assets under federal tax law. This letter reflects the views of select persons of our member-based organization, and only in our individual capacities, which may not reflect the views of our respective organizations.

The WSBA is an industry-leading non-profit trade association based in New York City, with a mission to guide and promote the comprehensive adoption of blockchain technology and digital assets across global markets in a manner that complies with all applicable laws and regulations. The WSBA is structured into Working Groups that, in turn, coordinate the collaboration of leaders across industries and professions to fulfill the WSBA's mission. The WSBA membership encompasses a wide variety of organizations and roles, including, banks, broker-dealers, investment firms, law firms, accounting firms and compliance professionals, all of whom are deeply familiar with and appreciative of laws and regulations relating to blockchain technologies and digital assets.

Given the important questions that the Committee has raised, we have taken this opportunity to provide our thoughts on a select number of them, and would be happy to discuss these in further detail as needed:

Marking-to-Market for Traders and Dealers (IRC Section 475)

- *Should traders of digital assets be permitted to mark to market? Why?*

  IRC Section 475(e) of the Code allows commodities traders and dealers to elect mark-to-market accounting for tax purposes similar to that currently required for a securities dealer.

  Traders of digital assets should be permitted to mark-to-market their positions as it allows traders a more streamlined option for calculating taxes due, which is particularly important where there is no third-party intermediary keeping track on behalf of the trader and reporting to the IRS.

- *Should dealers of digital assets be permitted or required to mark to market? Why?*

  Dealers of digital assets should be permitted to mark their positions to market as mark-to-market accounting generally provides a clear reflection of income with respect to assets that are actively traded in established markets. Where assets are actively traded on a regulated or widely utilized exchange, obtaining an exact price for such assets is relatively straightforward, and for such assets, mark-to-market accounting imposes few burdens and offers few opportunities for manipulation.

- *Should the answer depend on the type of digital asset? How should digital assets be determined to be actively traded (under IRC Section 475(e)(2)(A))?*

  The answer should not depend on the type of digital assets as there is no meaningful distinction that can be made across most digital assets. Digital assets should be determined to be actively traded under IRC Section 475€(2)(A) under the same criteria applied to securities.

Trading Safe Harbor (IRC Section 864(b)(2))

Background and Present Law

Foreign persons are subject to U.S. taxation generally on two types of income: (1) income effectively connected with the conduct of a trade or business within the United States ("effectively connected income" or "ECI"), which is generally taxed in the same manner as business income of a U.S. resident; and (2) investment income received from sources within the United States which are "fixed or determinable annual or periodical gains, profits, and income" (referred to as "FDAP income"). ECI is subject to net-basis income tax; FDAP income is subject to a 30-percent gross-basis tax, though that tax rate can be reduced by bilateral income tax treaties.

The U.S. taxation of foreign persons depends on whether the foreign person's activities rise to the level of a trade or business. In general, to rise to that level, an activity must be considerable, continuous, and regular. Whether an activity rises to that level is, for many activities, unambiguous: most foreign persons, for example, are not importing goods for sale in the United States.

For certain activities, though, the line separating a trade or business from an activity not subject to net U.S. income tax is less clear. Buying and selling stock, securities or commodities is one such activity. For example, when does investing become "trading" which would be considered ECI and subject to tax. The test for whether an activity rises to the level of a trade or business is based on all facts and circumstances: there is no bright line.

However, to provide certainty and to attract foreign direct investment in U.S. capital markets, the Internal Revenue Code provides a safe harbor for trading stock or securities (or commodities) (the "trading safe harbor"). Under the trading safe harbor, a foreign person trading stock, securities or commodities generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which the transactions are effected.

In addition, a foreign person trading stock, securities, or commodities for the person's own account, even through an office or other fixed place of business in the United States, generally is not treated as engaged in a U.S. trade or business if the person is not a dealer in stock or securities (or commodities).

With respect to trading in commodities, the trading safe harbor applies only if the commodities are of a kind customarily dealt in on an organized commodity exchange and if the transaction is of a kind customarily consummated at such place.

Thus, a foreign person trading in stock or securities (or commodities) generally is taxed on only FDAP income (and not on capital gains).

- *When should the policies behind the trading safe harbor (of encouraging foreign investment in U.S. investment assets) apply to digital assets? If those policies should apply to (at least some) digital assets, should digital assets fall under IRC Section 864(b)(2)(A) (trading safe harbor for securities), IRC Section 864(b)(2)(B) (trading safe harbor for commodities), or should the answer depend on the regulatory status of the specific digital asset? Why?*
- *Another possibility is that a new, separate trading safe harbor could apply to digital assets. In that case, should the additional limitation on commodities eligible for the trading safe harbor apply? Why?*
- *To the extent that the additional limitation on commodities for the trading safe harbor applies, how should the terms "an organized commodity exchange" and "transactions of a kind customarily consummated" (in IRC Section 864(b)(2)(B)(iii)) be interpreted in the context of different kinds of digital asset exchanges?*

  In an effort to attract foreign direct investment, the safe harbor exception of IRC § 864(b)(2) should be extended to all digital assets including cryptocurrencies and Non-Fungible Tokens

("NFTs") regardless of whether they are customarily traded on an organized commodity exchange. The goal should be to cast as broad a net as possible to attract foreign investment in digital assets and their ecosystems located in the United States.

In that regard, we would recommend a separate safe harbor for digital assets that does not depend on whether there is "an organized commodity exchange" or whether "transactions of a kind customarily consummated" occur on the exchange.

Given the large number of Internal Revenue Code provisions that use the term commodities we recommend that digital assets be considered a separate form of property, i.e., digital assets.

If the safe harbor is not expanded to all digital assets, it is reasonable to expect that offshore traders would either (i) refrain from trading in those cryptocurrencies or (ii) move their trading of those cryptocurrencies to a non-U.S. office in order to avoid subjecting themselves to U.S. taxation with respect to income from such trading activity. In other words, we would expect that there would be movement of economic activity to foreign jurisdictions.

We are not concerned about tax avoidance with this additional safe harbor. There are two new information reporting provisions that were introduced in the Infrastructure Investment and Jobs Act ("Infrastructure Act").

First, historically, IRC § 6050I required businesses that "receive" over $10,000 in cash (or other untraceable instruments like cashiers' checks and money orders) to file a Form 8300 with the IRS, which includes the name, address, and taxpayer identification number, among other information, of both the payer and the beneficiary (usually the recipient) of the transaction. The Infrastructure Act amended Section 6050I's definition of "cash" to include "digital assets," thus requiring persons that receive greater than $10,000 worth of digital assets in the course of their trade or business to file Form 8300 reports. Section 6045(g)(3) as amended by the Infrastructure Act broadly defines digital asset as follows: "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." That definition includes a broad range of digital assets, including traditional cryptocurrencies and even NFTs.

Penalties for failing to comply with IRC §6050I are severe: civil penalties of up to $3 million per year—with much higher penalties possible if the failure is due to "intentional disregard" of the filing requirements. IRC §§ 6721, 6722. Additionally, willful violation of Section 6050I is a federal felony, with violators facing up to 5 years imprisonment and corporate violators facing fines of up to $100,000. IRC § 7203.

Second, Infrastructure Act expanded existing IRS Form 1099-B reporting obligations by amending the definition of "broker" under IRC § 6045 to include businesses "responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." While the definition of broker may be limited in future legislation, we fully expect the major cryptocurrency exchanges including Kraken, Coinbase and Binance will be covered by even a pared-down definition of the term "broker."

Should the exchanges as withholding agents fail to withhold the appropriate tax at 30% (or a reduced treaty rate) the IRS could pursue the exchange for the failure to withhold. Thus, we see little possibility for tax avoidance if the safe harbor is expanded to separately include digital assets.

Treatment of Loans of Digital Assets (IRC Section 1058)

Background and Present Law

Internal Revenue Code § 1058(a) provides that no gain or loss is recognized on the transfer of securities (as defined in Section 1236(c)) pursuant to an agreement satisfying the requirements of Section 1058(b).

An agreement meets the requirements of Section 1058(b) if the agreement:

(i) provides for the return to the transferor of identical securities;

(ii) requires that payments be made to the transferor of amounts equivalent to all interest, dividends, and other distributions which the owner of the securities is entitled to receive during the loan's term; and

(iii) does not reduce the risk of loss or opportunity for gain of the transferor of the securities in the securities transferred.

The nonrecognition rule of IRC § 1058(a) applies only to the transfer of a "security," which is defined to include only "any share of stock in any corporation, certificate of stock or interest in any corporation, note, bond, debentures, or evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing." IRC § 1236(c). As a result, cryptocurrency loans are ineligible for nonrecognition treatment under section 1058 on its face.

Let's examine the state of the law concerning securities loans prior to the enactment of section 1058 in 1978.

In the pre-section 1058 landscape, a series of IRS rulings concluded that securities loans did not cause the owner/transferor to recognize gain or loss with respect to their transfer of the loaned securities. The earliest of these authorities held that no gain or loss would be recognized in connection with the making of a securities loan. *See* 1948 IRS Letter to New York Stock Exchange, Reprinted in 5 CCH 1948 Stand. Fed. Tax Rep. P6136

In Revenue Ruling 57-451, the IRS first provided a justification for this conclusion, holding that a securities loan was a tax-free exchange under section 1036 (that is, an exchange of common stock for common stock of the same issuer).

The final pre-section 1058 authority that directly addressed the treatment of securities loans is General Counsel Memorandum 36948 which analyzed a proposed revenue ruling addressing certain aspects of securities loans. The GCM concluded that no gain or loss would be realized in connection with a securities loan because the owner should be treated as having exchanged property for other property not differing materially in either kind or extent under Treasury Regulation § 1.1001- 1(a). The owner was viewed as exchanging the loaned securities for the securities that would ultimately be re-delivered to the owner (that is, a deferred exchange of securities for securities) and concluded that as long as the securities returned to the owner were not materially different than the securities it originally lent, there would be no realization event for the owner.

In the 1970s there was uncertainty in the marketplace as to whether the IRS would continue to treat securities loans as non-realization events. IRC § 1058 was enacted to provide certainty to these transactions. *See e.g.,* P.L. 95-345. The Senate Report noted that "uncertainty has developed as to the correct income tax treatment of certain securities lending transactions. As a result, some owners of securities are reluctant to enter into such transactions." S. Rep. No. 762, 95th Cong., 2d Sess. 7 (1978); 1978-2 C.B. 357, 359. The legislative history provides that the "materially different" standard in Treasury regulation section 1.1001-1(a) should be the appropriate yardstick for determining whether a securities loan is taxable, stating that "[i]n order to assure that the contractual obligation does not differ materially either in kind or in extent from the securities exchanged, the committee amendment makes the provision applicable only if the contractual obligation satisfies certain specified conditions." S. Rep. No. 762, 95th Cong., 2d Sess. 7 (1978).

This is consistent with the analysis in the GCM that relied on Treasury regulation section 1.1001-1(a) for non-realization treatment.

- *If IRC Section 1058 expressly applied to digital assets, would companies allowing customers to lend digital assets institute a standard loan agreement to comply with the requirements of that section? What challenges would compliance present?*

  We do not expect to see standard loan agreements for cryptocurrency lending transactions. Currently, there are no industry-standard documents for these types of loans of cryptocurrencies.

  There are wide differences in key features of cryptocurrency loans, from the duration of the loan, whether collateral is required and the impact of hard forks and airdrops during the loan term.

Many cryptocurrency loans are made in DeFi transactions through smart contracts[1] without any separate legal documentation, third-party custodians or off-blockchain payments.

Due the variance in the types of cryptocurrency lending arrangements, we do not foresee a standard lending agreement such as the (i) the Global Master Securities Lending Agreement produced by the International Securities Lending Association or (ii) the Master Securities Loan Agreement published by the Securities Industry and Financial Markets Association. Trying to shoehorn cryptocurrency lending into one of these types of agreements would invariably stifle additional technical innovation in this area.

- *Should IRC Section 1058 include all digital assets or only a subset of digital assets? Why?*

  IRC § 1058 should include a safe-harbor for all digital assets. There is no logical reason to differentiate between the various digital asset classes. Market participants may be reluctant to engage in the lending of digital assets if the effect will be a recognition event, and thus, a potential tax liability.

  For the very same reasons that Congress enacted Section 1058 – providing clarity to financial markets – its protections should be extended to digital asset loans.

- *If a digital asset is lent to a third party and the digital asset incurs a hard fork, protocol change, or air drop during the term of the loan, is it more appropriate for there to be a recognition of income for the borrower upon such transaction or subsequently by the lender when the asset is returned? Please explain.*

  The underlying rationale for non-recognition treatment is that the owner is not truly parting with beneficial ownership in the underlying assets. Under IRC § 1058(b)(2), a qualifying securities loan must entitle the owner to payments equivalent to all interest, dividends, and other distributions which the owner of the securities is entitled to receive during the loan's term. This requirement is reasonably straightforward to apply in the case of securities, as most interest and dividends are of a known amount, are paid in cash and are easily transferred.

  Certain market participants have entered into cryptocurrency lending agreements that require a pass-through of hard forks and airdrops based on the presence of one of various objective indicia that the newly distributed tokens resulting from a hard fork or airdrop have material value within a specified period of time of their transfer.

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[1] Smart contracts were first described by Nick Szabo, a computer scientist and cryptographer, in 1996. Nick Szabo has described "the humble vending machine is the original form of a smart contract."

To be consistent with the requirement that all interest, dividends and other distributions be paid to the owner, the hard fork or air drop should not be taxed to the transferee/borrower because the transferee/borrower should not have any rights in the airdrop or the hard fork. Rather, those proceeds (if material) should be transferred to the owner and taxed at the owner.

Any income received as a result of an airdrop or hard fork should be taxed to the party with dominion and control over the asset and/or a contractual right to such income on the asset. A lender who does not possess and cannot contractually claim or possess dominion and control over an airdropped asset or assets received as a result of a hard fork, by virtue of a loan agreement in which keys and a specific wallet address associated with assets are transferred to the transferee/borrower, for example, should not be liable for any income tax liability resulting from assets received that it does not control, by default, unless the owner and transferee/borrower contractually agree otherwise prior to initiating the loan.

IRC § 1058 does not require collateralization of the transferee/borrower obligations in order to benefit from nonrecognition treatment. This was not an oversight. As part of the same legislation that included section 1058, Congress enacted additional rules providing beneficial treatment to tax-exempt organizations and regulated investment companies receiving lending fees and substitute payments, but only if the lending agreement provides for: "reasonable procedures to implement the obligation of the transferee to furnish to the transferor, for each business day during such period, collateral with a fair market value not less than the fair market value of the security at the close of business on the preceding business day." (IRC §§ 512(a)(5)(B)(i) and 851(b)(2)(A).

The relevant legislative history states that "[i]n most cases, the loan of securities is fully collateralized (with adjustments made on a daily basis) by cash or marketable securities…However, no collateral is provided if securities are borrowed from margin accounts." S. Rep. No. 95-762, 95th Cong., 2d Sess. (1978)

Congress understood that most securities loans were fully collateralized, yet it generally did not make tax-free treatment dependent on the presence of collateral. Similarly, digital asset loans should not need collateral to be entitled to non-recognition treatment.

Wash Sales (IRC Section 1091)

- *In what situations do taxpayers take the position that economic substance (IRC Section 7701(o)) applies to wash sales with regards to digital assets?*

It is unlikely that many taxpayers take the position that economic substance (IRC 7701(o)) applies to wash sales with respect to digital assets as the wash sales rules apply specifically to stock and securities and pursuant to IRS guidance, digital assets are appropriately characterized as property that is excluded from "stock and securities" and as such exempted from wash sales.

- *Are there existing best practices for reporting transactions in digital assets that are economically equivalent to wash sales?*

  We are not aware of any widely used best practices for reporting transactions in digital assets that are economically equivalent to wash sales.

- *Should IRC Section 1091 apply to digital assets? Why or why not?*

  IRC Section 1091 should not apply to digital assets as the decentralized nature of exchanges and trading platforms and the lack of third-party intermediary native to the digital asset market would prove prohibitively burdensome for taxpayers to keep track and maintain compliance with 1091's requirements.
  While expanding Section 1091 to include digital assets would likely result in more taxes paid to the IRS, the burdensome requirements and inability of traders to offset capital gains realized through traditional financial investments may also quell interest in an already struggling emerging market that has suffered immensely from overregulation as well as a lack of certainty regarding applicable regulatory regimes.

- *Should IRC Section 1091 apply to other assets beyond digital assets? If so, what assets and why or why not?*

  IRC Section 1091 applies to dispositions of certain stock or securities but does not apply to foreign currency or commodities as both are not included in the definition of stock or securities, and related derivatives are likewise excluded. IRC Section 1091 should not be expanded to apply to assets beyond digital assets as the market for other assets is comparably small and the imposition of such rule to other assets in most cases would be unduly burdensome for recordkeeper and taxpayers to maintain compliance.
  Additionally, the nature of certain other markets including foreign exchange and commodity markets are unique, and often traders in this space are active traders that enter into and close out positions more frequently than ordinary investors in stock or securities.

Timing and Source of Income Earned from Staking and Mining

The receipt of cash or property for services generally is taxable as ordinary income at the time of receipt. For property received for services, the taxpayer generally includes in gross income the fair market value of the property on the date received. The basis of property in the hands of the taxpayer is the amount included in gross income. In contrast, income with respect to self-created property such as manufactured goods, farmed crops, and certain self-created intellectual property generally is not realized until the property is sold or otherwise disposed of.

Under Internal Revenue Code § 61, gross income is broadly defined to mean "all income from whatever source derived…" However, there are classes of property such as manufactured goods, extracted natural resources, farmed crops, and self-created intellectual property — specific tax rules provide or suggest that recognition of income is deferred until the property is sold. See Treas. Reg. §1.61-3(manufactured goods, natural resources); §1.61-4 (crops). These rules relate to property that is manufactured, produced, or created directly through the actions of the taxpayer, like widgets in the case of a manufacturer or crops in the case of a farmer.

In the staking context, it is the efforts of the stakers that creates the staking reward, should only be taxes upon disposition.

The immediate taxation of the digital asset when the validator earns the staking may have an adverse impact on the security of a Proof of Stake transaction validation protocol. The security of the Proof of Stake protocols depends, in part, on the number tokens staked in the network. If a validator (or block creator) is required to recognize gain on receipt of the staking reward, the validator will need to take one of the following steps to ensure that the income tax is paid:

1. Sell the recently rewarded digital assets;

2. Set aside, i.e., not stake a portion of the validator's digital assets; or

3. Set aside other liquid assets to pay the tax.

Each of these options has adverse consequences.

First, because the security of the Proof of Stake protocol depends, in part, on the amount of staked digital assets, by requiring the validator to sell those assets, the protocol becomes comparatively less secure.

Second, if the validator has set aside an amount of digital assets to cover tax liabilities, those digital assets have not been staked. What is worse is that unstaked digital assets in a Proof of Stake protocol are actually decreasing in value because many, if not all, of the other participants in the network are staking their digital assets. The tokens that remain unstaked become comparatively worth less because the staking validators continue to receive staking rewards.

Third, if the validator is required to set aside other liquid assets to pay tax, then those liquid assets have been utilized to invest in the Proof of Stake network. While many businesses must set aside a certain amount of liquid assets to pay current expenses, this requirement creates a drag on the business cash flow and business operations. If the United States wants to encourage the development of the blockchain technology, it should allow the validators to invest as much as possible in the Proof of Stake networks, while still paying taxes upon disposition of staking rewards.

Fourth, it is not unusual for digital assets to heavily fluctuate in value, even in the course of 12-month period. Taxing the value of the digital asset on receipt could very easily result in a tax on illusory income. For example, if a digital asset is trading at $100 on the date of receipt, the validator could pay at ordinary income tax rates of 35% or 37%. If the value of the digital drops to $35 (or less) prior to the validator disposing of the digital asset, the validator will have an income tax liability that exceeds the value of the asset when it is eventually sold.

Lastly, by taxing the validator upon the disposition (as opposed to acquisition) of the digital asset, there is no additional danger to the Proof of Stake network because the validator has chosen not to stake the assets, but rather to sell them.

We believe that it would be good policy to provide tax advantaged treatment of staking rewards and would be one way for the United States to encourage the growth the blockchain technology in a responsible fashion within the United States by utilizing the Proof of Stake protocols. The Internal Revenue Code is filled with provisions designed to encourage (or discourage) certain activities, including:

- IRC § 41 – Research and Experimentation Tax Credit
- IRC § 163(h) – deductibility of home mortgage interest
- IRC § 1231 – favorable tax treatment for depreciable property used in a trade or business
- IRC § 1202 - partial exclusion for gain from certain small business stock
- IRC § 1400Z–2 - capital gains invested in opportunity zones

Each of these sections exist because, as a policy matter, the United States wanted to encourage a particular activity, whether it was home ownership, research and development activities, opening a small business, or investing in lesser developed regions in the country.

In a global marketplace, businesses and technologies can be developed anywhere.

The United States should take steps to ensure that nascent industries and technologies are given the appropriate conditions to flourish in the United States. In particular, the uses of blockchain technology hold the promise of fast, secure services with real time data verification across a wide variety of industries including payment processing, money transfers, supply chain management, real estate transactions and tracking, electronic medical records, food safety management, and much more.

- *How should returns and rewards received for validating (mining, staking, etc.) be treated for tax purposes? Why? Should different validation mechanisms be treated differently? Why?*

Return and rewards received for validating either pursuant to mining or staking activities are not specifically addressed by any provision of the tax code and as such should be taxed according to traditional income tax principles. Long-standing application of traditional tax principles requires that a taxpayer experience an "ascension of wealth" for any income tax liability to arise, and also that the taxpayer possess dominion and control over an asset.

As discussed above, staking rewards should be treated as created property and taxed only on disposition. Like mining traditional gold, a taxpayer will only have a tax liability when it disposes of the gold, not when it has obtained the gold from the Earth and mining digital assets should be treated comparably. The immediate taxation of staking would discourage the development of staking protocols in the United States. Forcing stakers to liquidate a portion of their staked tokens will also have the unfortunate impact of weakening the security of the validation protocols, and thus the security and effectiveness of the underlying blockchain. As a policy matter, the United States should be doing everything it can to encourage the development of blockchain protocols and the underlying technology in the United States. The blockchain technology has the prospect to change large swathes of the economy.

- *Should the character and timing of income from mining and staking be the same? Why or why not?*

  In theory, the tax results could be the same, however, if Congress wished to encourage the development of staking protocols because they utilize less electricity disparate treatment might be appropriate.

  Under current law, the character and timing of income from mining and staking is treated the same.

  However, if Congress wished to encourage the development of staking protocols because they utilize less electricity, disparate treatment might be appropriate.

- *What factors should be most important when determining when an individual is participating in mining in the trade or business of mining?*

  The primary factor to consider when determining if an individual is participating in mining in the trade or business of mining is whether the individual is carrying on the activities on behalf of business or corporation for the purpose of earning ordinary income. Other relevant factors to consider is whether a taxpayer has incurred expenses that would be deductible as business expenses, which may include the purchase of special computers, servers, or real property, used to further such mining activities.

Borrowing from the Treasury Regulations under section 355, a taxpayer is engaged in a trade or business "if a specific group of activities are being carried on by the corporation for the purpose of earning income or profit, and the activities included in such group include every operation that forms a part of, or a step in, the process of earning income or profit. Such group of activities ordinarily must include the collection of income and the payment of expenses." Treas. Reg. §1.355-3(b)(2)(ii). Importantly, holding stock, securities, land, or other property for investment purposes is not considered conducting a trade or business. Treas. Reg. §1.355-3(b)(2)(iv).

In the context of mining, the most important factor is whether the individual is using computing power constituting a deductible business expense to engage in mining activities. Additionally, if the individual incurs expenses including paying for electricity or computing equipment this would be an important factor in determining whether that individual is engaged in a mining trade or business.

In contrast, if an individual merely purchased cryptocurrency with no mining activities we would expect that to be an investment activity as opposed to a trade or business.

- *What factors should be most important when determining when an individual is participating in staking in the trade or business of staking?*

  The same test is applicable for determining whether an individual is engaged in staking trade or business: if a specific group of activities are being carried on by an individual for the purpose of earning ordinary income or profit. The same factors that are important to consider in the context of mining should likewise apply here, including whether the individual incurred deductible business expenses in connection with its staking operation, including the purchase of special equipment or computers, purchase or lease of servers, purchase or lease of physical property dedicated to the furtherance of such staking activities.

  Here, if the individual is using computing power constituting a deductible business expense to solve a complex mathematical equation, then the individual is engaged in a trade or business. A more difficult question is whether an individual who delegates tokens to another who uses computing power to solve mathematical equations. This will depend on the various facts and circumstances for each protocol.

- *Please describe examples of the arrangements for those participating in staking pool protocols.*

  Staking on a given blockchain is governed by the applicable protocol that governs such activity on a blockchain-to-blockchain basis. Protocols vary depending on the specific blockchain assets are being staked.

Some protocols require a user to lock up staked assets for the duration of a defined period (e.g., Ethereum, Cosmos/Atom) while others do not impose any such lockup requirement (e.g., Tezos, Hedera Hashgraph). Some protocols require user to effect a transaction in order to receive staking rewards allocated to the user's wallet by the blockchain (Cosmos/Atom), while other protocols automatically distribute staking rewards to the user's wallet free of any restrictions and without the user's need to effect any transaction.

- *Please describe the appropriate treatment for the various types of income and rewards individuals staking for others or in a pool receive.*

  Our view is that the staking rewards should be treated as created property and taxed only upon disposition.

  But, even if the staking rewards were considered compensation for services, as a policy matter, in order to encourage the development of staking protocols, we still recommend that the staking rewards, gas fees or transaction fees only be taxed on disposition. As described above, the development of blockchain protocols has the prospect of revolutionizing how data is kept, stored, and utilized. The United States should be at the forefront of encouraging these innovative technologies.

- *What is the proper source of staking rewards? Why?*

  The proper source treatment of staking rewards should be where a persons or persons is located at the moment an asset earned via staking is disposed of, thus giving rise to an income tax liability. This is because most stakers engage in staking activities via delegations to validators or other staking pools that may be conducting operations anywhere in the world and the user may have no reasonable means to uncover the location at which such activity is occurring and no way to verify such location regardless. As such, requiring taxpayers to source income based on the location that the rewards are being earned on their behalf would be unduly burdensome for the taxpayer, not only to discover the applicable location but also to comply with various taxing regimes. Moreover, since we believe staking rewards should be taxed when a taxpayer disposes of them not receives them, the proper source of the staking rewards should be the location of the taxpayer when the taxpayer disposes of the asset(s) giving rise to a tax liability.

- *Please provide feedback on the Biden Administration's proposal to impose an excise tax on mining.*

  In *McCulloch v. Maryland*, 17 US (4 Wheat.) 316, 431 (1819) Chief Justice Marshall observed "the power to tax involves the power to destroy." The Biden administration proposed the Digital Asset Mining Energy (DAME) excise tax, which would impose a tax of 30% on the cost of the electricity used in mining cryptocurrency. The tax would be imposed on the miner regardless if the miner earns any mining rewards.

We therefore feel that this excise tax would effectively strangle the cryptocurrency mining industry in the United States. The cryptocurrency industry is a mobile industry, and it will likely leave the United States.

This is not hyperbole. Market participants are rationale actors and react to incentives (and disincentives). The Securities and Exchange Commission ("SEC") charged Payward Ventures, Inc. and Payward Trading Ltd., both commonly known as Kraken, with failing to register the offer and sale of their crypto asset staking-as-a-service program, whereby investors transfer crypto assets to Kraken for staking in exchange for advertised annual investment returns. As a result, Kraken no longer offers staking services to US clients. However, Kraken continues to offer staking services for non-U.S. clients through a separate Kraken subsidiary. *See Kraken to end on-chain staking services for U.S. clients*, (Feb. 9, 2023).[2]

FATCA and FBAR Reporting (IRC Sections 6038D, 1471-1474, 6050I, and 31 U.S.C. Section 5311 et seq.)

- *When do taxpayers report digital assets or digital asset transactions on FATCA forms (e.g. Form 8938), FBAR FinCEN Form 114, and/or Form 8300? If taxpayers report some categories and not others, please explain and identify which categories of digital assets are reported and not reported with respect to each of these forms.*

  FATCA Forms - FATCA does not presently expressly address digital assets.

  FBAR FinCEN Form 114 - FBAR FinCEN Form 114 is required to be filed by any U.S. person that has an interest or signing authority over foreign financial accounts that hold more than $10,000 at any point during the year. Pursuant to FinCEN Notice 2020-2, FBAR regulations do not include foreign accounts holding digital assets in the definition of a reportable account. As such, a foreign account holding digital assets is not reportable on the FBAR FinCEN Form 114 unless it is a reportable account under 31 C.F.R. 1010.350 because it holds reportable assets besides digital assets.

  Form 8300 - Pursuant to new provisions delineated in the Infrastructure Act, which are set to take effect on January 1, 2024, any person who in the course of their trade or business receives more than $10,000 in a single transaction or a series of transactions, will be required to file a Form 8300 with the IRS and report the transaction(s).

[2] https://blog.kraken.com/news/settlement

- *Should FATCA, FBAR, and/or 8300 reporting requirements be clarified to eliminate ambiguity about whether they apply to all, and/or some categories of, digital assets? Why?*

  FATCA and 8300 reporting requirements may require additional amendments to improve clarity regarding the applicability to digital assets. FBAR reporting requirements do not presently need clarification as FinCEN Notice 2020-2 already clarifies in what cases a foreign account holding digital assets is reportable on the FBAR[3]. If, however, FinCEN proceeds to propose amendments to the regulations implementing the Bank Secrecy Act (BSA), which it has previously expressed it intends to do, FinCEN will likely receive input from the digital asset community and if such input is not subsequently codified in any amendments to the regulations, the FBAR reporting requirements as they apply to digital assets may require further review.

- *How do stakeholders consider wallet custody when determining compliance requirements with FATCA, FBAR, and Form 8300? Please provide examples of wallet custody arrangements and identify which types of arrangements FATCA, FBAR, and/or Form 8300 reporting requirements should or should not apply to.*

  Many stakeholders consider the location of third-party exchange or custodian when considering wallet custody for purposes of complying with the requirements of FACTA, FBAR, and Form 8300.

Valuation and Substantiation (IRC Section 170)

- *Digital assets do not currently qualify for the IRC Section 170(f)(11) exception for assets that have a readily available valuation on an exchange. Should the substantiation rules be modified to account for digital assets? If so, in what ways and for which types of digital assets? More specifically, would something different need to be done for those publicly traded digital assets?*
- *What are the characteristics of an exchange and the digital asset for which this exemption would appropriately apply and why?*

  For certain digital assets it makes sense to modify the substantiation rule where for others

[3] See Notice 2020-2, available at https://www.fincen.gov/sites/default/files/shared/Notice-Virtual%20Currency%20Reporting%20on%20the%20FBAR%20123020.pdf

it does not. As valuation professionals, we have attempted to define and discuss which digital assets should be considered to qualify for the IRC 170(f)(11) exemption.

Tokens - The definition of "Tokens", for the purpose of IRC 170, should include all digital assets that were built for a decentralized project on an existing blockchain, or the native tokens of the underlying blockchain technology. Tokens offer functions including utility, security and governance and are sometimes used as a store of value and medium of exchange.

- Liquid Tokens: "Liquid Tokens" are tokens that are available and freely traded on either a centralized or decentralized exchange.
- Illiquid Tokens: "Illiquid Tokens" are tokens that are not available on either a centralized or decentralized exchange.

Liquidity restrictions imposed on otherwise Liquid Tokens - Tokens that are freely traded on either a centralized or decentralized exchange can be donated with a contractual or programmatic lockup period imposed on the property donated. Lockups imposed on Liquid Tokens prevent the receiving party of the donation to liquidate/exchange the donation to fiat currency, at the time of the donation. Instead, the donation recipient will be able to receive and liquidate the tokens as they unlock over time. Given the high volatility of token markets, lockup restrictions create great uncertainty on the realizable value of the tokens once the lockup period expires. Therefore, the effect of the lockups imposed should be considered when determining the fair market value ("FMV") of the donated property.

Liquidity of donated property - In absence of lockup restrictions, the level of liquidity of the specific token donated is also a very important consideration in determining its fair market value. Specifically, the market depth, and therefore the market's ability to absorb the donated tokens without significantly moving the market price, is an important factor to consider.

If the donated property size is substantial compared to the daily trading volume of the donated token, a theoretical liquidation of said donated property under the fair market value principles can materially decrease the market clearing price. Hence, in the case of a centralized exchange, the size of the order book of the subject token being donation needs to be able to easily absorb the hypothetical sell order of the donated tokens without materially moving the market clearing price. In the case of a decentralized exchange, the size of the liquidity pool needs to be sufficient to absorb the hypothetical addition of the donated tokens to said liquidity pool without materially moving the implied prize as estimated by the new liquidity pool post execution of the order of the donated token.

Given the volatility of token markets, the rapidly changing market conditions, and the complexity of token markets in general, it is not reasonable to expect someone that is not a qualified appraiser to determine if sufficient market liquidity is available. The possible exceptions to this situation could be donations in either Bitcoin or Ethereum. These tokens typically have very deep liquidity and are considered to be sufficiently decentralized to qualify for the 170(f)(11) exception.

Significance of the donating party –
Markets not only consider buy and sell orders but also monitor large dispositions of tokens of founders, well known supporters or other individuals that have significance to the project connected to the donated token ("Person of Significance"). Large dispositions of tokens by a Person of Significance can indicate a lack of confidence in the project and markets can interpret this as a sell signal going forward. As such, for the purpose of determining if a qualified appraisal is necessary for an accurate value estimation, analyzing the donating party and its significance to the underlying project can be highly relevant.

Determination on applicability of 170(f)(11) exception for donated tokens -
Based on the specific facts and circumstances related to the donated property and the specific market characteristics of the token markets, we have determined the following:

Tokens that we believe should receive the 170(f)(11) exception are:

Stablecoins: "Stablecoins" are tokens that are typically pegged to the value of a commodity or currency, and thereby designed to have a stable value.

- Liquid tokens, where:
    - The donated property that has very deep liquidity and is considered to be sufficiently decentralized (e.g., Bitcoin or Ethereum).
    - Lockup restrictions have not been imposed on said tokens.
    - The donating party is not a Person of Significance.

Tokens that we believe should not receive the 170(f)(11) exception are:

- Liquid tokens that are thinly traded with minimal liquidity and are not sufficiently decentralized.
- Liquid tokens where lockup restrictions have been imposed on said tokens.

- Liquid tokens made by a Person of Significance.
- Illiquid tokens.
- Non-fungible tokens.

For the tokens that should not receive the 170(f)(11) exception, we have determined that the estimation of their respective fair market value is too complicated for the average taxpayer. Therefore, the fair market value of said tokens should be determined by means of obtaining a qualified appraisal.

Thank you for your consideration and for the opportunity to submit this response. We would be happy to provide further information and commentary if needed.

Respectfully Submitted,

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