November 13, 2023

Internal Revenue Service
1111 Constitution Avenue., NW
Washington, DC 20224

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

Ladies and Gentlemen,

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to submit comments on the proposed digital asset reporting regulations[2] implementing section 80603 of the Infrastructure Investment and Jobs Act of 2021 (the "IIJA") regarding gross proceeds and basis reporting by brokers for digital asset transactions.

SIFMA appreciates the substantial and thoughtful work of the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") in developing the proposed regulations. This letter comments on concerns that SIFMA's members have identified in the proposed regulations and provides recommendations for clearer and more administrable rules that address the unique nature of digital assets.

I. Executive Summary

As discussed in more detail in Section II, and to address the concerns raised in the proposed regulations, SIFMA makes the following recommendations:

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the US and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, DC, is the US regional member of the Global Financial Markets Association (GFMA).

[2] REG 122793-19, 88 Fed. Reg. 59576 (Aug. 29, 2023) (the "proposed regulations").

- Section II.A.: Limit the scope of digital assets to exclude certain types of assets that have no gain or loss, do not impede the government's drive to increase tax compliance with respect to digital asset flows, or are tied to an underlying non-digital asset or backed by any existing collateral or reserve (e.g., tokenized assets where the underlying assets are already subject to IRS Form 1099-B reporting should be excluded). Clarify the reporting of grantor trust interests in cases where the grantor trusts own digital assets. Finally, provide a safe harbor for brokers in determining the applicability of IRS Form 1099-B or IRS Form 1099-DA.

- Section II.B.: Clarify the application of "a digital representation of value" to exclude digital asset uses of distributed ledger technology and blockchains for internal ledger purposes because such uses are unlikely to create reportable sale transactions, and also exclude blockchain-based deposit accounts, because the transactions are identical to those taking place on legacy systems. Similarly, add a definition of "closed systems" that covers an exemption from reporting for digital assets transacting within permissioned systems. Finally, eliminate "any similar technology" from the definition of digital asset to properly exclude a number of technology improvements being implemented by financial institutions.

- Section II.C.: Update the various rules that govern interactions between brokers, such as the multiple broker rule, the cash on delivery rule, and the definition of exempt recipient to avoid duplicative reporting.

- Section II.D.: Narrow the definition of "digital asset middleman" to include only a person that provides facilitative services that directly effectuate the relevant sale.

- Section II.E.: Provide greater clarity on who is a digital asset broker and what qualifies as providing hosted wallet services, particularly in the context where multiple digital asset brokers are involved in effectuating the transactions.

- Section II.F.: Remove the requirement to report transaction IDs, digital asset addresses, and timestamps, as these data points do not communicate meaningful tax information. Allow brokers to use the time zone corresponding with their location of transacting for determining transaction dates.

- Section II.G.: Include a de minimis exception for digital asset information reporting requirements, similar to the reporting requirements for other IRS Forms 1099.

- Section II.H.: Exempt from backup withholding the sale of digital assets that are unable to be fractionalized where there is insufficient fiat currency in the account after the sale to cover the full amount of backup withholding that would otherwise be due. Provide greater clarity on what is a reasonable valuation method for digital assets and how to apply backup withholding where the broker cannot determine with reasonable accuracy the value of received digital assets.

- Section II.I.: Remove the new US indicia that are solely applicable to digital assets.

- Section II.J.: Defer the application of the regulations to controlled foreign corporation ("CFC") digital asset brokers and non-US digital asset brokers pending further progress on the announced

plan for the US to participate in the Organisation for Economic Co-operation and Development's ("OECD") Crypto-Asset Reporting Framework ("CARF").

- Section II.K.: Change the effective date for implementing the regulations to no earlier than at least 18 months after the issuance of the final regulations and begin on the following January 1, to coincide with the IRS information reporting cycle Correspondingly, modify the applicable date for a digital asset to qualify as a "covered security" to align with the effective date of the remainder of the regulations.

II. Detailed Comments

A. The definition of digital assets subject to reporting should be narrowed to exclude assets already subject to IRS Form 1099-B reporting or that do not present compliance risks.

SIFMA supports Treasury's goals of closing the tax gap while creating administrable rules that address the unique nature of digital assets without imposing unnecessary or duplicative reporting. The proposed regulations define a digital asset broadly as "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[.]" SIFMA recommends that the final regulations more precisely define "digital asset" to better achieve the stated policy objectives. Treasury should clarify that the definition of digital assets is intended to capture crypto-assets that are neither tied to an underlying non-digital asset nor backed by any existing collateral or reserves.[3]

As written, the definition of digital assets could create unnecessary reporting on transactions that may have no gain or loss (e.g., stablecoins) or otherwise do not impede the government's goal of increasing tax compliance with respect to digital asset transaction flows. The definitional complexity regarding the appropriate reporting for "dual classification assets" is broad enough to encompass assets that may qualify as specified securities under both the existing Internal Revenue Code ("IRC") section 6045[4] rules and the proposed digital asset rules. These dual classification assets cover all forms of tokenized assets—including traditional securities in tokenized form such as bonds, equities (including money market mutual funds), and other financial instruments.

The definition of digital assets should exclude tokenized assets that would otherwise be reported on IRS Forms 1099-B.

Treasury should appropriately limit the scope of what is considered a digital representation of value to exclude tokenized assets where the underlying assets are currently subject to the existing IRS Form 1099-B requirements. This exclusion will avoid capturing assets which are already subject to IRS information reporting. Brokers will be able to leverage existing IRS Form 1099-B processes to report

[3] In a similar context, when considering what is a digital asset, Treasury's Financial Crimes Enforcement Network ("FinCEN") has recently defined "virtual convertible currencies" as "a medium of exchange that either has an equivalent value as currency, or acts as a substitute for currency, but lacks legal tender status." See FinCEN Guidance FIN-2019-G001 and, for example, FinCEN Order RIN 1506-AB42. Narrowing the scope of the definition of digital assets in this manner for purposes of the final regulations would help avoid duplicative reporting requirements without creating any reporting gaps.
[4] Unless otherwise noted, all "section" references are to the IRC of 1986, as amended.

these transactions without requiring them to build new systems to include the additional data points contemplated on the IRS Form 1099-DA (for further discussion, see section II.F. addressing these additional data points). Doing so would achieve Treasury's policy objective of requiring reporting on crypto-asset transactions, without capturing transactions where the substantive tax treatment of the transaction involves non-digital assets subject to existing reporting rules.

Accordingly, the definition of digital assets should explicitly exempt tokenized assets, whether digitally native to the blockchain or account based, that are tied to the value of, or represent, non-digital assets. In account-based systems, the blockchain is simply used to record the change of ownership of an asset. In this type of system, a token may be used to represent a claim of ownership to an underlying asset, but that token does not represent the asset itself. In the future, tokens may also be natively issued where the clearing and settling occurs on chain and the token itself is the security. Regardless, current law adequately imposes reporting requirements on brokers for these types of transactions. This exemption would ensure that the intended transactions and assets do not escape reporting requirements, while leaving existing, well-functioning reporting requirements intact. Additionally, without this exemption, a given security could have different reporting depending on whether such security is in tokenized form, which could result in taxpayer confusion.

The requested exclusion would also align with 12 C.F.R. Part 208 and the policy statement in section 9(13) of the Federal Reserve Act, which states that the term ''crypto-assets'' refers to digital assets issued using distributed ledger technology and cryptographic techniques (for example, bitcoin and ether), but does not include such assets to the extent they are more appropriately categorized within a recognized, traditional asset class (for example, securities with an effective registration statement filed under the Securities Act of 1933 that are issued, stored, or transferred through the system of a regulated clearing agency and in compliance with all applicable federal and state securities laws).

Additional guidance should be provided to clarify the appropriate reporting of certain grantor trust interests.

The proposed rules do not coordinate new digital asset reporting requirements with existing rules for reporting securities interests that are treated as widely held fixed investment trusts ("WHFITs"), including exchange traded funds ("ETFs") structured as grantor trusts for federal income tax purposes. As grantor trusts, holders of WHFIT and similar interests are treated as directly holding the underlying assets for federal income tax purposes. Where a grantor trust holds digital assets, the proposed rules may be interpreted to read that the sale of a non-tokenized grantor trust interest may be reportable on an IRS Form 1099-B or, alternatively, as a sale of the underlying digital asset requiring an IRS Form 1099-DA. Where a trust sells the digital assets it is holding, the rules may also be interpreted to require a broker to file IRS Form 1099-DA with the IRS reporting that digital asset sale, the trust sales proceeds for which will be captured on the supplemental tax information statement furnished to the trust interest holders ("TIH") as required under the WHFIT reporting rules.[5] The proposed rules include an example of a fund holding digital assets, clarifying that the transfer of the fund interest would not be reportable on an IRS Form 1099-DA.[6] Treasury should include similar clarifying guidance, in the form of an example or otherwise, to confirm that the sale of interests in WHFITs remain reportable on IRS Form 1099-B, even where such structure holds digital assets, and providing that any proceeds associated with

[5] See Treas. Reg. § 1.671-5(e).
[6] Prop. Treas. Reg. § 1.6045-1(b)(27), Example 27.

the sale of underlying digital assets by the WHFIT should be reported by filing Form 1099-B reporting the proceed amounts that will be reflected on the tax information statement furnished to the TIH.

A safe harbor should be available to brokers reasonably determining the applicability of IRS Form 1099-B or IRS Form 1099-DA to digital assets that represent underlying non-digital assets.

Given the complexity associated with the determinations described above, Treasury should also provide a safe harbor for brokers who have made a reasonable determination that a digital asset transaction should be reported on an IRS Form 1099-B as opposed to an IRS Form 1099-DA, or vice versa, but that determination later turns out to be incorrect, so long as the transaction was reported on one of those two forms.

Certain stablecoins should be excluded from the definition of digital asset.

Fiat-backed, reserve-backed stablecoins that are regulated by a federal, state, or local body should also be excluded from the definition of digital asset. Such stablecoins function like deposit tokens (discussed in section II.B. below) and are used for similar purposes. These stablecoins do not pose the price fluctuation risk that algorithmic-based stablecoins not supported by fiat reserves may pose. As a result, the vast majority of stablecoin transactions will generate no material gain or loss. The negligible tax compliance benefit from reporting is thus outweighed by the enormous number of returns that would result if stablecoins are not carved out.[7] The voluminous reporting of digital assets as a whole, anticipated to reach 8 billion returns initially on an annual basis according to the IRS, creates a significant burden on digital asset brokers to file and furnish the forms, the form recipients to intake and account for the information on their returns, and the IRS to process the information to determine tax relevance.[8] This burden would be meaningfully reduced by the exclusion of appropriately-regulated fiat-backed, reserve-backed stablecoins from the definition of digital assets for section 6045 purposes.

SIFMA Recommendations:

- Limit the scope of "a digital representation of value" to exclude tokenized assets that represent non-digital securities or commodities from the definition of digital assets, and also exclude assets that do not pose a compliance risk.
- Clarify the appropriate reporting of WHFITs, ETFs, and other similar grantor trusts that hold digital assets.
- Provide a safe harbor for brokers in determining IRS Form 1099-B and IRS Form 1099-DA applicability.
- Exclude fiat-backed, reserve-backed stablecoins that are regulated by a federal, state, or local body.

B. The definition of digital assets should exclude internal ledgering activity using distributed-ledger technology; include a definition of "closed system" virtual assets that are exempt, inclusive of activities within permissioned blockchains; and remove "or similar technology" from the definition.

[7] See also section II.G. below for the recommendation for a de minimis threshold to exclude any gain or loss from stablecoins.

[8] "Our estimate right now is that we will ingest — don't fall off your chairs — 8 billion information returns, and that's just the in-development Form 1099-DA." Available at: https://www.taxnotes.com/tax-notes-today-federal/tax-system-administration/irs-prepping-least-8-billion-crypto-information-returns/2023/10/26/7hhdp.

In the preamble to the proposed regulations, Treasury requests comments on whether the definition of digital assets is appropriately defined to exclude uses of distributed ledger technology ("DLT") for internal ledger purposes where such uses are unlikely to create reportable sale transactions. While the preamble acknowledges that the definition is not intended to apply in such cases, there is no regulatory language supporting this intent. In the case of tokenized assets used for internal ledger purposes, the use of blockchain-based technology should not change the underlying reporting requirements for the activity of well-regulated and capitalized financial institutions. Tokenization does not change the status of the underlying instrument itself—it simply modernizes and creates backend systems infrastructure efficiencies. This use of blockchain technology for efficiency purposes should be excluded from the definition of a digital asset, notwithstanding that these efficiencies may be executed on a cryptographically secured distributed ledger. Treasury should appropriately limit the scope of what is considered a digital representation of value to exclude these types of tokenized assets, whether digitally native (i.e., directly associated to a blockchain) or account based (i.e., existing in an internal ledger).

Traditional assets that are recorded using DLT on a financial institution's internal, permissioned book and records system should be excluded from the definition of digital asset.

Treasury should also exclude traditional instruments recorded on an internal, permissioned books and records system based upon blockchain or DLT from the definition of "digital asset." The design philosophy of such a system does not transform such traditional assets (e.g., securities and cash) into a crypto-asset or digital asset. The securities recorded in this manner are still held by the financial institution in its omnibus account at the relevant central securities depository, subcustodian, or registrar, and the securities' legal properties and risks have not changed. The financial institution's obligation to its customer remains to safeguard and eventually deliver the securities as instructed by its customer, not any crypto-asset or digital asset.

Similarly, Treasury should make clear that blockchain-based deposit accounts, whether account-based or token-based, are excluded from the definition of digital asset under this proposal. Blockchain-based deposits, which are in early stages of research and development, are deposit claims against a licensed depository institution for stated amounts recorded on blockchain. They are economic equivalents of existing deposits recorded in a novel form used for payment, to settle trades between digital assets, and generally act as a store of value and means of exchange on blockchain ledgers. The nature and fundamentals of the transaction that would incorporate blockchain based deposits are identical to those taking place on legacy systems and should not be subject to additional requirements.

While from a purely technological perspective, the book entries recorded on such a system may be tokens, these book entry tokens have the same functional equivalent and legal properties as any other digital book entry on a traditional system: they cannot leave the internal systems of the financial institution, have no intrinsic value, and are meaningless and valueless outside the financial institution's books and records. In addition to stifling innovation by financial institutions with this new technology, without this distinction in the definition of "digital asset," the adoption[9] or planned adoption[10] of

[9] See, *e.g., HKEX to Introduce Synapse, a Settlement Acceleration Platform to Stock Connect*, HKEX, November 24, 2020. Available at: https://www.hkex.com.hk/News/News-Release/2020/201124news?sc_lang=en. See, *e.g., Deutsche Börse Launches Next-Generation Digital Post-Trade Platform*, Deutsche Börse Group, October 6, 2021. Available at: https://www.deutsche-boerse.com/dbg-en/media/press-releases/Deutsche-B-rse-launches-next-generation-digital-post-trade-platform--2800582.

[10] See, *e.g., DTCC'S Project on Platform Now Live in Parallel Production Environment, Processing Over 100,000*

blockchain or DLT based settlement systems by major central securities depositories would cause otherwise traditional securities to be misclassified as digital assets.

A regulatory definition of "closed system" should be provided that includes the use of permissioned blockchains.

The term "closed systems" should be defined in the text of the final regulations, and the definition should include the use of permissioned blockchains operated by regulated financial institutions. The preamble to the proposed regulations states that the definition of digital assets is not intended to apply to other types of virtual assets including those that exist only in closed systems, specifically citing the example of video game tokens that cannot travel outside of the system. However, there are other permissioned systems being built throughout the financial services ecosystem which incorporate centralized controls and currently limit the digital asset's ability to travel outside that particular ecosystem that should be specifically included through the regulatory text.

Treasury's intent seems to be ensuring that there are parties accountable to capture and report crypto-asset transactions that travel on public, permissionless blockchains—blockchains that permit anyone access—in contrast to permissioned blockchains—blockchains with limited access to specific users. There may be tax compliance risks associated with activity on public, permissionless blockchains; those same risks are not equivalent for tokenized, non-digital assets traveling on permissioned blockchains operated by regulated financial institutions.

In permissioned systems, a centralized party or administrator controls network participation, access, governance, and all other features. These permissioned systems are commonly referred to as closed looped systems, providing enhanced levels of accountability, security, and compliance within existing legal and regulatory requirements, such as KYC and AML mandates. Additionally, the development, adoption, and operation of internal books and records systems are subject to the supervisory oversight of the relevant regulator of the financial institution. Treasury should explicitly specify that digital assets transacting within these systems should be exempt from the final rules. Transactions of digital assets of this nature will already be subject to the existing reporting requirements. With participation limited to supervised institutions and those that have passed robust due diligence checks, each party's responsibility for reporting is already clearly established.

As of now these assets largely do not travel outside of a single permissioned ecosystem. They may, however, in the future be able to travel across other blockchains with similar security and compliance features. Interoperability between permissioned networks is fundamental to the technology reaching its full potential and scaling to mass adoption. Without interoperability, assets can be isolated within singular permissioned networks, creating market illiquidity. Digital asset transactions of this nature should also be exempt from the proposal because, while the infrastructure empowering the transaction of the asset may have changed, the nature and fundamentals of the transaction, including the parties to the transaction, are identical to those taking place on legacy systems and would similarly already be subject to the existing reporting requirements. Understanding the importance of appropriately framing the exemption for "closed systems," SIFMA members would be pleased to discuss the potential universe of exempted systems further.

Transactions per Day on DLT, DTCC, August 22, 2022. Available at: https://www.dtcc.com/news/2022/august/22/project-ion.

The phrase "any similar technology" should be removed from the definition of digital asset.

The phrase "or any similar technology"[11] creates a broad and unclear scope that could have implications on a number of technology improvements being implemented by financial institutions. Use cases include leveraging of privacy-preserving technology, cryptography, distributed database systems, distributed network systems, or other evolving technical capabilities for, as an example, creating efficiencies in internal bookkeeping systems. Given the nature of other expansive definitions within the proposed regulations, it may be difficult to gauge what types of transactions are included, or intended to be included, by this phrase without further guidance and clarity. Treasury should remove the phrase "or any similar technology," as doing so will be consistent with the stated policy objectives of providing clarity and avoiding ambiguity to ensure compliance. Should Treasury identify other transactions that it intends to subject to reporting, it can always bring such transactions in scope in the future with additional guidance.

SIFMA Recommendations:

- Exclude traditional assets recorded using distributed ledger technology or similar technology on a financial institution's internal, permissioned book and records system from the definition of digital asset.
- Provide a regulatory definition of "closed system" that includes the use of permissioned blockchains.
- Remove "any similar technology" from the definition of digital asset.

C. To avoid duplicative reporting, update the various rules that govern interactions between brokers, such as the definition of exempt recipient, the multiple broker rule, and the cash on delivery rule.

Under the current rules, no information return is required (1) with respect to a sale effected for a customer that is an exempt recipient or (2) if a broker is instructed to initiate a sale by certain exempt recipients. As currently drafted, the proposed regulations do not include digital asset brokers, which include digital asset middlemen and digital asset payment processors, as exempt recipients. Absent a change, brokers will likely issue unnecessary Forms 1099-DA to parties transacting in their own name on behalf of customers (e.g., a digital asset broker effectuating a sale on behalf of its customer through another digital asset broker). Furthermore, absent a change, two or more brokers could be required to file an information return on the same transaction, resulting in either (i) a taxpayer reporting the income more than once (and overpaying taxes), or (ii) the IRS unnecessarily challenging the taxpayer reporting a single transaction when multiple Forms 1099 are produced. For the same reason, two brokers may subject the same transaction to backup withholding.

For example, consider a bank that offers to process payments for goods and services in digital assets as a third party settlement organization ("TPSO") for customers and merchants. In this capacity, the bank contracts with and submits instructions to a third-party service provider who is a digital asset broker. The third-party service provider processes the payment in the form of digital assets from the customer, converting the digital assets into fiat currency, and settles the funds with the bank. The bank subsequently settles the fiat currency to the merchant.

[11] While this phrase is included in the definition of a digital asset that is a covered security in section 6045(g)(3)(D), it leaves the inclusion of such "similar technology" as a reporting matter to Treasury's discretion.

Under the proposed rules, both the bank and the third-party service provider, as digital asset brokers, could interpret the rules to impose reporting obligations on the conversion of digital assets to fiat currency. Absent inclusion of a digital asset broker as an exempt recipient and one of the listed exempt recipients in the multiple broker rule, the bank would not be permitted to rely on the third-party service provider's representation that it will report to the customer. In this and other situations where multiple digital asset brokers are involved with effecting sales on behalf of a customer, both brokers may be required to report on the transaction under the proposed rules, resulting in customers receiving multiple IRS Forms 1099-DA on the same disposition.

The multiple broker rule should be updated to extend to the digital asset context.

To address this and similar situations, Treasury should update Treas. Reg. § 1.6045-1©(3)(i)(B) to include persons qualifying as digital asset brokers as exempt recipients. Moreover, Treas. Reg. § 1.6045-1(c)(3)(iii) should be updated to extend the existing multiple broker rule to the digital asset context. The regulations should provide that if a broker is instructed to initiate a sale by a party that may be treated as a digital asset broker, no return of information would be required with respect to the sale by the first-mentioned broker. A corresponding rule should provide that a broker may, absent actual knowledge to the contrary, treat the party so instructing as a digital asset broker that will make a return of information on the sale if the first-mentioned broker obtains a written statement that the instructing party is a digital asset broker. This statement could be provided on a revised IRS Form W-9 or IRS Form W-8 that contains an exemption code or status for digital asset brokers. Additionally, in the absence of such statement, the first-mentioned broker should be permitted to reasonably determine that such party has such status based on such party's name or other information that is publicly available or in the possession of the first-mentioned broker.

Digital asset brokers should be allowed to contract for the responsibility to file Forms 1099-DA.

Certain information reporting provisions of the IRC allow parties to contract between them about who should file the relevant IRS Form 1099 where the obligation may belong to multiple parties. IRS Form 1099-MISC reporting allows parties that have the obligation to report to agree in writing that one of them will report the payment. A party with the obligation to report may designate by contract another party to issue IRS Forms 1099-K. Treasury should add a rule that would allow digital asset brokers to contract with one another to establish who is responsible among them for IRS Form 1099-DA reporting where multiple brokers may have the obligation. Brokers could so agree when the multiple broker rule does not resolve which party has the reporting obligation or as a conscious departure from the multiple broker rule.

The cash on delivery rule should be modified to apply to digital assets.

To address a related issue, Treas. Reg. § 1.6045-1(c)(3)(iv) (regarding cash on delivery transactions) should be modified to apply to digital assets, and for sales of digital assets, to include the receipt of other property (including digital assets) against delivery of the digital assets sold. Any third party that receives the gross proceeds from the sale against delivery of the digital assets sold would, by definition under Prop. Treas. Reg. §§ 1.6045-1(a)(1) and (a)(10), be a digital asset broker that is required to make a return of information on the sale and thus, duplicative reporting would arise absent extension of this

rule to digital asset sales.

Rules requiring a broker to obtain proof that the instructing party in Prop. Treas. Reg. § 1.6045-1(c)(3)(iii) or the third party in Prop. Treas. Reg. § 1.6045-1(c)(3)(iv) is indeed a digital asset broker that will make a return of information on the sale would be disproportionate to any absence of information reporting that would arise from the failure to obtain such proof, particularly considering the expansive definition of digital asset brokers in the proposed regulations. The proposals above would address duplicative reporting that both Treasury and industry want to avoid. Without these amendments, taxpayers will need to understand and reconcile multiple IRS Forms 1099-DA for the same transaction, including upon audit. Given the exponential increase in the number of forms that will be filed under the new rules, as digital asset transactions become more common, this will create an inordinate amount of taxpayer confusion and frustration without the changes outlined above.

SIFMA Recommendations:

- Extend the multiple broker rule to digital asset brokers, including allowing brokers to represent their status as brokers or to "eyeball" other brokers.
- Allow digital asset brokers to contract for IRS Form 1099-DA responsibility.
- Modify the cash on delivery rule to apply to digital assets.

D. The definition of "digital asset middleman" should be narrowed to only include a person that provides a facilitative service that directly effects the sale.

With respect to a sale of digital assets, the term "effect" now includes acting as a "digital asset middleman" for a party in a sale. Digital asset middleman is broadly defined to include 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 (1) the identity of the party that makes the sale, and (2) the nature of the transaction potentially giving rise to gross proceeds from the sale.

A facilitative service includes "the provision of a service that directly or indirectly effectuates a sale of digital assets." Examples of a facilitative service set forth in the proposed rules include providing a party in the sale with access to (a) an automatically executing contract or protocol; (b) digital asset trading platforms; (c) order matching services; (d) market making functions to offer buy and sell prices; and (e) escrow or escrow-like services. The proposed rules also provide examples of persons that would not be considered digital asset middleman under this definition (e.g., persons that only act as miners or validators, sellers of hardware and software wallets that permit persons to control private keys, merchants that accept digital assets directly on a sale of their own goods or services, or non-fungible token ("NFT") creators who create and sell their own NFTs).

While the examples set forth in the proposed rules are helpful, SIFMA members remain concerned that the definition of digital asset middleman is overly broad and could bring into scope financial service providers that are not effecting a sale directly but nonetheless have knowledge about the identity of the party making the sale and the nature of the transactions and the gross proceeds amount. For example, a fund administrator providing ancillary administrative services—such as calculating a client's entitlement in a sale of a digital asset or reconciling a fund's book of record against the custodian's records—may not be in the chain of proceeds settlement. This fund administrator would know the identity of the party and the gross proceeds of the transaction but is not directly facilitating the sale. To address such cases, Treasury should narrow the definition of digital asset middleman to only include a

person that provides a facilitative service that *directly* effects the sale.

SIFMA Recommendation:

- Narrow the definition of "digital asset middleman" to only include a person that provides a facilitative service that directly effects the sale.

E. Further explanation of who is a broker providing hosted wallet services is necessary where two or more parties could be considered as effectuating transactions on behalf of a customer.

The proposed regulations amend the definition of "covered security" to include digital assets in instances where the digital assets are acquired in a customer's account by a broker providing hosted wallet services. However, the rules do not clarify how to determine when a party qualifies as a "broker providing hosted wallet services." This ambiguity is most apparent where two or more parties are effectuating transactions in digital assets on behalf of a customer, where one party effects sales and another party custodies private keys.

As an example, assume a customer interacts directly with a digital asset exchange to purchase a digital asset. The exchange directs the customer to a custodial wallet for custody of the customer's private keys. This wallet structure is maintained by a third-party wallet provider, the identity of which in some cases may be known by the customer but in other cases may appear under the branding of the digital asset exchange (i.e., white labeled). In either case, the wallet provider may be in the position to know both the identity of the customer and the nature of the transaction potentially giving rise to basis tracking of the purchase (and therefore would be considered a digital asset middleman providing facilitative services). In such case, it is unclear whether the wallet provider, as the party maintaining a hosted wallet in which private keys are custodied, or whether the exchange, as the party directing the customer to this wallet structure, is the party providing hosted wallet services.

While there are limited examples in the proposed regulations of digital asset brokers providing hosted wallet services, these examples do not illustrate what it means to provide hosted wallet services, particularly where multiple digital asset brokers and middlemen are involved in effectuating the transactions. This could result in various interpretations, with multiple parties tracking and reporting cost basis or, alternatively, no party tracking cost basis as one party is involved in the purchase and the other is involved in providing custody services on an ongoing basis. Which broker is better positioned to track basis could depend on, among other things, whether the wallet service provider is in privity with the purchaser.

The final rules should further define the meaning of "providing hosted wallet services" to resolve these interpretive difficulties. Understanding the importance of appropriately framing the covered security reporting requirements, SIFMA members would be pleased to discuss different permutations involving multiple digital asset brokers and recommend which broker is in a better position to maintain basis in each variation.

SIFMA Recommendation:

- Provide greater clarity with a definition of what qualifies as providing hosted wallet services, exempting digital asset brokers who only provide an interface and are not custodying the customer's private keys.

F. Treasury should not require reporting of certain information on the IRS Form 1099-DA and should allow brokers to use the appropriate time zone for a transaction.

Information to be reported on digital assets (i.e., on IRS Form 1099-DA) should only differ from the information provided on the existing IRS Form 1099-B when there is a compelling reason for the difference. As currently drafted, the information required to be reported under the proposed regulations is overly broad. Some information is logical and reasonable to request, such as whether the consideration for the sale was cash or non-cash. Other information presents privacy and security concerns while failing to further tax compliance objectives.

Transaction IDs and digital asset addresses should not be required information.

Treasury should not require reporting of transaction IDs or digital asset addresses (i.e., wallet addresses). Although these data points are publicly available on the blockchain, they are not currently linked to personal information of any taxpayer. Linking this information would allow a taxpayer's transaction history to be publicly available, creating significant privacy concerns for customers (e.g., if there is an IRS data breach and the information is made public). Brokers generally are not required to provide this same level of detail for IRS Form 1099-B reporting (e.g., account numbers). Further, transactional information that can be obtained from viewing a customer's wallet activity does not inherently communicate tax relevant information (e.g., in the case of inheritance).

Additionally, the use of omnibus account/wallet structures (common throughout the digital assets industry) impacts the IRS's intended use of the wallet address data. Providing wallet and transaction data in the proposed manner will primarily provide information on the omnibus wallets of the broker itself, not additional data on the taxpayer. Digital asset brokers may route client trades through multiple separate omnibus wallets to maintain liquidity and improve execution.

Accordingly, provision of transaction IDs and wallet addresses does not increase the integrity of the data reported (i.e., gross proceeds and basis), and would seem only to serve an investigatory purpose outside the scope of standard information reporting. The IRS could still request this information if needed during an enforcement action, based on its expected use in an investigation.

Timestamps should not be required information. However, if timestamps are required, a 24-hour clock should be used.

Treasury should not require the reporting of timestamps, as SIFMA members believe the burden of reporting this information outweighs any benefit to tax compliance efforts. Requiring reporting in Coordinated Universal Time ("UTC") would require revamping existing systems that record transactions in the traditional finance space, and it is unclear why this information is necessary. Reporting in UTC is inconsistent with traditional brokerage and despite the volatility of some digital assets, different times within a day may not correspond to a material change in price. SIFMA also notes that brokers using omnibus wallets will never have clear one-to-one action in the blockchain for the activity of a specific client, and thus the provision of the timestamp will not allow the IRS to find that transaction on the blockchain.

In the case that Treasury continues to require reporting of timestamps, and in response to Treasury and the IRS's question regarding whether it would be less burdensome to report the time using a 24-hour clock and the extent to which all brokers should be required to use the same 12-hour or 24-hour clock for these purposes, SIFMA suggests that a 24-hour clock is preferable. Designating AM or PM is an additional data point for which internal systems would have to code. Therefore, a 24-hour clock would reduce the burden on new systems infrastructure.

Brokers should be able to use the time zone corresponding with their location of transacting for determining transaction dates.

Treasury and the IRS indicated that the time standard should correspond to any convention for time generally used by the industry. SIFMA members currently use the time zone corresponding to the location of the broker effecting the sale. Maintaining this standard is important in situations where using a different time zone can result in different reporting outcomes. For example, a broker may be effecting a sale that, in their time zone, is on December 31, while in UTC that time would be dated January 1 of the following year. An alternative proposal to use the time zone of the customer is not technologically or operationally feasible, especially with existing platforms that are in place to comply with current law. Attempts to determine customer location on a transaction basis would likely result in more instances of misreported dates and times. If that determination is made using IP address information, customer location can be rendered inaccurate by use of virtual private networks ("VPNs"), as discussed further in section II.I., and, in cases where trade orders are received through analog means, customer location cannot be determined with any level of certainty. Allowing each broker to determine the time zone based on its location will eliminate misreporting of the month or year of the transaction and will keep time zone reporting consistency on customer returns, putting them in the best position to appropriately capture gain/loss information on their returns. Whether or not Treasury continues to require reporting of timestamps, the rules should maintain the industry standard of reporting based on the time zone of the relevant broker.

SIFMA Recommendations:

- Remove requirement to report transaction IDs or digital asset addresses.
- Remove requirement to in UTC and to report timestamps. In the alternative, if they can be shown to be useful, require timestamps to be reported on a 24-hour clock.
- Allow brokers to use the time zone corresponding with their location of transacting for determining transaction dates.

G. Treasury should not require reporting of transactions (1) of digital assets with gross proceeds or gain/loss below a de minimis amount and (2) in stablecoins.

The IRC currently does not require brokers to issue IRS Forms 1099-B for sales of fractional shares of stock if the gross proceeds are less than $20; payors to issue IRS Forms 1099-MISC, 1099-DIV, and 1099-INT for payments of royalties, dividends, and interest of less than $10; payors to issue IRS Forms 1099-MISC for payments of other FDAP income for payments of less than $600; or TPSOs to issue IRS Forms 1099-K for payments made in settlement of third party network transactions for gross amounts of

less than $600.

Reporting for certain de minimis amounts of gross proceeds or gain/loss should be excluded.

Consistent with the foregoing precedent, the final rules should include a de minimis threshold for digital asset information reporting requirements that brokers could choose to apply. Absent a de minimis exception, taxpayers and the government will receive excessive amounts of information reporting without significantly improving tax compliance.[12] Including a de minimis threshold appropriately balances the burden on the industry of producing extraordinary amounts of information reporting with the relatively low benefit to the government from such reporting.

As an example of how the de minimis threshold might be structured, for sales of covered securities, transactions with gain or loss of less than $100 would not be reportable on an IRS Form 1099-DA. If the cost basis is unavailable or the security is not covered, the transaction would not be reportable: (a) if the gross proceeds are less than $100; or (b) if the lot originated with the selling broker and that broker has actual knowledge that the gain or loss is less than $100. A transaction to which *any* backup withholding applies would be reportable regardless of the gain or loss from the transaction.

Reporting for transactions in stablecoins should be exempted.

As discussed in Section II.A. above, a separate exemption from reporting should be applied to transactions in stablecoins given that the vast majority of such transactions will not generate material gain or loss.

SIFMA Recommendations:

- Exclude reporting for certain de minimis amounts of gross proceeds.
- Exempt transactions in stablecoins from reporting.

H. Backup withholding should only be required where the digital asset sold can be fractionalized, and greater clarity on valuing digital assets is needed.

For digital assets, the amount subject to backup withholding generally is the total amount in US dollars paid or credited to the customer plus the fair market value ("FMV") of any property or services received. FMV is measured at the date and time the transaction was effected, using a reasonable valuation method. Backup withholding is required on the full amount of the gross proceeds, even if the payment is made wholly in property other than cash, such as digital assets.[13] However, backup withholding on transactions that have no cash component may be problematic in the digital asset space.

Certain digital assets, specifically cryptocurrencies and NFTs, present unique challenges regarding

[12] As previously noted, the IRS has recently acknowledged that it expects to receive 8 billion IRS Forms 1099-DA which it has questioned its ability to process using current technology. See note 8 above.

[13] While the existing rules allow a broker to withhold from an alternative source of cash held by the customer with the broker, if no such source is available by the close of the fourth calendar year after the obligation arose, brokers will have to either liquidate some of the held assets (if they are still in custody and the account terms and conditions so allow) or otherwise be responsible for the backup withholding liability from the brokers' own funds. *See* Treas. Reg. § 31.3406(h)-2(b).

market value. To further complicate matters, digital assets often are exchanged for other digital assets, and, in these digital asset swap contexts, the digital asset received may not be able to be fractionalized. For customers who only use a broker for digital asset transactions not involving any fiat currency, the accounts may never have cash available for withholding debits, necessitating liquidation of some of the customer's digital assets to satisfy backup withholding liability. Such volatility would make the sale of digital assets to satisfy withholding difficult, with the withheld amount frequently being more or less than the required remittance once liquidated.

Digital assets that are unable to be fractionalized should be exempted from backup withholding.

Digital assets that cannot be fractionalized include NFTs and certain tokenized assets such as tokenized financial instruments. Where these digital assets are received as proceeds by a customer subject to backup withholding, a broker is forced to either sell the asset, which could be especially contentious with the customer where the asset cannot be replicated or repurchased (notwithstanding that the broker may have the legal right to sell), or be responsible for the withholding liability if customer has no other assets with that broker. This is in contrast to a cryptocurrency where a portion of the digital asset can be liquidated to generate cash for deposit to satisfy any withholding liability. Accordingly, the final regulations should include an exemption from backup withholding on the sale of digital assets that are unable to be fractionalized where there is insufficient fiat currency in the account after the sale to cover the full amount of backup withholding that would otherwise be due. This exemption avoids the volatility risk to the broker and removes the need for forced liquidation for this limited class of digital assets. Such a rule would be similar to those that apply under other regulations that exempt withholding when cash is not available.[14]

Clarification is needed generally on reasonable valuation methods and on what a broker must do to "reasonably" determine that the value of a digital asset cannot be determined with reasonable accuracy, and how to backup withhold where the value cannot be determined.

The proposed regulations state that a broker must determine the FMV of a digital asset by either (1) performing its own valuations or (2) relying on valuations performed by a "digital asset data aggregator," provided such valuations use a "reasonable valuation method for digital assets." Where the FMV of digital assets that are received in exchange for other digital assets cannot be determined with reasonable accuracy, the FMV of the digital assets received should be the FMV of the digital assets exchanged. If the broker reasonably determines that neither the value of the received digital assets nor the value of the transferred digital assets can be determined with reasonable accuracy, the broker must report that the received digital assets have an undeterminable value and treat the FMV of the received digital assets as zero.

Some clarity is provided in the proposed rules defining a reasonable valuation method, including an example of a valuation method that is not reasonable. This guidance is not sufficiently clear to give brokers comfort on instances where they are permitted to backup withhold using their own valuation methods, including exempting a transaction from backup withholding where the broker has estimated

[14] See section 3402(j) (regarding noncash remuneration to retail commission salesman); Temp. Treas. Reg. § 35.3405-1T, Q&A A-29 (providing that, when an employee receives a payment from a qualified plan that includes employer securities, the amount subject to withholding is the cash plus FMV of other assets, but does not include the value of employer securities which would otherwise have to be liquidated to generate required withholding).

that the digital assets received have an undeterminable value. Therefore, Treasury should further clarify the reasonable valuation method rules and should explicitly exempt a broker from backup withholding liability where a broker has determined in good faith that a digital asset has a zero value (i.e., an undeterminable value).

SIFMA Recommendations:

- Exempt digital assets that are unable to be fractionalized from backup withholding where there is insufficient fiat currency in the account after the sale to cover the full amount of backup withholding that would otherwise be due.
- Clarify what a reasonable valuation method is, what a broker must do to "reasonably" determine that the value of a digital asset cannot be determined with reasonable accuracy, and how a broker should backup withhold where the value cannot be determined.

I. The existing US indicia rules should be extended to digital asset transactions and the proposed new US indicia relevant to digital assets should be removed.

SIFMA is concerned about the implementation and operational complexities caused by the introduction of new US indicia in the proposed rules as well as by the presumption rules for digital assets that differ from the existing rules. In general, upon the identification of US indicia, brokers will be required to obtain additional documentation from a customer or otherwise treat such customer's transactions as reportable.

Most notably, the proposed rules have updated the US indicia list for digital assets to add:

> (1) a customer's communication with the broker using a device that the broker has associated with an Internet Protocol ("IP") address or other electronic address indicating a location within the United States (the "US IP indicium");
> (2) cash transfers where the customer's account is linked to a bank or financial account maintained within the United States (the "US cash transfer" indicium); and
> (3) certain transactions in a customer's account to or from a second digital asset broker that the first broker knows or has reason to know is organized within the United States (the "US digital asset broker" indicium).

Absent a change to the proposed rules, US digital asset brokers and non-US digital asset brokers (including CFCs) operating as money services businesses ("MSBs") must now create new systems, processes, and procedures—in many cases in parallel to existing systems and processes—to validate withholding certificates documenting customer foreign status and to monitor on an ongoing basis the presence of any new US indicia. Further, CFC and non-US digital asset brokers that are not MSBs must, in the absence of documentation, treat customers that are individuals as US persons subject to reporting if any of the above US indicia is present. Finally, non-US digital asset brokers not operating as MSBs must examine each sale of a digital asset for the new US indicia, as the presence of US indicia will determine whether the sale is treated as being effected within the US, requiring reporting unless the customer is determined to be an exempt foreign person.

Treasury should eliminate the new US indicia that are solely applicable to digital assets as they do not provide a way to identify US taxpayers accurately. For example, with respect to the US IP indicium, the location associated with an IP address is easily masked by VPNs, many of which are accessible for free online, making it unlikely that a US person looking to avoid tax compliance will be identified through

monitoring of this indicium.

For the US cash transfer indicium, the rule appears to require all US digital asset brokers that are existing securities brokers to cure *any* Form W-8 provided for digital asset transactions simply because the broker maintains US financial accounts, effectively negating the utility of the certification of non-US status under penalties of perjury on Forms W-8.

For the US digital asset broker indicium, the rules do not provide a clear standard for a digital asset broker to use to determine that another party (to or from whom digital assets are being transferred, or to whom the customer's account is linked) is in fact a digital asset broker and such broker is organized in the US. By imposing a reason to know standard for this indicium, transferring brokers are placed in an arbitrary position of having to determine another party's status as a digital asset broker (or not) and that party's jurisdiction of organization.[15] Also, a client can be correctly registered as a non-US person at two US brokers, yet the rules will require reclassification of the client as a US person (and re-curing of the US indicia) when the client transfers assets from one US broker to the other.

Given the limited benefit of the new US indicia, the final regulations should apply the current indicia rules in place for broker transactions to include those in digital assets. This would avoid the burden on existing brokers of having to create parallel systems, processes, and procedures for document validation and indicia monitoring, one for digital assets and another for traditional securities transactions.

SIFMA Recommendation:

- Extend the existing US indicia to digital asset brokers and eliminate the new US indicia solely applicable to digital asset transactions.

J. Treasury should defer any application of the regulations to brokers located outside the US.

Treasury should defer any application of the regulations to CFC digital asset brokers and non-US digital asset brokers, pending further progress on the announced plan for the US to participate in CARF. The current Treasury guidance plan[16] indicates that the broker reporting regulations will be further amended to require the collection of information regarding digital asset transactions of non-US persons, which the US would presumably then exchange with other jurisdictions participating in CARF. Once the US has negotiated its participation in CARF as announced, brokers in non-US participating jurisdictions would provide information to Treasury on US persons through CARF, thus obviating the need to apply the proposed regulations to digital asset brokers outside the US.

Non-US and CFC digital asset brokers (whether or not such brokers are MSBs) should be exempt from reporting under the proposed regulations once CARF is in effect and should not be required to develop systems and processes to satisfy their obligations as digital asset brokers under two overlapping

[15] SIFMA acknowledges that in section II.C. above, it is seeking for brokers to be able to reasonably determine if another broker instructing a sale is a digital asset broker, such that the broker can treat the instructing broker as an exempt recipient and be relieved of the requirement to report. SIFMA does not believe that the request here is inconsistent. For example, a broker could reasonably choose to make the determination that an instructing broker that it regularly interacts with is a digital asset broker that is compliant with these reporting requirements. On the other hand, for a broker effecting a sale of a digital asset, anywhere in the world, to have to analyze every transaction of its customer with other third parties to ascertain that third party's business and country of organization would seem overly burdensome and extraterritorial in reach.

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

regimes. Implementing the proposed rules and CARF concurrently would be a monumental task for a regime that will be short-lived once the US participation in CARF is in place.

In addition to the benefit of reducing unnecessary operational complexity, a delay of the section 6045 rules for CFC and non-US digital asset brokers would avoid the difficulties of imposing rules extraterritorially. Treasury and IRS may not be able to impose reporting requirements and enforce compliance on non-US entities with only tangential US contacts. In similar contexts, Treasury has effectively addressed these issues through mutual agreement with participating jurisdictions, such as under the intergovernmental agreements implemented in the case of FATCA. These agreements and similar exchange of information arrangements enforce compliance through local (non-US) law and should be used in this case as well. There are additional conflicts of laws concerns presented by these rules applied outside the US which are avoided through application of reporting requirements under local law in each relevant jurisdiction.

SIFMA Recommendation:

- Defer reporting under section 6045 for non-US and CFC digital asset brokers until the US determines its status under CARF and exempt non-US and CFC digital asset brokers from section 6045 reporting once CARF is in effect.

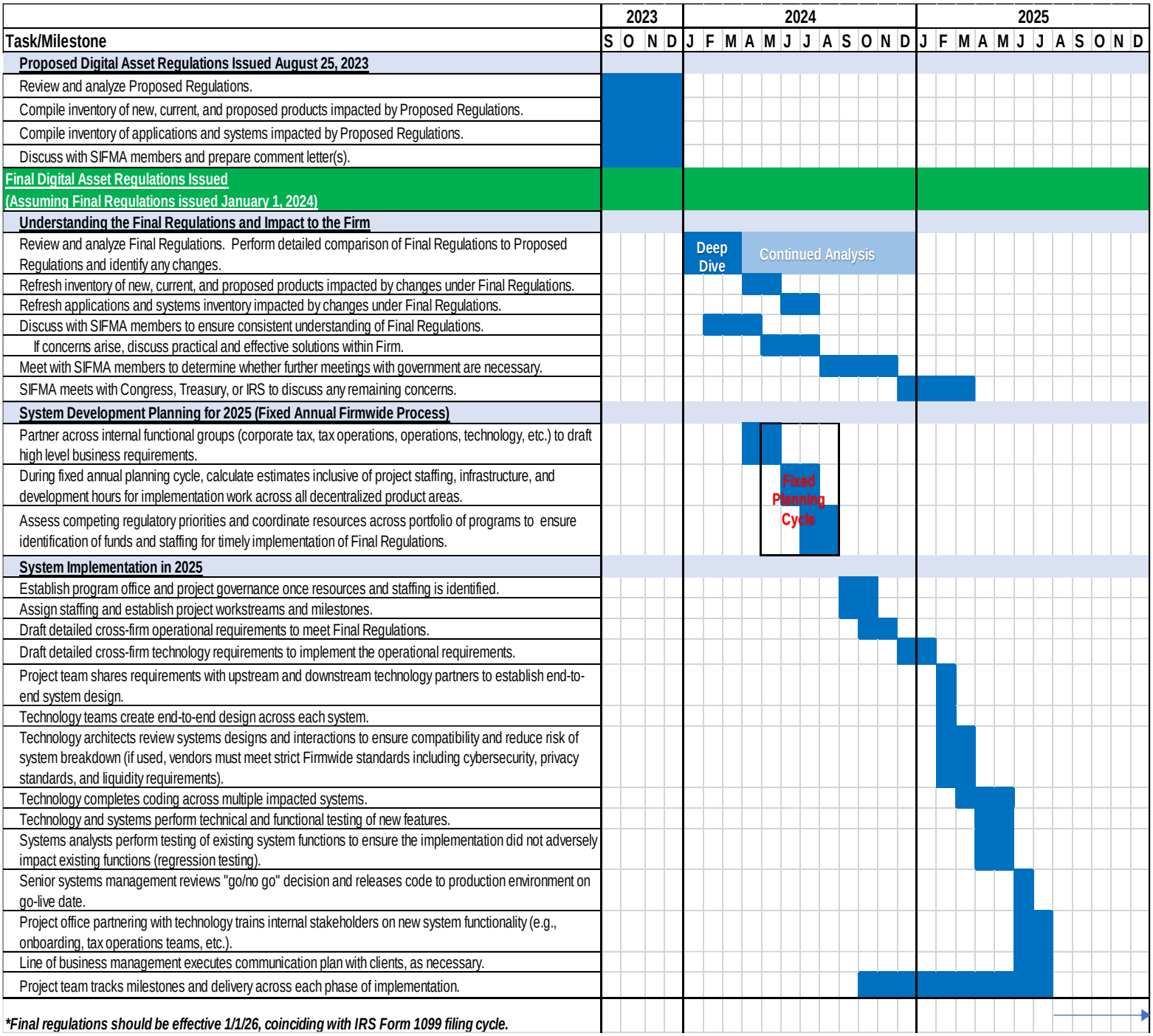
K. The effective date for implementing the regulations, including when digital assets become "covered securities," should be no earlier than at least 18 months after the issuance of the final regulations and begin on the January 1 thereafter, to coincide with the IRS information reporting cycle.

The proposed regulations would require brokers to report gross proceeds from sales of digital assets for sales occurring on or after January 1, 2025. Further, the proposed regulations require basis reporting for digital assets acquired on or after January 1, 2023. SIFMA is concerned about both effective dates, primarily due to the complexity of updating systems and resource considerations.

The proposed rules will require financial institutions to identify and track a new asset category, report on a new type of information return, adopt a different method for tracking cost basis, determine how to implement backup withholding on cashless transactions, and modify onboarding and indicia rules. These changes will require systems to be enhanced, which is not a trivial task due to the complexity of the technical infrastructure, the interactions between different systems, and the significant volume of processing given the scale of operations. Financial institutions require time to develop, implement, and perform end-to-end testing of new, and regression testing of existing, system features, and the planning for these enhancements is done as part of an annual planning/budgeting process.

The technology, planning, and implementation process is intricate and multifaceted. To best illustrate some of these complexities, SIFMA has prepared the below chart detailing the process that their members must undertake to implement new and complex requirements such as those in these regulations:[17]

[17] This chart is included for illustrative purposes only, based on the internal process and timeline for technology projects in a financial institution context.



Implementation ultimately depends on the requirements in the final regulations, and modifications and redesigns resulting from changes in the final regulations will adversely impact the system delivery timeline.

Based on the above, SIFMA respectfully requests that the regulatory effective date should be the January 1 that is at least 18 months after publication of the final regulations. Also, the applicable date for digital assets to qualify as a "covered security" should be aligned with the effective date of the remainder of the regulations.

SIFMA Recommendations:

- Delay the effective date for implementing the regulations to no earlier than at least 18 months after the issuance of the final regulations and begin on the following January 1 to coincide with the IRS information reporting cycle.
- Modify the applicable date for digital assets to qualify as a "covered security" to align with the effective date of the remainder of the regulations.

Conclusion

SIFMA appreciates the opportunity to be able to share its collective views and concerns on the regulations that are being developed to implement the digital asset reporting provisions of the IIJA. Due to the complexity of the proposed regulations and the limited time to comment to date, we would appreciate the opportunity to provide additional comments as they arise. Please do not hesitate to contact me at 202-962-7311 or paustin@sifma.org if you have any questions or if we can be of further assistance.

Very truly yours,

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