122 C Street N.W., Suite 700, Washington, DC 20001

November 13, 2023

Submitted via electronic mail at: www.regulations.gov

Internal Revenue Service
Attn: CC:PA:LPD:PR (REG–122793–19)
Room 5203, P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comment Letter Two on Proposed Rule on Gross Proceeds Reporting by Brokers and Determination of Amount Realized and Basis for Digital Transactions, REG–122793–19

Dear Sir or Madam,

On behalf of National Taxpayers Union Foundation ("NTUF") we write with comments on the Internal Revenue Service's ("IRS") proposed rule on Gross Proceeds Reporting by Brokers and Determination of Amount Realized and Basis for Digital Transactions (the "Proposed Regulation"). This letter constitutes the final of our two letters on these the Proposed Regulations and offers and expanded our analysis thereon.

I. Introduction

NTUF has been a leader in developing responsible tax administration for nearly five decades. We strive to offer practical, actionable recommendations about how our tax system should function. Our experts and advocates engage in in-depth research projects and informative, scholarly work pertaining to taxation in all aspects, including that of virtual currency.

In 2017, NTUF produced crucial research that guided policymakers as they overhauled the federal tax code for the first time in decades. Our annual Tax Complexity Report highlights the increasing time burden and out-of-pocket filing expenses imposed on taxpayers as they comply with the tax code each year. By combining policy expertise, outreach know-how, and true non-partisanship, we seek to build lasting consensus for impactful reforms.

As an initial matter, an analysis of the contextual background surrounding the Proposed Regulation offers a better understanding of the current issues with this proposed regulation, and potential avenues for improvement.

Cryptocurrency signaled, for one of the first times, a currency system which does not need a centralized bank or the backing of a state entity to ensure its success.[1] Indeed, the creation of cryptocurrency in the early twenty-first century was touted as the antithesis to the modern-day asset system.[2] One of the original undertones of early cryptocurrencies was an "us" versus "them" mentality, with "them" not being well defined but succinctly stated as any entity or person which may impose regulations or trace the currency.

Naturally, this more anarchical nature of cryptocurrency has shifted since 2009 as more individuals, actors, and businesses utilize cryptocurrency in their everyday transactions. With this increased popularity of cryptocurrency, however, comes the emergence of a global financial market. The combination of decentralized, digital trading platforms has caused banks, shops, investors, and users which cross international lines to an extent never seen before nor considered possible with non-digital financial infrastructures. Now, to conduct business, all one needs is a computer. "This lack of oversight has allowed cryptocurrency to operate on an almost instantaneous basis among a large cohort of users."[3]

Cryptocurrency introduced, for the first time, a complex manner of trade and tokens which do not precisely mirror that of the traditional financial market. Under a traditional stock exchange, stocks may be valued under a discounted cash flow model where "the intrinsic value of a stock is calculated by discounting the company's free cash flows to its present value."[4] Cryptocurrencies are not necessarily valued in this manner: "Rather than reflecting analysis of cash flows, crypto-asset prices may reflect the probability that economic use cases could develop in the future, balanced against the probability, as expressed by some industry commenters, that no significant economic uses for blockchain technologies may develop."[5] Succinctly stated, the fundamental valuation of cryptocurrency differs from that of traditional markets based off of its digital nature.

Cryptocurrency users now range from individuals to complex nation-states. The number of crypto assets have likewise increased by "more than 10,000 variants since the 2009 debut of

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[1] Shaanan Cohney, et. al, *Coin-Operated Capitalism*, 119, Col. L. Rev. 3, 603 (2019).
[2] *See* Zac Rogers, *Blockchain and the state: Vehicle or vice*? 89 AQ: Australian Quarterly 1, p. 8 (2018) (citing Alan Kohler, editor-at-large of Australian Business Review) (explaining cryptocurrency is, essentially, anarchic").
[3] ARE CRYPTOCURRENCIES SECURITIES? THE SEC IS ANSWERING THE QUESTION, REUTERS, https://www.reuters.com/legal/transactional/are-cryptocurrencies-securities-sec-is-answering-question-2022-03-21/ (last visited Oct. 30, 2023).
[4] STOCK VALUATION, CORPORATE FINANCE INSTITUTE, https://corporatefinanceinstitute.com/resources/valuation/stock-valuation/ (last visited Nov. 13, 2023).
[5] REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION 2022, FINANCIAL STABILITY OVERSIGHT COUNCIL, 4 https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf (Lat visited Nov. 7, 2023).

Bitcoin."[6] Domestically, cryptocurrency has also grown in popularity and use: sixteen percent of Americans have invested in, traded, or used cryptocurrency, but this number rises significantly when looking at younger Americans.[7] For instance, 42 percent of males ages eighteen to twenty-nine have engaged with cryptocurrency, and 33 percent of males ages thirty to forty-nine have done likewise.[8] The Federal Reserve is considering issuing a digital currency, explaining that with "technological advances ushering in a wave of new private-sector financial products and services, . . . the Federal Reserve and other central banks around the globe are exploring the potential benefits and risks of issuing a [coin based digital currency]."[9] In short, from these statistics one fact is clear: Cryptocurrencies are here, they are here to stay.

Despite the rapid proliferation of virtual assets, there is still no clear consensus on how to classify cryptocurrency. Under this proposed regulation, the IRS recommends treating all cryptocurrency as a stock or security, applying the taxation and regulatory rules used for stocks to virtual assets. This notably takes a different approach from the SEC, which classifies cryptocurrencies as cash or securities "depend[ing] on the characteristics and use of that particular asset."[10] On the legislative side, Congress has not yet passed any laws regarding the classification and regulation of crypto assets.[11]

Although we concur that clear regulations regarding cryptocurrency are necessary, Regulation 122793–19 as proposed contains elements that are harmful to the taxpayer and, if applied, are not likely to achieve the IRS's desired results. Rather, the IRS should focus on developing cryptocurrency regulations that are not only directly applicable to cryptocurrency, but also ensure the taxpayer is not subject to volatile taxation methods. As such, we write today to review the IRS's Proposed Regulation and offer recommendations for improvement.

II. Comments

A. The IRS's Approach to Cryptocurrency in the Proposed Regulations is Misplaced

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[6] CRYPTO POSES SIGNIFICANT TAX PROBLEMS – AND THEY COULD GET WORSE, IMF BLOG, https://www.imf.org/en/Blogs/Articles/2023/07/05/crypto-poses-significant-tax-problems-and-they-could-get-worse (last visited Oct. 27, 2023).

[7] 46% OF AMERICANS WHO HAVE INVESTED IN CRYPTOCURRENCY SAY ITS DONE WORSE THAN EXPECTED, PEW RESEARCH CENTER, https://www.pewresearch.org/short-reads/2022/08/23/46-of-americans-who-have-invested-in-cryptocurrency-say-its-done-worse-than-expected/ (last visited Oct. 27, 2023).

[8] Id.

[9] CENTRAL BANK DIGITAL CURRENCY (CBDC), BD. OF GOVS. OF THE FED. RESERVE SYS., https://www.federalreserve.gov/cbdc-faqs.htm (last visited Oct. 27, 2023).

[10] Chairman Jay Clayton, STATEMENT ON CRYPTOCURRENCIES AND INITIAL COIN OFFERINGS, U.S. SECURITIES AND EXCHANGE COMMISSION, https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11#:~:text=Speaking%20broadly%2C%20cryptocurrencies%20purport%20to%20be%20items%20of,to%20enable%20purchases%2C%20sales%20and%20other%20financial%20transactions (last visited Oct. 30, 2023).

[11] However, the House of Representatives' Financial Services Committee advanced a proposed bill regarding stablecoin requirements. A Bill to Provide Requirements for Payment Stablecoin Issuers, Research on a digital dollar, and for other purposes, H.R. ___, 118th Cong. (2023).

The overarching issue with the Proposed Regulations is attempting to apply securities regulations from the early twentieth century rather than creating a framework tailored for the unique characteristics of this asset. Such an approach would be already outdated from the beginning and ignores the fact cryptocurrency is a wholly virtual, digital currency.

The virtual aspect of cryptocurrency is the distinguishing factor between paper coin and post-modern day currency.[12] Physical U.S. notes can be held by its users and possessing identifying numbers which correlate to one of the twelve Federal Reserve Banks. A crypto asset, on the other hand, "is nothing more than an entry in a ledger that specifies that a particular user, identified by a certain 'private key' . . . is the sole party able to exercise a discrete set of powers associated with the ledger entry."[13] This unique characteristic of cryptocurrencies alters the traditional concept of the monetary landscape by introducing a monetary system where anyone can issue virtual currency, there is no centralized reserve board or banking entity, and the crypto users retain control over their virtual assets. Indeed, "[a]t the heart of . . . [the cryptocurrency] impact was the material transformation of fiat currency from paper, polymer, and metallic promises composed of digital strings of ones and zeros."

As a result, trade is no longer linked to paper. Rather, trade is now able to occur on a transnational basis over the internet. Cryptocurrency "activities and markets rely on complex and novel technology."[14]Unlike stock markets which have a closing time, the trade of virtual assets can happen anywhere, at any time. It is now purely digital, handled and managed by complex computer programs and miners, and is occurring nonstop, at an often instantaneous rate. For instance, while trade on a typical stock market may take a few minutes to effectuate, trading on the blockchain happens instantly. Likewise, crypto users are now able to transfer their money across transnational borders without being subject to the elongated wiring times often imposed by various banking institutions. The practicality of cryptocurrency, and ease with which users can access it through trading platforms, has allowed for users who, absent cryptocurrency, would be unable to access this level of trading, selling, and buying.

Moreover, the method of offering coins on the decentralized market differs from that of a standard market as well. Unlike standardized stock exchanges, there is no formal initial coin offering procedure or requirements to officially become a virtual asset broker in the digital world.[15] An universal method for recording crypto transactions or organizing one's virtual asset portfolio is non-existent or still in development.[16] Moreover, there is no secondary market as

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[12] Rogers, at p. 8.
[13] Cohney, at 602.
[14] REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION 2022, FINANCIAL STABILITY OVERSIGHT COUNCIL, 4.
[15] Id. at 608.
[16] Id.

exists for paper currencies and securities. Rather, "crypto assets [are] traded on hundreds of upstart markets[;] . . . [t]hey are located in diverse jurisdictions and have been embroiled in a range of legal controversies."[17] Thus, no longer is trade centralized on a stock exchange, but trade is universal through digital means, allowing any individual to access any currency, from any location, at any time. In other words, cryptocurrencies have the potential to be the next evolution of the monetary system, taking society from using a physical monetary system and the stock market to the digital age. The Proposed Regulations here fail to adequately comprehend this fact. Rather, they continue to attempt to equate a purely digital asset with that of physical assets. Indeed, repeatedly within the Proposed Regulations, the IRS likens cryptocurrency to a security.[18] The IRS then builds off of such presumption and attempts to place cryptocurrencies within the regulatory framework of securities.

Such an approach ignores not only what cryptocurrency inherently is (a virtual asset), but also the ever evolving nature of virtual assets. The virtual aspect of cryptocurrency necessitates that any cryptocurrency regulations by administrative or government bodies must reflect the change in the financial system from a banking institution with paper coins to a decentralized financial conglomerate with virtual assets. Although cryptocurrency users and institutions may want some regulation of the crypto market to ensure stability, this is not to say regulating cryptocurrency assets in the same manner as paper securities are regulated is appropriate.

In other words, the Proposed Regulations are premature. For instance, the infrastructure of the cryptocurrency market is still growing. As discussed, virtual cryptocurrency asset portfolios are not widely used, unlike asset portfolios for common stock. Under the Proposed Regulations, the IRS is attempting to require taxpayers to:

> specific[ally] identif[y] . . .the units of digital asset sold, disposed of, or transferred . . . no later than the date and time of sale . . . the taxpayer identifies on its books and records the particular unit to be sold . . . [a] specific identification can be made only if adequate records are maintained for all units of a specific digital asset held in a single wallet or account to establish that a disposed unit is removed from the wallet or account for proposed of subsequent transactions.[19]

Although such an approach is appropriate for the stock exchange where stock portfolios are common, this requirement overlooks the current, typical infrastructure of cryptocurrency users and ignores cryptocurrency's digital nature. As discussed above, for the average cryptocurrency users, a virtual asset portfolio is non-existent and not widely used per se.[20] Moreover, since cryptocurrencies are virtual assets, this means the "books and records" mentioned in the IRS's proposed regulations will also likely be virtual. Although the availability of reputable virtual

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[17] Id. at 609 (internal citation omitted) (citation omitted).
[18] *See* Proposed REG–122793–19, at p. 59582.
[19] Id. at p. 59626.
[20] Cohney, p. 608.

asset portfolio providers are growing, the infrastructure is not yet in place so as to require all cryptocurrency users to have one by 2025. Indeed, mandating cryptocurrency users obtain a portfolio by 2025 increases the cybersecurity risk of financial data and cryptocurrency leaks.

Another example is that the Proposed Regulations place the onus of reporting on brokers and requires cryptocurrency brokers to report every transaction. Although this proposed regulation is akin to that of the common securities markets, where such a requirement is easier because trading occurs on a centralized stock exchange, it ignores the virtual aspect of cryptocurrencies. Cryptocurrencies are transnational, allowing users to exchange funds globally. Given this nature of digital assets, outdated reporting regulation may "induce people to transact increasingly through decentralized exchanges or directly through peer-to-peer trades where no central governing body oversees these transactions. Those are still extremely difficult for tax administrators to penetrate."[21] As a result, it is possible advanced cryptocurrency users will be able to avoid these reporting requirements, while less advanced users will be subject to taxation. All in all, the IRS may not be able to obtain the revenue it hopes to obtain with these Proposed Regulations.

These cases illustrate how the Proposed Regulations fail to achieve the IRS's goal while harming taxpayers. The Proposed Regulations' use of outdated methods to tax cryptocurrencies is undermined by the digital aspect of cryptocurrency. Instead of taxing cryptocurrency with already-outdated regulations, the IRS should consider an innovative approach which blends the regulation methods used for the stock market, IT approaches, and cybersecurity methods to create a modern, twenty-first century method of regulation.

B. The Proposed Regulations Place Burdensome Taxation Practices on Crypto Users

These regulations proposed an expansive and aggressive taxation scheme which, if applied, will not only harm taxpayers, but also raise litigation issues as it has the potential to raise serious conflict of law questions. In all cases, these Proposed Regulations are premature. Undoubtedly some form of regulation, either private or public, is needed to ensure stability for taxpayers in cryptocurrency exchange. However, only after such context has been established may the IRS then introduce a taxation scheme.

The Proposed Regulations intend to treat the disposition of a digital asset for another digital asset like capital gains tax: "The amount realized on the exchange of a digital asset differing materially in kind or in extent is the sum of the fair market value of the digital asset received plus the fair market value of services received . . . reduced by the amount of digital asset transaction costs . . . ."[22] The Proposed Regulation's attempt to tax a digital asset as soon as the digital asset is exchanged for another is detrimental to taxpayers. Although this taxation pattern follows that

[21] CRYPTO POSES SIGNIFICANT TAX PROBLEMS – AND THEY COULD GET WORSE.
[22] *See* Proposed REG–122793–19, at p. 59624.

of the securities exchange, it ignores the virtual and volatile aspect of cryptocurrency. Unlike the stock exchange where there are, to some degree, secure stocks, cryptocurrencies "experience huge fluctuations in their valuation . . . . Cryptocurrency is an incredibly volatile investment."[23] As such, there are drastic gains, and drastic losses, in the crypto market.

These gains and losses differ significantly from traditional financial markets. First and foremost, the cryptocurrency sector has not yet been formally regulated. "Many crypto-asset activities lack basic risk controls to protect against run risk or to help ensure that leverage is not excessive."[24] "Market participants that hold crypto-assets on their balance sheets are particularly exposed to potential market losses on those assets in response to a shock."[25] This is because, in part, "cryptocurrency platforms and promoters often mislead consumers, have conflicts of interests, fail to make adequate disclosures, or commit outright fraud."[26] While taxpayers who invest on traditional financial markets are shielded from most of these issues because of regulations, those who invest in cryptocurrencies are not. As a result, taxpayers who invest in cryptocurrency are particularly susceptible to dramatic losses resulting from the crypto market.

Despite this, because the proposed taxation of digital assets follows the IRS's taxation of capital gains, cryptocurrency users will be taxed when they gain but prevented from deducting if they lose, if those transactions straddle taxable years. Thus, if a taxpayer sees a year or more of initial paper gain followed by a year of heavy losses, the IRS will require a huge tax payment but only allow him or her to deduct $3,000.00 per year in loss.[27] Given the particularly volatile nature of cryptocurrency, such a deduction is insufficient to offset taxpayers' total tax liability. The $3,000 carryforward regulation may not be as detrimental to taxpayers if the cryptocurrency market followed that of Wall Street, but the developing, virtual, volatile nature of cryptocurrency makes its operation radically different from securities or even commodities markets.

Moreover, there is no regulatory framework in place to secure taxpayers' losses from fraud, Ponzi schemes, etc. Although Congress is working on a bill regarding stablecoins, and states are attempting to regulate the cryptocurrency industry, there has yet to emerge a sustainable regulatory framework to ensure taxpayers are protected from large losses in the cryptocurrency market.[28] As a result, the IRS's proposed taxation of digital assets exchanged for other digital

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[23] EXPLAINING CRYPTO'S VOLATILITY, FORBES, https://www.forbes.com/sites/nicolelapin/2021/12/23/explaining-cryptos-volatility/?sh=2b7fc2457b54 (last visited Oct. 30, 2023).
[24] REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION 2022, FINANCIAL STABILITY OVERSIGHT COUNCIL, 4.
[25] Id.
[26] THE ADMINISTRATIN'S ROADMAP TO MITIGATE CRYPTOCURRENCIES' RISKS, THE WHITE HOUSE, https://www.whitehouse.gov/nec/briefing-room/2023/01/27/the-administrations-roadmap-to-mitigate-cryptocurrencies-risks/ (last visited Nov. 7, 2023) (blog).
[27] TOPIC NO. 409, CAPITAL GAINS AND LOSSES, IRS, https://www.irs.gov/taxtopics/tc409 (last visited Oct. 30, 2023).
[28] See A Bill to Provide Requirements for Payment Stablecoin Issuers, Research on a digital dollar, and for other purposes, H.R. ___, 118th Cong. (2023).

assets creates a serious risk of further harming taxpayers who may already be suffering critical financial losses.

Additionally, the Proposed Regulations' taxation of digital assets exchanged for other digital assets is impractical as written. This proposed regulation operates, to some degree, on the presumption the exchange of cryptocurrencies is akin to stocks and securities. However, unlike the stock market, there are a myriad of ways to exchange digital assets. Users may use proxies to exchange cryptocurrency wallet to wallet, engage in purely private transactions, or use a trading platform to exchange assets.[29] As discussed above, one of the main philosophies behind cryptocurrency was to abstain from main trading platforms. Thus, while the proposed regulation may ensure digital asset exchanges on frequently used platforms are taxed, other exchange methods may go unnoticed, and untaxed.

All in all, the proposed regulation pertaining to the exchange of digital assets for other digital assets is not practical. It will only harm taxpayers by ensuring those who have significant losses can not easily claim this on their tax returns, while encouraging other users to engage in alternative exchange methods. The regulation's outdated method of taxation is not practical in the cryptocurrency digital economy, and the IRS should consider alternative methods of taxation.

C. The Proposed Regulations Ignore that Cryptocurrency May not Only be Categorized as Stock

An inherent problem with the Proposed Regulations is the IRS's unilateral decision to categorize cryptocurrency as a security. Although categorizing cryptocurrency as stock may be correct for many, or even the majority, of cryptocurrency uses, it is not correct for all cases.

Cryptocurrency is unique because it has the option to be interconnected to a myriad of traditional financial assets. For instance, cryptocurrency may, in some instances, be correctly categorized as cash. "Cash" is defined as "[r]eady money; whatever can be used as money without being converted into another form; that which circulates as money, including bank-bills . . . ."[30] Cryptocurrency is "cash" in that is can be used as money without being converted into another form. For instance, major retailers such as Gucci and Ralph Lauren are beginning to accept cryptocurrency as a form of payment for their goods.[31] If these major retailers continue to transact deals purely in cryptocurrency without converting it into the US dollar, it is possible that

[29] *See* 11 PLACES TO BUY BITCOIN ANONYMOUSLY, SOFTWARE TESTING HELP 2023, https://www.softwaretestinghelp.com/buy-bitcoin-anonymously/ (last visited Oct. 30, 2023).
[30] CASH, BLACK'S LAW DICTIONARY (2d ed.)
[31] GUCCI LEADS IN CRYPTO TRANSACTION, FORBES, https://www.forbes.com/sites/walterloeb/2022/08/04/gucci-leads-in-crypto-transactions/?sh=2e3f3fa7135b (last visited Oct. 30, 2023); RALPH LAUREN MIAMI STORE TO ACCEPT CRYPTO PAYMENTS, YAHOO FINANCE, https://finance.yahoo.com/news/ralph-lauren-miami-store-accept-204403614.html (last visited Oct. 30, 2023).

cryptocurrency, in these instances, may be "used as money without being converted into another form."[32]

Stablecoins offer another valuable example of when cryptocurrency is not necessarily stock. Stablecoin valuation differs from that of normal cryptocurrency because it "is a digital currency that is linked to an underlying asset such as a national currency or precious metal such as gold."[33] Stablecoins also present the opportunity to integrate digital currencies with traditional assets: "Crypto-asset trading platforms have the potential for greater interconnections by providing a wide variety of services, including leveraged trading and asset custody, to a range of retail investors and traditional financial institutions."[34]

Furthermore, at least one court case has indicated a blanket categorization of cryptocurrency as stock is not correct. In July of this year, the Southern District of New York addressed the question of whether the sale of a cryptocurrency was a sale of a security.[35] There, Ripple Labs first "sold XRP directly to certain counterparties . . . pursuant to written contracts."[36] Next, Ripple Labs "sold XRP on digital asset exchanges 'programmatically,' or through the use of trading algorithms."[37] Third, Ripple Labs "distributed XRP to its employees as a form of employee compensation. Ripple also distributed XRP in conjunction with its Xpring initiative to fund third parties that would develop new applications for XRP and the XRP Ledger."[38] The SEC alleged all of these sales concerned the sale of an "investment contract[]" and thus was a sale of an unregistered security.[39] The Court relied on the factors set by the Supreme Court in *SEC v. W.J. Howey Co.*, which "held that under the Securities Act, an investment contract is a contract, transaction, or scheme whereby a person (1) invests his money (2) in a common enterprise and (3) is led to expect profits solely from the efforts of the promoter or a third party."[40] The Court noted that "the subject of a contract, transaction, or scheme is not necessarily a security on its face. The Court analyzes the economic reality and totality of circumstances surrounding the offers and sales of the underlying asset."[41]

Applying the *Howey* standard, the Court concluded the first sale did violate *Howey*, but the second and third sale did not. Under the first sale, "reasonable investors would understand that Ripple would use the capital received from its Institutional Sales to improve the market for XRP

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[32] CASH, BLACK'S LAW DICTIONARY.
[33] WHAT ARE STABLECOINS AND HOW CAN I INVEST IN THEM? U.S. NEWS, https://money.usnews.com/investing/cryptocurrency/articles/what-are-stablecoins-and-how-can-i-invest-in-them (last visited Nov. 13, 2023).
[34] REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION 2022, 4.
[35] *SEC v. Ripple Labs, Inc.*, No. 20 Civ. 10832 (AT), 2023 U.S. Dist. LEXIS 120486 (S.D.N.Y. Jul. 13, 2023).
[36] Id. at * 8.
[37] Id. at * 8-9.
[38] Id. at * 9.
[39] Id. at * 18.
[40] Id. at * 18 (cleaned up) (quotation omitted).
[41] Id. at * 22.

and develop uses for the XRP Ledger, thereby increasing the value of XRP."[42] This is markedly different from the second sale, where the third *Howey* prong could not be established as "[b]uyers Buyers could not have known if their payments of money went to Ripple, or any other seller of XRP."[43] The Court further concluded the third sale did not satisfy the *Howey* test as the recipients "did not pay money or 'some tangible and definable consideration' to Ripple."[44]

Under the analysis in SEC v. Ripple Labs, Inc., it is clear courts do not adopt the approach taken by these Proposed Regulations that all cryptocurrency transactions are considered the sale of a stock. This, paired with the nature of stablecoins and cryptocurrency's ability to function as cash, illustrates not all cryptocurrency is a stock. As such, the Proposed Regulations should be tailored to recognize the diverse forms cryptocurrency may have.

D. The Proposed Regulations Pose Significant Litigation Risks

The Proposed Regulations pose significant litigation risks to both the IRS and taxpayers. First, the "fair market value" standard, as written, indicates the exclusion of agreed upon contract price terms, thus violating a fundamental tenancy of contract law. Moreover, the Proposed Regulations treatment of cryptocurrency as purely stock goes against case law and, potentially, Congress's intent on how to categorize cryptocurrency. Thus, enacting these regulations as is will further strain the IRS's litigation and personnel resources.

a. Litigation Risks arising From the "Fair Market Value" Standard

The Proposed Regulations suggest a fair market value standard for determining "the value of . . . property and services received" in exchange for digital assets. [45] Specifically, the Proposed Regulations propose:

> The amount realized on the exchange or other disposition of digital assets for services or property differing materially in kind or in extent, other than digital assets or debt instruments described in paragraph (b)(1)(iv) of this section, is the sum of the fair market value of such property and services received (including services received described in paragraph (b)(1)(ii) of this section), reduced by the amount of digital asset transaction costs allocable to the disposition of the transferred digital assets, as determined under paragraph (b)(2)(ii) of this section.[46]

[42] Id. at * 29-30.
[43] Id. at * 35-36.
[44] Id. at * 40.
[45] Proposed REG–122793–19, at p. 59623.
[46] Proposed REG–122793–19, at p. 59623-24.

When describing this regulation, the IRS poses a hypothetical where the parties agree for one party to mow the lawn for another in exchange for a digital asset.[47] The IRS analyzed the gain in this transaction was the fair market value of having one's lawn mowed compared to the value of the digital asset exchange.[48] This proposed hypothetical is problematic as it ignores the parties' agreement for a service to be done and instead it inserts the fair market valuation standard. In other words, the plain language of the regulations seems to suggests parties' contractual agreements for services is not relevant when determining the gains or losses associated with digital asset exchange. The regulation itself states the "sum of the fair market value," but at no point indicates the terms of a parties' contract controls when dictating the value of services performed.[49] Indeed, the hypothetical also glosses over the fact the parties *agreed* for the lawn mowing service to occur. In short, the IRS seems to focus its determination of whether a digital asset exchanged for a service was a gain or loss dependent upon the fair market value of the service, not the contractual terms of the service.

When drafting a taxation regulation, the IRS should use precise language in order to protect taxpayers from potential overreach. By not incorporating contractual price terms as a basis for measuring gain or loss, potential taxpayers may be subject to a higher rate of taxation based off the IRS's determination of a gain. Likewise, there may be an increase in litigation costs as parties dispute what is considered the fair market value under the regulation. Indeed, taxpayers and the IRS frequently engage in litigation over what is considered "fair market value." [50]

Accordingly, the IRS's proposition to use "fair market value" as the standard for determining a gain or loss when digital assets are exchanged for services is not prudent. This proposed regulation likely violates contract law as it fails to exempt contracts which includes price terms, and opens the door to litigation as to what is "fair market value." Should the IRS adopt this section as is, this opens the door to widespread litigation founded in contract law when crypto users attempt to evaluate their cryptocurrency spent for taxation purposes.

If the IRS intended for a fair market value standard to override contract law, then this is worrisome for taxpayers as it represents an unprecedented expansion of the IRS's taxation power. It represents the novel idea that parties' contracts for services would not be controlled by the terms of the contract, but by the arbitrary fair market valuation used by the IRS agent. Moreover, such an unprecedent concept may be expanded to other assets and currencies owned by taxpayers, all the while harming the taxpayer in the process.

b. Litigation Risks from Digital Asset Transaction Cost Proposed Regulation

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[47] Id. at p. 59624.
[48] Id.
[49] Id. at p. 59623; *see also Doctor's Assocs. v. Casaroto*, 517 U.S. 681, 686 (1996) (explaining price and service as the "basic terms" for a contract).
[50] *See Rolfs v. Comm'r*, 668 F.3d 888 (2012).

The Proposed Regulations also may be subject to further lawsuits based in contract law arising from its proposed 50/50 division of transaction costs. Under the Proposed Regulations,

> [i]n the case of an exchange of digital assets described in paragraph (b)(1)(iii)(C) of this section, one-half of the total digital asset transaction costs paid by the taxpayer to effect the exchange are allocable to the disposition of the transferred digital assets, and the other half of such costs are allocable to the acquisition of the received digital assets for purposes of determining basis under § 1.1012–1(a).[51]

Succinctly stated, the Proposed Regulations proffer to divide the transaction fee 50/50. Such a requirement vastly differs from that of the traditional stock market, where contracts and industry standards typically mandate the buyer bears the burden of the transaction fee. Here, this proposed regulation overrides any contract between the parties and mandates that the transaction fee be split evenly.

This is primarily open to litigation because transaction fees play a significant role in a company's profits, especially high volume cryptocurrency companies. Companies may wish to allocate the burden through contracts between the transacting parties. Thus, not only does this Proposed Regulation limit a company's profit, but it limits any ability of the company to control how its money is spent through contract law. The elimination of contracts to control the transaction fee is an excessive infringement on individuals' rights to freely entire into contracts, and opens the door for mass litigation.

c. Litigation Risks From the General Treatment of Cryptocurrency as Stock

The Proposed Regulations' flat approach of treating cryptocurrency as stock opposes case law and, likely, violates Congress's potential categorization of cryptocurrency. As explained above, although a large portion of cryptocurrency may be categorized similar to stock in a traditional financial institution, this is not true for all cryptocurrency.

The *SEC v. Ripple Labs, Inc.* case shows courts, to varying degrees, do not agree with the blanket approach cryptocurrency is a stock. Indeed, that is the very argument put forward by the SEC therein.[52] The Proposed Regulations tend to follow the SEC's position in *Ripple* that all cryptocurrency is stock. Adopting such a position will open up the IRS to a floodgate of litigation as the cryptocurrency industry, the courts, and the IRS grapples with when a cryptocurrency may be considered a stock.

[51] Proposed REG–122793–19, at p. 59582.
[52] *See Ripple Labs, Inc.*, at *18.

Moreover, recent appropriations bills proposed by various members of Congress indicate the legislature, to varying degrees, oppose a blanket treatment of crypto assets as stock. One bill entitled "Amendment to H.R. 4664, as Reported Offered by Mr. Donalds of Florida" stated,

> None of the funds appropriated or otherwise made available by this act may be used to finalized, implement, or enforce the proposed rule entitled 'Gross Proceeds and Basis Reporting by Brokers and Determination Amount Realized and Basis for Digital Asset Transactions' . . . or any future proposed rule of a substantially similar nature.[53]

Likewise, another bill proposed the following amendment "[n]one of the funds made available by this Act may be used to the Securities and Exchange Commission to carry out an enforcement action related to crypto asset transaction."[54] Both proposed appropriations bills show members of Congress's intent to limit the number of lawsuit against the crypto industry. Particularly, the proposed appropriations bill by Mr. Donalds of Florida directly addresses these Proposed Regulations and attempts to stop their effect.

Therefore, given a court's reluctance to broadly define cryptocurrency as stock, and emerging appropriations bills that are reluctant to entertain a strict cryptocurrency regime which can cause an onslaught of litigation, the IRS should reconsider the Proposed Regulations. These sources indicate the tone of the legislative and judicial branches are opposed to broadly interpreting cryptocurrency as a stock for taxation, regulatory, and litigation purposes. Thus, should the IRS enact these Proposed Regulations, it will likely face a slew of litigation.

E. The Proposed Regulations, as Written, Threaten a Booming Industry

Although we agree with the IRS that taxation guidance for cryptocurrency should be provided, the Proposed Regulations threaten to cripple the booming cryptocurrency industry.

The United States is one of the leading nations in the cryptocurrency market. In 2020, an estimate $ 4.1 billion USD was realized in bitcoin gains in the United States alone.[55] This is more than three times more than the second highest ranking country.[56] In 2022, the United States was ranked first in Coinclub's global rankings for Q4.[57] The crypto financial market itself has created new jobs as already established companies and establishing corporations invest resources

[53] Amendment to H.R. 4664, Bill.
[54] Amendment to H.R. 4664, Bill.
[55] BITCOIN GAINS BY COUNTRY: WHO BENEFITS THE MOST FROM THE 2020 BOOM? CHAINALYSIS, https://www.chainalysis.com/blog/bitcoin-gains-by-country-2020/ (last visited Nov. 13, 2023).
[56] Id.
[57] Q4 2022 COINCUB GLOBAL CRYPTO RANKING, COINCUB https://coincub.com/ranking/q4-2022-global-crypto-ranking/ (last visited Nov. 13, 2023).

into this sector.[58] Moreover, the blockchain offers promising results for future uses in varying areas from society. Such status bolsters the American economy, provides more employment opportunities for Americans, and encourages American innovation which can be promulgated on a global scale.

Under the current state of affairs, America has the potential to be a global leader in the cryptocurrency industry. As a result, it is imperative for the American economy that any taxation regulation need focuses on bolstering this economy instead of hindering it. These Proposed Regulations, if enacted, will only operate to slow down the cryptocurrency sector. By placing a taxation scheme on the crypto industry before a formal regulatory scheme has been enacted and because the Proposed Regulations contain ambiguous provisions and try to liken the crypto financial market to that of a traditional market, the Proposed Regulations will create a burden on the cryptocurrency market.

F. Neither the Crypto Industry nor the IRS has the Infrastructure Necessary to Promulgate these Proposed Regulations

The Proposed Regulations propose a taxation scheme which is not achievable by the cryptocurrency industry by 2025 nor feasible for the IRS to administer. Regarding the cryptocurrency sector, there is no standard regulation for the crypto market. Under these Proposed Regulations, the IRS is attempting to tax an industry that is unregulated. Because of such, although the crypto industry and its users are highly advanced, the necessary infrastructure needed to fully comply with these lengthy Proposed Regulations cannot be achieved by 2025. As a result, the industry will become crippled as litigation ensues and smaller cryptocurrency traders, investors, and platforms are pushed off the market due to lack of resources to comply by 2025.

The IRS itself, moreover, is not prepared to handle the amount of tax returns which will result from these proposed regulations. As of May 13, 2023, the IRS had 4.3 million unprocessed individual tax returns.[59] Julie Foerster, IRS's director of digital assets, predicted the IRS will receive "8 billion" information returns from the IRS's taxation of cryptocurrency.[60] This is more than double what the IRS currently receives in other 1099 Forms.[61] Director Foerster explained

[58] HOW CRYPTOCURENCY HAS INTRODUCED NEW CAREERS IN TECH., FORBES, https://www.forbes.com/sites/laurencebradford/2017/12/18/how-cryptocurrency-has-introduced-new-careers-in-tech/?sh=6848fd0a3e79 (last visited Nov. 13, 2023).
[59] IRS STILL HAS MILLIONS OF TAX UNPROCESSED RETURNS; TIMELINE, WHAT TO DO, WHERE TO CHECK, WOLTERS KLUWER, https://www.wolterskluwer.com/en/expert-insights/irs-still-has-millions-of-tax-unprocessed-returns-timeline-what-to-do-where-to-check (last visited Nov. 13, 2023).
[60] IRS PREPPING FOR AT LEAST 8 BILLION CRYPTO INFORMATION RETURNS, TAXNOTES, https://www.taxnotes.com/featured-news/irs-prepping-least-8-billion-crypto-information-returns/2023/10/25/7hhdp (last visited Nov. 13, 2023).
[61] Id.

the IRS's "technology, the way it is today, will not support the data and the volume[] . . . ."[62] With the IRS already not able to timely process individual's tax returns, it should focus on bolstering its processing personnel, technology, and customer service sector to assist taxpayers before implementing a new taxation scheme.

III. Recommendations

As stated *supra*, the Proposed Regulations are premised on an outdated approach to securities regulation, ignores the digital aspect of cryptocurrency, and places burdensome taxation practices on taxpayers. As such, we respectfully recommend the following methods to improve the Proposed Regulations while safeguarding taxpayers' rights.

A. The IRS Should Employ a Sandbox Method to Develop Cryptocurrency Regulations

The cornerstone issue with these Proposed Regulations are their lack of understanding about cryptocurrency as a whole. As discussed above, cryptocurrencies are a digital asset which exists in a virtual, decentralized platform. "Innovation is always a challenge for regulators. [They] are used to the way things have been done. Our rules have grown up in response to past technologies. Figuring out whether and how they apply to new ideas is difficult."[63] In order to avoid trying to apply traditional financial regulations to cryptocurrencies, the IRS should employ a sandbox method to develop appropriate and functionable tax regulations.

Under this sandbox method, the IRS would recruit cryptocurrency experts from outside the IRS. These experts should represent all areas of cryptocurrency: Regulatory, taxation, trading platforms, cybersecurity, investors, brokers, sellers, and etc. Then, in a controlled environment, the IRS should foster discussion amongst these individuals, allowing for the free flow of ideas about cryptocurrency and how to properly tax such. Creating such a group would allow for "an intelligent, coherent national policy to provide certainty for the next waive of blockchain innovations."[64] Notably, the IRS should not rush this process, but allow for a generous amount of time so that the individuals could address the potential issues in taxation regulations and how to solve them. From these discussions and exchange of ideas, the experts should submit to the IRS their recommendations on how to best implement a taxation scheme into the cryptocurrency exchange.

[62] Id.
[63] Trautman, *Bitcoin, Virtual Currencies, and the Struggle of Law and Regulation to Keep Pace*, 474-75 (quotation omitted).
[64] Id. (quotation omitted).

This method allows for the IRS's taxation scheme to be brought into the twenty-first century. Instead of using the outdated regulatory scheme, recruiting experts to assist on this taxation dilemma would allow the IRS to promulgate modern regulatory rules.

B. The IRS Should Implement the Flat Rule of Taxation Upon Cash-Out

Another issue with the Proposed Regulations is the convoluted taxation scheme it attempts to establish for the sale and use of digital assets. The purported taxation creates a complicated situation where a taxpayer wants to comply, but is unsure how. Moreover, as stated above, the Proposed Regulations' treatment of digital assets exchanged for digital assets or services is impractical and harmful to taxpayers. To eradicate these issues, the IRS should only tax digital assets upon cash-out. Although there are many avenues for purchasing digital assets and even more options for how to use cryptocurrency, a majority of users still want their cryptocurrency converted into hard currency. Thus, to avoid the convoluted attempts to tax cryptocurrency as proposed in these Regulations, the IRS should only tax cryptocurrency when its users take the cryptocurrency out of the digital world in exchange for hard currency or assets.

C. Any Proposed Regulation by the IRS to treat Crypto Assets as Stock Should be Postponed Until a Regulation Scheme for Cryptocurrency is Established

We also recommend the IRS postpone implementing taxation regulations until Congress or the Securities and Exchange Commission acts to implement a centralized exchange method for cryptocurrency. The IRS is moving too fast in pursuit of taxing cryptocurrency. This regulation marks an unprecedent event where the IRS is attempting to tax an industry which has yet to be regulated by Congress or the SEC. A cryptocurrency regulation should first be imposed and then the IRS should promulgate taxation regulations.

If the IRS waited for a cryptocurrency regulatory framework to be published and standardized, taxation would in fact be easier. Rather than having to create a cryptocurrency regulatory framework and a tax system, as these Proposed Regulations are attempting to do, the IRS could implement a taxation scheme within a regulated cryptocurrency scheme.

Indeed, Congress is already moving to enact a regulatory framework pertaining to cryptocurrency. In July of this year, a Congressional Committee passed a bill pertaining to stablecoins.[65] Also, as mentioned above, various appropriations bills were offered which pertained to cryptocurrency. In short, Congress is aware of the need to address cryptocurrency and is starting to act on this need.

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[65] A Bill to Provide Requirements for Payment Stablecoin Issuers, Research on a digital dollar, and for other purposes, H.R. ___, 118th Cong. (2023).

Moreover, other sectors are working on developing draft regulations for the cryptocurrency sector. For instance, in 2017, the Uniform Law Commission promulgated a Uniform Regulation of Virtual Currency Business Act which provided model regulatory schemes for digital currencies.[66] Traditional financial institutions, as well, are working towards regulations: "Some banks reportedly have connections with stablecoin activities or have announced their intentions to build such connections. Some banks reportedly have partnered with stablecoin issuers for various activities, including holding assets for stablecoin issuers."[67] Banks' involvement in the cryptocurrency sector is promising for future regulations as banks are already bound to comply with traditional financial regulations.

Although the IRS may want to enact regulations to tax cryptocurrency as soon as possible, the enacted regulations should be appropriate and workable. The IRS should allow Congress or other administrative bodies, such as the Securities and Exchange Commission, to first enact a regulatory framework for cryptocurrency. As they stand, the Proposed Regulations harm taxpayers, the cryptocurrency market, and innovators in this space. Thus, only after a cryptocurrency regulatory scheme is established should the IRS enact a taxation regulation for cryptocurrency.

D. The IRS Should Create a Division of Cryptocurrency Experts within the IRS to Assist in the Proposed Regulations Implementation

Finally, even if the IRS enacts these Proposed Regulations, it should develop a sector of cryptocurrency experts within the IRS to assist taxpayers. The Proposed Regulations are riddled with convoluted reporting and recording requirements and taxation schemes. Moreover, they are the first of their kind as there has yet to be a formal attempt to tax cryptocurrency users. Taxpayers, accountants, and lawyers will have questions regarding these Proposed Regulations and need guidance on how to proceed. Ideally, these cryptocurrency experts could interpret the guidelines for taxpayer and offer advice on best practices for compliance. By creating a group of cryptocurrency experts within the IRS will assist the IRS with compliance issues and ease the taxpayer's burdens.

IV. Conclusion

Any proposed regulation relating to the exchange of cryptocurrencies should contemplate the nature and characteristics of cryptocurrency as a virtual currency on a decentralized platform with a myriad of uses. Regulations should clearly delineate between cryptocurrencies as a security and cash, and proposed modern methods of regulating digital assets. We believe the

[66] REGULATION OF VIRTUAL-CURRENCY BUSINESSES, UNIFORM LAW COMMISSION, https://www.uniformlaws.org/viewdocument/enactment-kit-45?CommunityKey=e104aaa8-c10f-45a7-a34a-0423c2106778&tab=librarydocuments (last visited Nov. 9, 2023).
[67] REPORT ON DIGITAL ASSET FINANCIAL STABILITY RISKS AND REGULATION 2022, 4.

recommendations we have offered will serve the goal of alleviating any ambiguity in the statute while protecting taxpayers.

NTU is grateful for your consideration. If you have any questions or concerns, please do not hesitate to contact us.