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Cryptocurrency Industry, Bi-Partisan Group of Senators Criticize Provisions of Senate-Passed Infrastructure Bill

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On August 10, 2021, the U.S. Senate passed the $1 trillion infrastructure bill, known formally as the Infrastructure Investment and Jobs Act[1] (Infrastructure Bill). The Infrastructure Bill includes provisions for approximately $550 billion in new federal spending over 10 years on various transportation, broadband, utilities and other infrastructure projects.

Various revenue raising provisions are earmarked to offset the additional spending. Among those revenue raising provisions, the Infrastructure Bill contemplates that $28 billion in income tax attributable to the disposition of digital assets will be collected over 10 years. The Infrastructure Bill anticipates generating this revenue by facilitating compliance with digital asset users' tax payment obligations by imposing reporting requirements on ''brokers'' of ''digital asset'' transfers. Digital assets for purposes of these amendments is meant to include cryptocurrencies.

U.S. FEDERAL INCOME TAXATION OF THE DISPOSITION OF DIGITAL ASSETS

According to IRS guidance issued in 2014,[2] the IRS treats cryptocurrency (which the IRS refers to as virtual currency) as property for U.S. federal income tax purposes. Consequently, a disposition of virtual currency generates a taxable capital gain or loss. A taxable disposition is the result of many typical transactions, such as exchanging virtual currency for fiat currency (e.g., exchanging bitcoin for U.S. dollars) or exchanging one type of virtual currency for another type of virtual currency (e.g., exchanging bitcoin for ether).

The 2020 version of the IRS Form 1040, *U.S. Individual Income Tax Return,* includes a question, ''At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?'' A U.S. taxpayer who answers ''yes'' to this question must also report and pay any resultant U.S. federal income tax liability and include a completed IRS Form 8949, *Sales and Other Dispositions of Capital Assets*.

The IRS has asserted that, despite its efforts to make U.S. taxpayers aware of their obligations, there are significant deficiencies in reporting and tax payment with respect to virtual currencies. The IRS claims to have received only 800 to 900 IRS Forms 8949 for the years 2013 through 2015.[3] The deficiencies are thought to be the result, at least in part, of limited obligations of services such as virtual currencies exchanges to report transaction information to virtual currency users and the IRS.

INFORMATION REPORTING FOR BROKERS AND DIGITAL ASSETS

The Infrastructure Bill contemplates greater U.S. federal income tax compliance by imposing reporting requirements on businesses that provide services in

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[1] H.R. 3864, Infrastructure Investment and Jobs Act, 117th Cong., 1st Sess., §1 *et seq.* (passed Senate Aug. 10, 2021).

[2] Notice 2014-21.

[3] Coinbase, 17-cv-01431-JSC, Declaration of IRS Agent David Utzke, Docket No. 3 at ¶ 20.

the disposition of virtual currencies. The Infrastructure Bill includes amendments to §6045[4] that would require ''brokers'' to furnish written statements to their customers concerning transfers of ''covered securities'' made on behalf of the customers. The Infrastructure Bill would amend the definition of ''broker'' in this section to include ''any person who (for consideration) is responsible for providing any service effectuating transfers of digital assets on behalf of another person.''[5] Further, the definition of ''covered securities'' would be amended to include ''digital assets.''[6] Digital assets for the purposes of these amendments is meant to include cryptocurrencies.

Existing regulations accompanying §6045 provide that brokers must use an IRS Form 1099 to provide the required information to their customers, and file the Form 1099 with the IRS.[7] With the amendments included in the Infrastructure Bill, the required information would include the name and address of the customer, the gross proceeds of the customer's transfers, the customer's adjusted basis in the transferred digital assets, and whether any gain or loss with respect to the digital assets is long-term or short-term.

The Infrastructure Bill also includes amendments to reporting requirements for transfers between two brokers.[8] When one broker transfers a covered security, which would include digital assets, to another broker, the transferring broker would have to furnish to the receiving broker a written statement that would enable the receiving broker to meet their basis and holding period reporting requirements of §6045(g).

These amendments for brokers and digital assets would apply to returns required to be filed, and statements required to be furnished, after December 31, 2023.[9] Penalties may be imposed when a broker fails to fulfill their reporting obligations under §6045.[10]

RESPONSES TO THE INFRASTRUCTURE BILL'S BROKER AND DIGITAL ASSETS PROVISIONS

When the Infrastructure Bill was initially proposed, the definition of ''broker'' within the Digital Assets provisions sparked significant concerns within the digital asset industry. Critics contended that the definition ''any person who (for consideration) is responsible for providing any service effectuating transfers of digital assets on behalf of another person'' — was overly broad because it captured not only parties that execute transactions where customers buy, sell and trade digital assets (such as digital asset exchanges) but also other parties that validate digital asset transactions (such as miners or stakers) and entities that sell hardware or software that customers use to control their private keys — which are used to access digital assets.

Coinbase CEO Brian Armstrong was one of the harshest critics. He tweeted that the Digital Asset portion of the Infrastructure Bill was ''hastily conceived.''[11] Similarly, Neeraj Agrawal, director of communications at Coin Center (a think tank started in 2014 that focuses on cryptocurrency policy), told CNN: ''There's decisions being made that will massively influence how cryptocurrency develops in America, but it's being done as a last-minute addition to a must pass infrastructure bill.''[12]

In follow-up tweets, Armstrong wrote that ''Coinbase is happy to help customers fulfill tax obligations just like the rest of the financial services industry[,]'' but he was concerned about other parts of the digital assets industry because, as the bill was drafted, ''almost anyone in the industry'' including miners, validators, smart contracts, open source developers, etc. could be treated as a ''broker'' with ''massive reporting obligations.'' He explained that, for example, smart contracts ''are not companies, and cannot be modified to collect KYC info or issue [Form] 1099s.''[13]

Other critics also argued that miners, stakers, hardware, and software companies are not positioned to fulfill the reporting requirements imposed by §6045 because these parties do not have access to the requisite information about individuals engaged in digital asset transfers. Imposing impracticable reporting requirements on a broad array of parties within the digital assets industry, critics argued, would stifle the innovation and drive business out of the United States, especially to China, which is embracing blockchain technology.

[4] All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

[5] Infrastructure Bill §80603(a)(3).

[6] Infrastructure Bill §80603(b)(1)(A).

[7] Reg. §1.6045-1.

[8] *See* §6045A(d) (as would be amended by Infrastructure Bill §80603(b)(2)(A)(ii)).

[9] Infrastructure Bill §80603(c).

[10] *See* §6724(d)(1)(B) (as would be amended by Infrastructure Bill §80603(b)(2)(B)).

[11] Brian Armstrong, Coinbase is happy to help customers fulfill tax obligations. . . ., @brian_armstrong, Twitter (Aug. 4, 2021), https://twitter.com/brian_armstrong/status/1423043376627265538.

[12] Rachel Janfaza, *'This is no way to make policy': Cryptocurrency advocates express frustration with bipartisan infrastructure language*, CNN (Aug. 8, 2021).

[13] Brian Armstrong, But the bill defines ''brokers'' to include anyone who. . . , @brian_armstrong, Twitter (Aug. 4, 2021), https://twitter.com/brian_armstrong/status/1423043405085564930.

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To address these concerns, Senators Cynthia Lummis (R-WY), Ron Wyden (D-OR), and Pat Toomey (R-PA), proposed an amendment that would have clarified that digital assets exchanges, trading desks and similar types of businesses would be considered ''brokers'' subject to the reporting requirement, but other entities such as miners and validators would not be subject to the reporting requirements. This bipartisan effort was supported by many in the crypto industry. The proponents of this amendment made clear that investors failing to pay tax they owe due to cryptocurrency transactions is a real problem, and they strongly supported third-party reporting by exchanges where cryptocurrency is bought, sold and traded. But, as Senator Toomey explained, ''by clarifying the definition of broker, our amendment will ensure non-financial intermediaries like miners, network validators, and other service providers — many of whom don't even have the personal-identifying information needed to file a [Form] 1099 with the IRS — are not subject to the reporting requirements specified in the bi-partisan infrastructure package.''[14]

In response, Senators Rob Portman (R-OH), and Mark Warner (D-VA) offered their own amendment, which the Biden administration supported.[15] Saying that they were responding to criticism of the original bill, Senators Portman and Warner proposed exclusions to the definition of ''broker'' for parties that validate transactions in a ''proof of work'' system and parties that create and sell software and hardware that permit an individual to control cryptocurrency private keys. Bitcoin uses the ''proof of work'' system, but other prominent digital assets use a different system referred to as ''proof of stake'' (where an individual mines or validates new block transactions by contributing — or ''staking'' — their own digital assets). Consequently, the Portman-Warner proposal would have left in place the reporting requirements for parties involved in ''proof of stake'' systems but parties involved in a proof of work system would be excluded from the requirements. Senators Portman and Warner did not explain their rationale for excluding proof of work over proof of stake (although some with a cynical view hypothesized that this choice would generate more revenue).

The response to the Portman-Warner proposal was even more harsh than the response to the original text included in the Infrastructure Bill. Armstrong called the Portman-Warner proposal ''disastrous''[16] because it put the government in the role of picking winners and losers in a nascent industry. He analogized it to the government deciding to favor Apple's iOS operating system over the Android operating system when drafting legislation. Elon Musk echoed the same sentiments.[17] Furthermore, proof of stake is seen by many as a much more climate-friendly choice to the significant energy-consumption needed to maintain a proof of work system. Indeed, Ethereum, the second largest cryptocurrency network by market capitalization behind Bitcoin, is in the process of migrating to a proof of stake system. Jack Dorsey, CEO of payments company Square, which offers and is developing cryptocurrency product and service offerings, urged that the Digital Asset provisions of the Infrastructure Bill to be eliminated entirely until hearings and deliberation on the provisions could be held.[18]

Based in part on the technical rules of the Senate, none of the amendments were approved, meaning that the Infrastructure Bill as passed by the Senate includes the original definition of broker that many in the digital asset industry maintain is overly broad. Thus, it will now be up to the U.S. House of Representatives, which receives the Infrastructure Bill after its passage in the Senate, to adopt amendments to the broker and digital assets provisions. In that regard, Rep. Anna Eshoo (D-CA), who has been described as Speaker Nancy Pelosi's (D-CA) ''closest friend in Congress,'' has already asked Pelosi to modify the tax reporting requirement.[19] Reports of comments from anonymous sources at the U.S. Treasury Department indicate that, if the House of Representatives does not revise the Digital Assets provision of the Infrastructure Bill, the Treasury Department will issue guidance to clarify the meaning of ''broker.''[20]

[14] *See* Wyden, Lummis, Toomey Amendment Would Clarify Digital Asset Reporting Requirements, United States Senate Committee on Finance, Chairman's News, available at https://www.finance.senate.gov/chairmans-news/wyden-lummis-toomey-amendment-would-clarify-digital-asset-reporting-requirements

[15] *See* On Senate Floor, Portman, Warner Conduct Colloquy Clarifying Cryptocurrency Provision in Infrastructure Investment & Jobs Act, Rob Portman, United States Senator from Ohio Press Release, available at https://www.portman.senate.gov/newsroom/press-releases/senate-floor-portman-warner-conduct-colloquy-clarifying-cryptocurrency.

[16] Brian Armstrong, There are a few key moments that define our future. One is happening now in the Senate . . . @brian_armstrong, Twitter (Aug. 6, 2021), https://twitter.com/brian_armstrong/status/1423744994444206092?lang=en.

[17] Elon Musk, Agreed, this is not the time to pick technology winners or losers in cryptocurrency technology. There is no crisis that compels hasty legislation, @elonmusk, Twitter (Aug. 6, 2021) https://twitter.com/elonmusk/status/1423780661639344131.

[18] Jack Dorsey, Forcing reporting rules on Americans who develop software and hardware, who mine and secure the network, ... , @jack, Twitter (Aug. 8, 2021), https://twitter.com/jack/status/1424219726838960131.

[19] Rep. Anna G. Eshoo, Letter to Speaker Nancy Pelosi (Aug. 12, 2021), https://eshoo.house.gov/sites/eshoo.house.gov/files/Aug12_Crypto.pdf.

[20] Christopher Condon and Laura Davison, *Treasury Seeks to Quell Fears Crypto Tax Rules Are Overly Broad*, Bloomberg (Aug. 13, 2021), https://www.bloomberg.com/news/articles/2021-08-13/treasury-seeks-to-quell-fears-crypto-tax-rules-are-overly-broad.

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