WHO YOU CALLING A BROKER? THE INFRASTRUCTURE BILL'S IMPACT ON CRYPTOCURRENCY

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In 2016, the Treasury Inspector General for Tax Administration ("TIGTA") recommended that the IRS "*revise third-party information reporting documents to identify the amounts of virtual currency used in taxable transactions,*" as a partial solution to TIGTA's concern that too much virtual currency activity goes unreported to the IRS.

The bipartisan infrastructure bill that just passed the Senate contains a provision designed to accomplish a similar objective. And, according to many participants in the cryptocurrency space, that very same provision could spell doom for innovation in the space, at least within the borders of the United States.

How did that happen? Let's dive into a world where the legislative process, tax law, and cryptocurrency intersected to create this angst.

What's cryptocurrency got to do with infrastructure?

Nothing, *really*.

Except that H.R. 3684, known as the Infrastructure Investment and Jobs Act,

> *"allocates money to build roads, bridges, transportation systems, and support clean energy, among other developments."*

And political considerations dictated that, to get the bill passed, every dollar spent had to have a corresponding source of revenue. The drafters of the bill looked high and low to find the money to pay for their proposals. **They found cryptocurrency.**

Now, the bill doesn't impose any new taxes on cryptocurrency transactions or raise tax rates on anyone.

Instead, Section 80603 of the bill redefines the word "broker" to specifically include:

> *"any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."*

How does H.R.3684 raise money for the government?

Because anyone defined as a "broker" must report to the government numerous types of transactions entered into by those with whom the broker does business. (Look at IRS Form 1099-B to see what such a report looks like with respect to stocks and other financial assets.)

And, the thinking goes, the more transactions reported to the government,

- the more parties will voluntarily report those transactions on their tax returns and pay the taxes that are due (such as capital gains taxes) or
- the government, having learned about the transactions, can go after those who failed to pay taxes on them, and hit them up for the unpaid taxes, penalties, interest, and, in extreme cases, criminal prosecution, thereby deterring others from noncompliance and raising revenue that way.

Kind of off topic, but too important not to mention, the bill also requires businesses to report to the IRS any receipt of virtual currency with a value of more than $10,000, just as has been the case for cash receipts for many years.

The government has estimated that the enhanced reporting requirements will help bring in an additional $28 billion in federal revenue. I'm not sure anyone really knows how they came up with that number, but that's their number and their sticking to it.

How does that potentially spell doom for the cryptocurrency space?

The answer lies in the breadth of the expanded definition of "broker". Almost anyone will tell you that the drafters of the legislation intended to impose this reporting requirement on exchanges, such as Coinbase or Kraken, where people buy and sell virtual currency.

Because the IRS has, since 2014, defined cryptocurrency as property, a person's sale of virtual currency in exchange for dollars, or even a person's trade of virtual currency in exchange for a different virtual currency (*such as swapping Bitcoin for Ether or Litecoin*) has the potential to trigger capital gain (*or loss*). Exchanges haven't always been consistent about whether or how they report transactions to the IRS. The infrastructure bill sought to change that. And some exchanges even support the concept.

Validators

But the actual words of the proposed new statute arguably include other crypto players besides exchanges. In the Bitcoin system, for example, when someone wants to sell and someone else wants to buy bitcoin, that transaction can't occur unless "validated" by other parties (other computers, really) running complicated algorithms designed to ensure that the seller really owns, and hasn't already transferred to someone else, the bitcoin at the center of the proposed transaction.

Such a validator (referred to as a bitcoin "miner") could be deemed to be a "person…effectuating transfers of digital assets" (although arguments against such a construction certainly exist). If so, the statute might consider the person behind the computer a "broker" under Section 80603, subject to reporting requirements.

The way the Bitcoin system works, though, that person **simply cannot comply with the requirement** because the miner doesn't have access at all to the identities of the participants in the transaction.

Hard Wallets

Similar scenarios exist for other cryptocurrency participants, such as those who sell "hard wallets," where bitcoin owners can "store" their bitcoin (by storing the private keys that allow access to the bitcoin). Although I think it's a stretch, some might argue that a hard wallet, in some way, "effectuate transfers" of bitcoin.

Software Developers and Others

Indeed, some have suggested that a software developer who creates and makes available open source code used by others to swap digital assets might also be considered a "broker" under the definition in the infrastructure bill.

And, the concern is that numerous potential players in the cryptocurrency space will not willingly subject themselves to the reporting requirements that "broker" status will thrust upon them. Instead, if they choose to get involved in the space at all, they will do so from outside the United States.

Thus, the fear that the infrastructure bill will stifle creativity and innovation in the cryptocurrency space and/or drive such creativity and innovation overseas.

Can H.R. 3684 be fixed?

Some legislators tried. Senators Wyden (D-Oregon), Lummis (R.-Wyoming) and Toomey (R-Pennsylvania) put forward a proposal, backed by most in the cryptocurrency space, which would have explicitly carved out from the definition of "broker" those who validate transactions, sell certain hardware or software, or develop "digital assets or their corresponding protocols for use by other persons."

A competing proposal, introduced by Senators Warner (D-Virginia), Portman (R-Ohio) and Sinema (D-Arizona), and supported by the White House and the Treasury Department, did not go as far and actually garnered opposition from the cryptocurrency industry.

On Monday, August 9, the key Senators reached a compromise that appeared to have widespread support.

Why didn't the compromise pass?

Under the Senate rules governing the consideration of the infrastructure bill, no amendments to the bill could be put to a Senate vote. Consequently, the bill could only be amended by a procedure known as "unanimous consent," meaning a Senator could propose an amendment, but if even one other Senator objected, the amendment could not go forward.

On Monday, Senator Toomey asked unanimous consent that the compromise be adopted. Senator Shelby (R-Alabama), using fancy legislative talk, said he'd go along, but only if everyone else in the Senate agreed to adopt his unrelated proposal to add $50 billion in spending on military infrastructure. Senator Sanders (I-Vermont) objected, which meant the end of the compromise.

Now what?

For now, the broad definition of "broker" remains in the bill. To become law, the bill must pass the House of Representatives, which could make changes–to the definition of "broker" or any other provision in the bill, and the Senate could go along with those changes and send the bill to the President. Or, if the bill ultimately becomes law in its present form, hope exists that the IRS will interpret "broker" to mean "exchanges," the result a number of Senators involved in the drafting of the bill say they intended.

With a few exceptions, everyone in government says they want to advance technological development and innovation, including in the cryptocurrency space, and they want the United States to lead the way (and reap the economic rewards of doing so).

I am optimistic that, eventually, we will get to the right place, where workable laws with workable definitions will strike the proper balance (or at least a reasonable balance) that will allow creativity and entrepreneurship to flourish while protecting the investing public with appropriate regulatory safeguards… and making sure the Treasury gets its fair and lawful cut.

I can dream, can't I?