LEDGIBLE

November 9, 2023

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

Re: REG-122793-19, Notice of Proposed Rulemaking: Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions

To Whom it May Concern:

We appreciate the opportunity to comment on REG-122793-19. At Ledgible we support practical tax reporting regulations that maintain competitive market environments, allow industry participants to continue innovating the future of financial services, and provide taxpayers with useful and timely information to help them comply with their tax obligations. Enclosed please find our comments which include requests for guidance, responses to questions, and recommendations regarding the Notice. We have also provided additional comments in Section C that were not specifically requested through the listed questions from the Notice of Proposed Rulemaking but which we believe provide the IRS and U.S. Treasury with critical feedback regarding other provisions of the proposed regulations.

Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance. You may contact us at policy@ledgible.io. We would be happy to discuss our comments in further detail. Thank you in advance for your time and consideration.

Jessalyn Dean	**Gabriel Brin**	**Kell Canty**
VP of Tax Information Reporting	VP of Tax & Accounting Product	CEO and Co-Founder

About Ledgible Digital Asset Tax and Accounting

The Ledgible Tax Information Reporting (TIR) Platform enables digital asset providers and traditional financial institutions to handle cryptocurrency and digital asset data and to quickly aggregate, normalize, and format tax data for tax form preparation. Digital asset brokers rely on Ledgible to calculate, track, and store the cost basis information needed in order to report on tax forms such as IRS Form 1099-B and 1099-DA for cryptocurrencies, NFTs, tokenized assets, and other digital assets. Through on-chain nodes, proprietary tax algorithms, and robust data mapping, all in a SOC 1 and 2 Type 2 audited solution, Ledgible is the choice of institutions, enterprises, and financial leaders looking for a solution in post-trade digital asset tax data normalization and cost basis tracking. Ledgible partners with the world's leading Form 1099 filing providers to allow digital asset brokers to seamlessly integrate their Ledgible cost basis calculations into tax form filings.

A. Questions from the Explanation of Provisions

1. *Does the proposed definition of digital asset accurately and appropriately define the type of assets to which these regulations should apply? See Part I.A.1 of this Explanation of Provisions.*

We disagree with the broad inclusion of Non-Fungible Tokens ("NFTs") as an asset to which these regulations should apply. In its most basic concept, most NFTs are simply a digital receipt for some other asset or right. That asset or right could be tickets to an event, digital artwork, rights to a share of income from music royalty revenues, or a variety of infinite other possibilities. The inclusion of NFTs as an asset to which these regulations should apply is akin to creating Form 1099 reporting any time digital receipts are issued, without regard to the economic reality of the transaction. The IRS has recognized this concept in Notice 2023-27 where it sought public comments on the "look-through approach" to the tax treatment of certain NFTs as collectibles. We recommend that a similar look-through approach is appropriate for NFTs with regards to Form 1099 reporting. In such a look-through approach, we recommend that Form 1099 reporting would only apply in the case that the underlying asset (or rights) are otherwise already subject to Form 1099 reporting, such as NFTs representing real estate or NFTs representing goods where the payment is guaranteed and settled by a Third Party Settlement Organization ("TPSO"). In the case that the IRS does not accept this recommendation, we instead recommend that the IRS exclude NFTs from cost basis reporting on Form 1099 reporting. We offer this alternative recommendation due to the possible confusion to taxpayers regarding their cost basis in the underlying asset or rights versus the perceived cost basis of the NFT itself. The NFT itself, as a digital receipt, cannot have its own cost basis however the digital asset brokers are unlikely to know the true cost basis of the underlying asset or right. We provide further concerns about NFTs in our comments in Section C later in this comment letter.

2. *Does the definition of digital asset or the reporting requirements with respect to digital assets inadvertently capture transactions involving non-digital asset securities that may use distributed ledger technology, shared ledger, or similar technology to process orders without effecting sales? Should any definitions or reporting rules be modified to address other transactions involving tokenized or digitized financial instruments that are used to facilitate back-office processing of the transaction? See Part I.A.2. of this Explanation of Provisions.*

Yes, the definition inadvertently captures non-digital asset transactions that we recommend in the next question A.3 to exclude from the proposed reporting on Form 1099-DA. We offer in this response the rationale behind why they should not be captured.

<u>General Remarks</u>
The IRS considered that sales of digital assets that are also reportable under existing 6045 regulations on Form 1099-B as securities shall only be reportable under the proposed 6045 regulations on Form 1099-DA thereby eliminating double reporting. The drafting of this proposed coordinating regulation has been written primarily with native crypto tokens in mind that could possibly have uncertainty as to their nature as digital asset securities (e.g. disputes with the SEC). However, the proposed regulations will create a significant and undesirable burden on the existing tax reporting infrastructure of the traditional financial services industry, for example highly regulated mutual funds otherwise known in the U.S. as Registered Investment Companies under the Investment Company Act of 1940 ("1940 Act Funds"). Though 1940 Act Funds are not the only securities that would be adversely affected by this coordinating regulation, we have chosen it as our primary example to illustrate our concerns due to its overwhelming market size when looking at the entire tokenized

securities industry. We also note that where a tokenized fund or other asset is not a 1940 Act Fund, it will typically end up as a partnership structure. We separately address our concerns with tokenized partnerships later in this comment letter at Section C, comment C.2.

The following comments form the basis for our recommendations which we discuss in the next question A.3.

Proposed Coordination Rule Is Based On False Assumptions

Here we point out some false assumptions used in the commentary as to why the IRS proposed different reporting (on Form 1099-DA) for digital assets regardless of whether they would also qualify as a security:

A. “digital asset trading platforms that trade both tokenized stock and other digital assets would be subject to two different sets of reporting rules when such assets were sold for cash.”
    i. **Response**: the tokenized security industry in the U.S. today is not mature enough and therefore there will be nearly zero situations where this occurs. Today, most brokers hold custody of either tokenized stock or other digital assets but not both. The cases where a broker could therefore be burdened with two different sets of rules will be inconsequential.
B. “tokenized stock would be subject to one set of reporting rules if sold for cash – that is, the existing regulations relating to the reporting of sales of securities for cash – and to a different set of reporting rules if sold for another digital asset or other consideration – that is, these proposed regulations for sales of digital assets”
    i. **Response**: the tokenized security industry in the U.S. today is not mature enough and therefore there will be very few instances where this occurs. Today, most brokers listing tokenized stock are traditional financial institutions that have been around for many decades and have closely regulated offerings such as mutual funds, ETFs, and equities. These well known and well regulated financial institutions are in the very early stages of leveraging blockchain technologies and therefore do not allow their customers to hold or exchange other digital assets for tokenized stock. The cases where a broker could therefore be burdened with two different sets of rules will be inconsequential.
C. “the tax compliance concerns associated with transactions in digital assets are different from the tax compliance concerns associated with trading in conventional or non-digital asset securities, including as a result of the common market practice of transferring digital assets from a centralized platform to a private wallet and back again.”
    i. **Response**: this practice is not unique to digital assets and blockchain activity. In the traditional financial services industry, investors can take their shares of stock off of their brokerage platform into what we could effectively call a self-managed custody which is similar to the concept of a private wallet for digital assets. The vast majority of investors in these traditional financial assets do not take advantage of such self-custody opportunities because they prefer to trust a broker with their custody needs. However, the tax compliance concerns remain the same: a holder of self-custodied digital assets still needs to bring their digital assets onto a centralized exchange in order to convert their digital assets back into fiat currencies, just like the holder of self-custodied stock shares still needs to bring their stock shares onto a regulated stock brokerage in order to convert their shares back into fiat currencies.

Impacts to the Tokenized Funds Industry

Today, the biggest use case for tokenized securities is the tokenization of fund structures such as index and money market mutual funds. In the majority if not all cases, these are highly regulated 1940 Act Funds that

are working closely with the U.S. Securities and Exchange Commission ("SEC") and other regulators to modernize their back office infrastructures and shareholder record keeping by leveraging blockchain technology through tokenization. Today, most use cases have not advanced far enough to allow for withdrawal to private self-custody wallets, peer-to-peer trading, indirect investment through omnibus accounts, or broker transfers. The most common trend today is to launch new funds rather than tokenizing existing funds so that blockchain is leveraged from Day 1. These funds are operated by heavily regulated traditional financial institutions with decades of experience operating funds and filing Forms 1099 with the IRS and to payees. Today, these tokenized funds are already subject to existing Form 1099 reporting requirements such as Form 1099-B to report sales of securities; Form 1099-DIV to report dividends, return of capital, and long term capital gain distributions; and IRS Form 8937 to report organizational actions affecting basis of securities; amongst others. Shareholders are very familiar with receiving these tax forms. Shareholder recordkeepers are very familiar with preparing and filing these tax forms. For many decades, shareholder recordkeepers (also referred to as transfer agents) have invested significant amounts of their operating budget into software and infrastructure that is adapted to these existing Form 1099-B (etc) tax form structures. In this existing infrastructure, the cost basis calculation engines are designed according to the cost basis regulations applicable to 1940 Act Funds.

With the proposed coordination rule, sales of tokenized funds would be reportable on Form 1099-DA and not on Form 1099-B simply by the fact that they are recorded on a cryptographically secured distributed ledger. This would cause:

A. traditional financial institutions to have to overhaul their cost basis and Form 1099 reporting software and infrastructure for a specific subset of their funds even though they are economically identical to their non-tokenized counterparts. As mentioned earlier in this section, these institutions are not typically offering both tokenized securities and other digital assets for custody or sale on their platform and therefore would have no other reason to make such an overhaul. As also mentioned earlier, exchanges of tokenized funds with other digital assets is not currently widespread, however it could occur if a broker decided to implement stablecoins for improving the efficiency of on-ramps and off-ramps to fiat currencies. In this case, the broker would have the added complexity of allocating transaction costs 50% to acquisition and 50% to disposal which is not aligned with how existing non-tokenized 1940 Act Funds allocate transaction costs for purposes of cost basis calculations.
B. confusion for taxpayers invested in both tokenized funds and non-tokenized funds due to potential differences in how their cost basis is calculated. This is due to the proposed regulations regarding 50% allocations of transaction costs for exchanges of digital assets which would not apply to the non-tokenized funds.
C. confusion for taxpayers who have been and will continue receiving Form 1099-B for sales of tokenized funds until the proposed regulations are fully implemented. At that point, they will suddenly start receiving a Form 1099-DA and stop receiving Form 1099-B.

3. *If an exception is necessary for transactions involving non-digital asset securities that may use distributed ledger technology or similar technology to process orders without effecting sales, how should it be drafted so that it does not sweep in other transactions (such as tokenized securities, or other digital assets that are securities) that should not be exempted from the reporting requirements? For example, should, and if so how should, reporting requirements distinguish between, and thus avoid double-counting of, sales of digital assets from use of distributed ledger technology or similar technology for mere recordkeeping, clearing, or settlement of tokenized securities or other assets? See Part I.A.2. of this Explanation of Provisions.*

Based on our commentary provided in question A.2, we recommend the following:

A. Sales of tokens that are a digital representation of a 1940 Act Fund shall not be reportable on Form 1099-DA and will continue being reportable on existing Form 1099-B as they are today. IRS should consider similar exclusions for tokens that represent other highly regulated products outside of 1940 Act Funds.
B. Allocation of transaction costs should not be 50% to the acquisition and 50% to the sale on an exchange of digital assets in the case that the broker specifically allocates the transaction cost in their books and records. In such a case, the allocation for purposes of cost basis calculations should follow the specific allocation in the books and records of the broker. This recommendation is discussed in more detail at questions A.41 and A.42. The objective is to prevent tokenized 1940 Act Funds from having to make major adaptations to their existing cost basis calculation engines for only a subset of their funds (the tokenized funds). Maintaining existing cost basis rules for 1940 Act Funds is of the utmost importance.

4. *How common are digital asset options that are also section 1256 contracts? Are there less burdensome alternatives for reporting these digital asset option transactions? For example, would it be less burdensome to allow brokers to report transactions involving section 1256 contracts that are also digital assets or the delivery of non-digital assets that underlie a digital asset option as a sale under proposed §1.6045-1(a)(9)(ii)? See Part I.A.3 of this Explanation of Provisions.*

Through our work with a network of global and regional Certified Public Accounting ("CPA") firms, we understand that today there are investment products on the market that qualify as Section 1256 contracts and they are becoming more common. For example, some derivative investments on the Chicago Mercantile Exchange ("CME") do qualify under the rules of Section 1256 and are being treated as such by many taxpayers.

5. *No comment.*

6. *No comment.*

7. *Are there any technological or other technical issues that might affect the ability of a non-custodial digital asset trading platform that is a person who qualifies as a broker to obtain and transmit the information required under these proposed regulations, and how might these issues be overcome? See Part I.B of this Explanation of Provisions.*

Yes, there are technological or other technical issues. Under existing regulations, brokers are tasked with collecting the accurate names and tax identification numbers ("TINs") from their customers in order to issue correct Form 1099 reporting at year end that enables the IRS to do data matching against taxpayer filings in order to verify compliance with income reporting. In the case that the broker cannot get accurate names and TINs, then they have to withhold tax and remit it to the IRS. This is called backup withholding and the rate is currently 24% of the gross proceeds on a sale transaction (not the gain). This backup withholding acts in two ways:

A. As a way for the IRS to get their revenue before the funds disappear into the hands of a taxpayer that they cannot track down; and

B. To deter the taxpayer from ignoring requests by the broker to provide an accurate name and TIN. Ignoring name and TIN requests from a broker results in 24% of their gross proceeds being withheld which causes most customers (taxpayers) to act quickly to provide brokers with up-to-date and accurate information.

As the IRS describes in Part I.B of the Explanation of provisions, decentralized exchanges can be in scope of broker reporting on the sales of digital assets if they have sufficient control of the exchange or its smart contracts to be in a position to know their customers and therefore collect their name and TIN on a certified Form W-9. But the IRS recognizes that since these decentralized exchanges do not hold custody of the private keys of customer wallets then they are not in scope of cost basis reporting on such sales transactions. As discussed in more detail at question A.49, what is not addressed in the proposed regulations is that since decentralized exchanges do not have control of their customers' private wallets then they do not have any funds from which to withhold any tax. Therefore decentralized exchanges may be in a position of reporting unusually large volumes of incorrect or missing TINs to the IRS.

We therefore recommend that the IRS draft coordinating regulations with Internal Revenue Code ("IRC") Sections 6721, 6722, 6723, and especially 6724 with regards to "Reasonable Cause" penalty abatements where a broker is unable to collect and remit tax withholding due to its lack of control or custody of customer funds.

8. *No comment.*

9. *No comment.*

10. *No comment.*

11. *No comment.*

12. *No comment.*

13. *No comment.*

14. *No comment.*

15. *What is the frequency with which creators or issuers of digital assets redeem digital assets? See Part I.B.4 of this Explanation of Provisions.*

This varies based on tokenomics that are set up for certain projects and their attempt to maintain value integrity and "dumping" which is a form of liquidating a digital asset coin and its value. The unlock period and methodology changes from asset to asset and is usually outlined in written documents and "whitepapers" on top of an automatically unlocking mechanism on a smart contract.

16. *Should the broker reporting regulations apply to initial coin offerings, simple agreements for future tokens, and similar contracts? See Part I.B.4 of this Explanation of Provisions.*

We do not believe so as the information that would need to be gathered may not be done in a feasible and uncostly manner. Furthermore, ICOs, SAFTs, and similar contracts are all different based on project fundamentals and goals. It would be difficult to attain a "one size fits all" approach to reporting.

17. *No comment.*

18. *No comment.*

19. *What is the frequency with which forward contracts involving digital assets are traded in practice? Are there any additional issues that should be considered to enable brokers to report on these transactions? See Part I.C of this Explanation of Provisions.*

In our experience, forward contracts involving digital assets are traded at a lesser frequency than both futures and options contracts. The forward contracts involving digital assets that we do see being traded are done so over-the-counter ("OTC").

20. *Should the definition of sale or other parts of these proposed regulations be revised to address transactions not addressed in these proposed regulations, such as the transfer of digital assets to and from a liquidity pool by a liquidity pool provider, or the wrapping and unwrapping of digital assets? See Part I.C of this Explanation of Provisions.*

We recommend that before the IRS addresses the Form 1099 reporting over such transactions, that substantive taxation law is first drafted and addressed. Such substantive taxation law would be addressed outside the scope of Form 1099 reporting and must come first. The digital assets industry is currently facing the unprecedented situation of being given Form 1099 reporting regulations at the same time that substantive taxation law is either missing or being changed. The traditional financial services industry has had the historic advantage of clear and established substantive taxation laws being introduced first, with Form 1099 reporting over such transactions being introduced at a later time. We discourage the IRS from collecting tax information through Form 1099 reporting over transactions before it is clear to the IRS, taxpayers, and the public what the taxation effects are of such transactions (such as transfers in and out of liquidity pools and wrapping and unwrapping of digital assets mentioned in this question).

21. *No comment.*

22. *No comment.*

23. *Should the time reported using UTC time be reported using a 12-hour clock (designating a.m. or p.m. as appropriate) or a 24-hour clock? To what extent should all brokers be required to use the same 12-hour or 24-hour clock for these purposes? See Part I.D of this Explanation of Provisions.*

We recommend that all brokers be required to use a 24 hour clock. The 24 hour clock is a global standard and ensures that systems will be designed in a consistent and scalable way in case brokers have to comply with similar tax reporting rules in other non-U.S. jurisdictions and for purposes of transfers between brokers.

24. *Is a uniform time standard overly burdensome, and are there circumstances under which more flexibility should be provided? See Part I.D of this Explanation of Provisions.*

We do not expect a uniform standard to be overly burdensome however we recommend allowing brokers to decide which time zone is appropriate for their reporting standard. As discussed further in question A.25, there is no single time zone that will solve the problems of taxpayers having a different time zone than the broker therefore it is not necessary to enforce a single strict standard for all brokers.

25. *Are there alternatives to basing the transaction date on the UTC for customers who are present in different time zones known to the broker at the time of the transaction? See Part I.D of this Explanation of Provisions.*

We do not recommend allowing for different time zones based on customer location, even if the time zone is known to the broker. Allowing for more than one time zone based on customer location would cause the broker to be unable to properly reconcile their annual tax reporting obligations to their accounting records, for example during preparation of audit trails, during regular internal audits, or under IRS audit. More importantly, it would make the broker and the IRS unable to reconcile backup withholding, timely tax deposits, and the annual Form 945 and 1042 filings. Our recommendation instead is to add a new column to the Form 8949 (or equivalent) where taxpayers report their disposals in their tax return to allow the taxpayer to specifically reconcile any variances in their tax return to the Form 1099 received. Using the example in the proposed regulations at 1.6045-1(d)(4)(iii)(B) Example 2, while P2X would report this sale on a Year 2 Form 1099-DA, taxpayer J would report in Year 1 on their Form 8949 by using a new adjustments column to add in the sale and its basis not reported on a Form 1099 in Year 1. In Year 2, when taxpayer J receives the Form 1099-DA for the sale already reported and taxed in Year 1, then they (taxpayer J) would again use the new adjustments column on Form 8949 to back out (reverse) the sale reported on Form 1099-DA that was reported and taxed in the previous year. This does create a situation where a taxpayer is tasked with calculating and reporting their own cost basis of sales that won't be reported to them in Year 2. As such, digital asset brokers may consider optional reporting to the taxpayer that is not reported to the IRS of all transactions in the 24 hour period after the digital asset broker's year end closes.

26. *Should the fair market value of services giving rise to digital asset transaction costs (including the services of any broker or validator involved in executing or validating the transfer) be determined by looking at the fair market value of the digital assets used to pay for the transaction costs? Are there circumstances under which an alternative valuation rule would be more appropriate? See Part I.E.2 of this Explanation of Provisions.*

Yes, we recommend that the fair market value of the digital asset paid for transaction costs at the time of payment would be the most feasible and easily attainable value of the consideration given.

27. *Are there any suggestions that could work to avoid duplicative multiple broker reporting for sale transactions involving digital asset brokers without sacrificing the certainty that at least one of the multiple brokers will report? See Part I.H of this Explanation of Provisions.*

Without adding digital asset brokers to the list of exempt recipients, the IRS risks both duplicate reporting to the IRS but also to payees. A digital asset broker exempt recipient is also an absolute necessity for institutional omnibus accounts held at large digital asset brokers on behalf of other large digital asset brokers.

Where the omnibus account is held by a broker that is not otherwise an exempt recipient, the volume of duplicate reporting that would result would be staggering (e.g. reporting by the first broker to the second broker and then reporting again by the second broker to their customer, the identifiable beneficial owner). We recommend that the IRS add digital asset brokers to the list of exempt recipients. We further recommend that the IRS establish a registration system for brokers which assigns a unique broker identification number once an application is reviewed and approved by the IRS. Similar to the Foreign Financial Institution ("FFI") Register of Global Intermediary Identification Numbers ("GIIN") under the Foreign Account Tax Compliance Act ("FATCA"), this new broker database would be searchable and updated on a monthly basis by the IRS to add new brokers and remove brokers that are no longer verified. With the implementation of such a system, digital asset brokers could then have a new exempt payee code added on IRS Form W-9 and upon using this digital asset broker exempt payee code such broker would provide its unique broker identification number. Other brokers in a chain of multiple brokers would be able to check that the broker identification number is in the IRS database and perform ongoing monthly maintenance checks. When a broker is removed from this proposed IRS database, then other brokers would no longer be able to treat it as an exempt recipient and Form 1099 reporting would begin where appropriate. We suggest that as part of the public facing database, the IRS could consider listing the name of the broker, their broker identification number, and which type of broker they are (U.S. broker, CFC broker, or non-U.S. broker).

28. *No comment.*

29. *No comment.*

30. *Should the regulations define when a broker has reason to know that a digital asset broker is organized within the United States, and are there suggestions for objective indicators that a digital asset broker is organized in the United States? See Part I.I.3 of this Explanation of Provisions.*

Leveraging our recommendations at question A.27, we recommend that a broker has reason to know that a digital asset broker is organized within the United States if the name of the broker can be reasonably ascertained and is unambiguously identified in the IRS database of digital asset brokers as a U.S. broker.

31. *No comment.*

32. *No comment.*

33. *No comment.*

34. *No comment.*

35. *No comment.*

36. *No comment.*

37. *Is it appropriate to treat stablecoins, or a subset of stablecoins, as digital assets for purposes of these regulations? What characteristics should be considered when assessing whether stablecoins, or a subset of stablecoins, should be treated as digital assets under these regulations? See Part I.K of this Explanation of Provisions.*

We recommend that before the IRS addresses the Form 1099 reporting over such transactions, that substantive taxation law is first drafted and addressed. Such substantive taxation law would be addressed outside the scope of Form 1099 reporting and must come first. The digital assets industry is currently facing the unprecedented situation of being given Form 1099 reporting regulations at the same time that substantive taxation law is either missing or being changed. The traditional financial services industry has had the historic advantage of clear and established substantive taxation laws being introduced first, with Form 1099 reporting over such transactions being introduced at a later time. We discourage the IRS from collecting tax information through Form 1099 reporting over transactions before it is clear to the IRS, taxpayers, and the public what the taxation effects are of such transactions (such as purchases, sales, and transfers of stablecoins mentioned in this question).

38. *Should the regulations exclude reporting on transactions involving the disposition of U.S. dollar related stablecoins that give rise to no gain or loss, and if so, how should those stablecoin transactions be identified? See Part I.K of this Explanation of Provisions.*

We recommend that the proposed regulations should be revised to exclude reporting on transactions involving the disposition of U.S. dollar related stablecoins that give rise to no gain or loss in the case that they are acquired, held, and disposed of at the same broker. This would eliminate a large volume of over reporting due to the fact that most digital asset exchanges use U.S. dollar stablecoins as fiat currency on-ramps and off-ramps. For example, when a customer of a broker wishes to buy a crypto currency from the broker they first will pay with fiat currency (for example, by ACH transfer or credit card) which is immediately stored in U.S. dollar stablecoins by the broker until the purchase of the crypto currency is executed (typically a short time later). This is exactly how stock brokerages operate using money market funds as the initial on-ramp into the brokerage account from fiat currency until the purchase of stock is later executed. It is important to note that this proposed exclusion is only effective if the taxpayer is also exempt from reporting the sale transaction. Without such equivalent taxpayer exclusion, the taxpayer will suffer a reconciliation burden of figuring out which transactions were reported on a Form 1099 and which ones were not and then accounting for the difference in their tax return.

39. *No comment.*

40. *In the case of cascading digital asset transaction costs (that is, a digital asset transaction cost paid with respect to the use of a digital asset to pay for a digital asset transaction cost), should all such costs be treated as digital asset transaction costs associated with the original transaction? See Part II.A of this Explanation of Provisions.*

Cascading digital asset transaction costs are very common. Especially in the world of decentralized finance and decentralized exchanges. These can be transaction costs to access a platform to then execute a transaction on the platform (this creates multiple transaction costs to execute one trade) or a cost to qualify a certain digital asset to then be traded itself. We believe both costs should be attributable to the trade itself as both are necessarily for the sole purpose of executing that one trade. However, the initial cost of platform use

or of qualification of a digital asset to then be used in a following trade should only be allowed to be accounted for once to ensure it won't be double counted for any future trades that would be allowed once initially paid as these initial costs are usually one time fees for either access or coin "qualification".

41. *Is the allocation of one-half of total digital asset transaction costs paid to the disposition of digital assets for purposes of determining the amount realized and the allocation of the other half to the acquisition of the received digital assets for purposes of determining basis administrable? See Part II.A of this Explanation of Provisions.*

While administrable, this is a daunting task as well as an increased probability of error when it comes to application. We also note that a one-half allocation to each side of the transaction is not the current practice of most taxpayers and we therefore recommend guidance be issued for taxpayers that may face reconciliation issues to this change. Since the current industry consensus on treatment of a trade of digital assets is to recognize a sale followed by a purchase with the consideration (denominated in fiat currency) received from the sale, it would be consistent to align the costs with a selling expense as denoted in IRS Publication 544. If the IRS does not accept this recommendation, then we instead propose an exception as discussed in our earlier remarks and recommendations at questions A.2 and A.3. In this case, we recommend that where a digital asset transaction cost is specifically allocated in the books and records of the broker (either as an allocation to acquisition, disposal, or a mix) then such specific allocation should also apply for cost basis calculation purposes.

42. *Would a 100 percent allocation of digital asset transaction costs to the disposed-of digital asset in an exchange of one digital asset for a different digital asset be less burdensome? See Part II.A of this Explanation of Provisions.*

Yes, a 100% allocation to disposal would be less burdensome.

43. *No comment.*

44. *Should the ordering rules for unhosted wallets be applied on a wallet-by-wallet basis as proposed, or should these rules be applied on a digital asset address-by-digital asset address basis or some other basis? See Part II.C of this Explanation of Provisions.*

We recommend applying the ordering rules on a digital asset address basis rather than wallet-by-wallet basis. Investors have records for all wallets and all assets in question and they will find that ordering on a digital asset address basis is easier for them to comply with.

45. *Are there any alternatives to requiring that the ordering rules for digital assets left in the custody of a broker be followed on an account-by-account basis; for example, if brokers have systems that can otherwise account for their customers' transactions? See Part II.C of this Explanation of Provisions.*

We recommend that whatever ordering rules are followed are consistent for the broker and for the taxpayer. We therefore do not recommend allowing multiple alternatives. Consistency is key so that digital asset transfers between brokers can maintain their cost basis integrity and that the taxpayer does not need to reconcile variances in approaches between brokers.

46. *Should exceptions be made to the ordering rule for digital assets left in the custody of a broker to allow brokers to take into account reasonably reliable purchase date information received from outside sources? If so, what types of purchase date information should be considered reasonably reliable? See Part II.C of this Explanation of Provisions.*

Yes, we recommend that exceptions be made to the ordering rule to account for reasonably reliable purchase date information received from outside sources. We at Ledgible, amongst a number of other providers on the market, offer software solutions to track digital assets as they move through the blockchain ecosystem. We recommend that a broker could consider such data sources, like those provided by Ledgible as an independent third party, as reliable information about the purchase date of an asset for purposes of the ordering rule. We recommend that the broker should be able to perform their own due diligence as to what is a reasonably reliable third party resource and that penalties would not be assessed to the broker for relying on such information for purposes of the ordering rules.

47. *Should the current rules under section 6045A applicable to transfers of securities from one broker to another remain applicable for securities that are also digital assets prior to the implementation of a later phase of the information reporting guidance? See Part IV of this Explanation of Provisions.*

No. We believe that it is reasonable to exempt securities that are also digital assets from existing 6045A transfer reporting simply due to the fact that we are not aware of any digital asset brokers today that allow for the transfer of tokenized securities to another broker, which is discussed more in our response to question A.2. We therefore recommend retaining the proposed exemption during this interim phase.

48. *Who would be the responsible party required to provide the reporting if section 6045B is made applicable to securities that are also digital assets prior to the implementation of this later phase of information reporting guidance? See Part IV of this Explanation of Provisions.*

It is first worth mentioning that we disagree with the proposed regulation 1.6045B-1(a)(6) to exempt issuers from reporting on any security that is also a digital asset where, for example, the security is a 1940 Act Fund as discussed in response to questions A.2 and A.3. Tokenized funds (securities) are already subject to 6045B reporting which provides critical information to institutional investors that are otherwise exempt from Form 1099 reporting.

With regards to other digital assets that were intended to be covered by this new proposed regulation (other than tokenized securities), we recommend that the IRS first and separately drafts and addresses substantive taxation law on what corporate actions affect the basis in these types of digital assets. What is a corporate action that affects the basis of a unit of ETH? Such substantive taxation law would be addressed outside the scope of 6045B reporting and must come first. The digital assets industry is currently facing the unprecedented situation of being given 6045B reporting regulations at the same time that substantive taxation law is either missing or being changed. The traditional financial services industry has had the historic advantage of clear and established substantive taxation laws being introduced first, with 6045B reporting over such transactions being introduced at a later time. We discourage the IRS from requiring the reporting of tax information through 6045B reporting over transactions before it is clear to the IRS, taxpayers, and the public what the taxation effects are of such transactions.

49. *Should any changes be made to the backup withholding rules under existing §31.3406(b)(3)-2(b)(3) or (4) to address digital assets that may also be treated as securities for Federal income tax purposes or to address short sales of digital assets? Are any additional rules needed to address how backup withholding should apply to transactions involving digital assets? See Part VI of this Explanation of Provisions.*

As discussed in our response to question A.7, what is not addressed in the proposed regulations is that since decentralized exchanges do not have control of their customers' private wallets then they do not have any funds from which to withhold any tax. We therefore recommend that decentralized exchanges, and other parties not subject to cost basis reporting due to a lack of custody or control of funds, be exempt from backup withholding requirements.

For those brokers that have custody or control of customer funds, we recommend the following:

A. that a phased in approach is provided that delays the requirement to perform backup withholding and provides a sufficient amount of time to allow brokers to contact customers and collect certified TINs on Form W-9.
B. considering guidance with examples to inform brokers how to perform backup withholding on exchanges of two digital assets where no fiat currency is present to withhold and remit to the IRS.
C. making it clear that backup withholding does not apply to transfers of digital assets.

B. Additional questions

1. *No comment.*

2. *No comment.*

C. Additional comments from Ledgible

The following comments are provided by Ledgible outside of the requested comments from the REG-122793-19, Notice of Proposed Rulemaking.

<u>Implementation and Deadlines</u>

1. As indicated in Part I.D of the Explanation of Provisions, digital asset brokers will be required to report certain information about the sales of digital assets that were transferred-in. This includes the date and time of the transfer-in transaction, the transaction ID, the digital asset address from which the digital asset was transferred-in, and the number of units transferred in. We observed that there is no effective date indicated by the IRS for assets meeting this criteria. Due to the fact that brokers may not have this information going back multiple years, we recommend that the IRS make this requirement effective for assets that were transferred in from January 1, 2023 to align with the enactment of the Infrastructure Bill. In the absence of an effective date, for example, a broker that effects the sale of a digital asset on January 2, 2025 for an asset that was transferred in June 1, 2017 would be obligated to report the transfer-in information mentioned above in January 2026 (over the 2025 calendar year) and would have no relief in the case that they never collected this information or no longer retain it.

Definitions, In-Scope Assets, Duplicate Reporting, and Coordination Provisions

2. As indicated in Part I.A.2 of the Explanation of Provisions, the IRS has spent considerable time addressing real estate transactions that involve digital assets. However, the examples and guidance proposed fail to capture and address the reality of most real estate transactions that leverage blockchain technology, particularly tokenized real estate. We specifically call your attention to the example provided in proposed regulation 1.6045-1(c)(8)(iv)(B). In this example, the IRS imagines a broker that offers tokenized real estate which represents partial interests in a building. This example does not reflect reality today for the following reasons:
    a. In the majority (if not all) cases, a token cannot hold legal title to real estate and therefore a legal entity must be formed and interposed in between the multiple owners, their tokens, and the building. In reality, what each token holder owns is a claim of ownership of an entity and not a claim of ownership of a piece of real estate. The entity choice is typically an LLC or a partnership. In fact, we are not aware of any use cases today where a corporation is used in the case of owning real estate through tokenization.
    b. Even in cases where there is only a single owner of a piece of tokenized real estate, rather than partial ownership, most use cases still interpose an LLC as the title holder of the real estate rather than the natural person.
    c. Even in the case that a legal entity was not required to be formed to hold title, the facts of the example provided by the IRS indicate that this unincorporated association of real estate co-owners would likely meet the definition of being a partnership anyway under the default rules of Regulations Section 301.7701-3(b)(1) of the IRC. Again, we arrive at the same outcome as the previous point which is that the token holder owns a claim of ownership of a partnership interest and not a claim of ownership of a piece of real estate.

    As a result, in the example provided, the IRS has incorrectly identified the transaction as a Form 1099-S reportable event involving the sale or transfer of real estate when in reality the transaction is the sale or transfer of a partnership interest. In this regard, the IRS has failed to address a coordinating regulation with Form Schedule K-1 and 1065 reporting requirements. The practical outcome is that, as drafted, the proposed 6045 regulations would require a Form 1099-DA to be issued on the sale or transfer of tokenized real estate, reporting both the gross proceeds and cost basis (unless otherwise exempted). This would have incredibly detrimental and confusing effects on taxpayers that will receive both a Schedule K-1 and Form 1099-DA regarding the exact same transaction. The Form 1099-DA would report a cost basis that has no reality in the true taxation to the taxpayer. We do not believe this is what the IRS intended and is instead an oversight in the drafting process. We therefore recommend that the IRS draft appropriate coordinating regulations to exempt tokenized real estate transactions from Form 1099-DA reporting where they are subject to Schedule K-1 reporting. The sale of an LLC or partnership interest is an incredibly complex tax calculation and one which a digital asset broker will never be in a position to know since the information is calculated and allocated at the Form 1065 filing level which is a service provided by accountants and tax advisors, not by digital asset brokers. Taxpayers will also be better off with such an exemption from Form 1099-DA reporting, otherwise they will have to reconcile duplicate Forms 1099-DA received in their tax return by reversing the transaction as it is already accounted for elsewhere in their tax return (via Schedule K-1). We further recommend that the IRS revise the examples provided in the regulations to address the fact that a default partnership exists and has Form 1065 filing and Schedule K-1 reporting obligations.
3. We are concerned regarding the definition of “goods and services” subject to Form 1099-K reporting by TPSOs under proposed 6050W regulations. Though our concerns relate to Part V of the Explanation of Provisions, the issue is not mentioned there and only arises later in the proposed regulations examples. A

new example proposed at 1.6050W-1(c)(5)(ii)(C) uses the following phrases in the analysis section: "and CRX is contractually obligated to settle transactions for the provision of goods and services, such as NFTs, by these persons to purchasers. Thus…CRX is a third party settlement organization (TPSO)". This is concerning for a number of reasons:

a. The IRS has not proposed an actual definition of "goods and services" but has simply inserted an example of one.
b. The phrasing in the example implies that all NFTs are "goods and services". We do not believe that a blanket capture of all NFTs as "goods and services" is appropriate. As discussed in our response to question A.1, most NFTs in their simplest form are simply a digital receipt for some other asset or right. A digital receipt for an economic transaction cannot be classified as a good or service, just like a paper receipt is also by itself not good or service. If we look through the NFT to the underlying asset or right, we can see that there are many examples of NFTs that clearly do not represent goods or services such as those NFTs representing intangible properties or rights to a share of income from music royalty revenues.
c. With this capture of all NFTs broadly as a "good or service", there could be other unknown and therefore unaddressed implications, such as creating greater uncertainty in the payments industry as to what constitutes a "good or service" for purposes of the TPSO definition outside of digital assets.

Given these concerns, we recommend the following:

i. Where a specific asset or transaction will be considered "goods and services" it should be clearly defined as such, not by way of examples.
ii. A look-through approach should be used, as described in our response to question A.1 and envisaged in Notice 2023-27. Such a look-through approach would look through the NFT to its underlying asset or right. If the underlying asset or right is a "good or service" only then does the NFT become in scope of "goods and services" for purposes such as the definition of a third party network, a TPSO, and other related applications of the definition. Unless the underlying asset can be seen, weighed, measured, felt, touched, or other manner which is perceptible to the senses, then it should not be considered a "good" for this purpose. For an NFT to be considered a "service", the IRS should provide examples as to when an NFT is a service. Additionally, we recommend that the IRS provide guidance as to such classification when an NFT represents more than one asset or right, part of which is a good or service and part of which is not. We may suggest a bright line test or a safe harbor be provided in this regard for the sake of simplicity and where identification of the separate components is difficult or impossible for the broker.
iii. The IRS should update the example at 1.6050W-1(c)(5)(ii)(C) to instead say "and CRX is contractually obligated to settle transactions for the provision of goods and services, including NFTs that represent goods or services, by these persons to purchasers. Thus…CRX is a third party settlement organization (TPSO)".
iv. The IRS should issue guidance that defines what it means to "guarantee" a payment for purposes of defining TPSOs. The TPSO industry has been requesting such guidance since 2011[1] and we know that it continues to cause confusion for payment platforms today that are unsure if they are a TPSO. A lack of definition to the term "guarantee" has given many digital platforms today a soft way to argue that they are not in-scope of Form 1099-K reporting today even though in principle they should be.

[1] See comment letter beginning at Page 105 of the PDF at: https://www.irs.gov/pub/irs-utl/2011_information_reporting_program_advisory_committee_public_report.pdf

v. If the IRS does not accept our recommendations, and instead maintains the position that all NFTs are a "good or service", then we recommend that such transactions should remain reportable on a Form 1099-K under existing 6050W regulations and not on a Form 1099-DA under the proposed regulations. This is because the proposed information reported on a Form 1099-DA is designed for the sale of a capital asset that could trigger a gain or loss, typically reportable on a Form 8949 for natural persons. Form 1099-K is a more appropriate form for business income, such as in the primary sales of NFTs by artists (as example). Because the sale of NFTs will primarily be a business income transaction associated to the sale of a unit of inventory, a Form 1099-K would be easier for the taxpayer to reconcile to their tax return because the transactions are reported in a single aggregate form. If the Form 1099-DA were used instead, then if an artist minted 100,000 NFTs for sale to buyers then they would receive 100,000 separate Form 1099-DA reportable events and have a reconciliation nightmare.

4. We need to next address a further practical outcome of our recommendations at the previous point C.3 regarding platforms offering the sale or exchange of NFTs, using the most well known example of NFTs that solely represent digital artwork. With our above recommendations in C.3, platforms such as CRX as described in example 1.6050W-1(c)(5)(ii)(C) would not be a TPSO since a look-through to the underlying asset or right reveals that digital artwork is neither a good nor a service. However, CRX would still be a digital asset payment processor under the proposed regulations due to the fact that a digital asset (the NFT) was sold or exchanged for another digital asset (the payment using DE). Even though we have recommended in our response to question A.1 earlier in this letter that NFTs should not be considered a digital asset, we provide our remaining comments here in the case that the IRS does not accept such recommendation. In this case where an NFT representing digital artwork is a digital asset but does not cause CRX to be a TPSO because digital artwork is neither a good nor a service, we can intuitively recognize that this outcome is still desirable. This is because such exchange of a digital asset (the NFT) for another digital asset (the payment using DE) is still captured as a reportable sale or exchange on Form 1099-DA in the proposed regulations under 1.6045-1(a)(9)(ii). Two examples where this could happen include:
    a. digital asset transactions that are processed by digital asset payment processors that are not TPSOs due to the fact that they do not guarantee settlement; and
    b. digital asset transactions settled on behalf of merchants that are not an exchange for goods or services.

   While we agree that these transactions in example 1.6050W-1(c)(5)(ii)(C) should be reportable on Form 1099-DA addressed to the artist (also known as the seller or payee), we have identified the following unaddressed issues:
    A. NFT artists (or other parties that are minting the original NFT) are not the only parties that are selling or exchanging NFTs. The so-called "secondary market" allows parties that are not the artist to sell the NFT amongst each other without any involvement or knowledge of the original artist.
    B. The Form 1099-DA proposed regulations are primarily focused on the sale of a capital asset that could trigger a gain or loss, typically reportable on a Form 8949 for natural persons. The proposed regulations regarding information to be reported do not contemplate transactions that are really business income and therefore do not fit neatly into a gain/loss reporting type of Form 1099. If an artist minted 100,000 NFTs for sale to buyers then they would receive 100,000 separate Form 1099-DA reportable events and a reconciliation nightmare. Because

the sale of NFTs will primarily be a business income transaction associated to the sale of a unit of inventory, a single aggregate Form 1099 is more appropriate.

C. The examples provided only address the so-called "primary sale" of the NFT from the artist to the buyer. The IRS has not provided any guidance or examples regarding secondary sales of NFTs (where the artist has no involvement in the sale). Many NFT digital artwork use cases for secondary sales of NFTs involve a percentage payment stream to the original artist which is akin to a revenue sharing agreement or additional sales proceeds. The NFT industry has chosen the term "royalty" as their marketing naming convention for this income stream even if its character for tax purposes is not a royalty. Most digital asset platforms have struggled with how to characterize these income streams to artists for tax purposes and therefore have uncertainty as to whether these payments are reportable at a $10 or $600 threshold, depending on which Form 1099 type would be appropriate for its character. Further to this, digital asset platforms have struggled with how to determine the source of these income streams for purposes of non-resident alien tax withholding under Chapter 3 of the IRC and application of treaty benefits (if applicable) for further reporting (if applicable) on Form 1042-S.

To address these issues, we recommend the following to the IRS:

i. Where an exchange transaction is reportable under 1.6045-1(a)(9)(ii) by a digital asset payment processor on behalf of a buyer and a merchant, the gross proceeds paid to the merchant is:
   1. reportable on Form 1099-DA but is exempt from cost basis reporting;
   2. reported in aggregate rather than by transaction; and
   3. marked as "merchant payments" in a new box on Form 1099-DA which would help to give the IRS an indication as to why aggregate reporting was used and cost basis was not provided.

ii. Substantive taxation law on the character and source of these revenue sharing income streams from secondary sales of NFTs should be issued by the IRS. Digital artwork artists that are selling NFTs, amongst other parties, need clarity on the taxation principles that apply to this income before the IRS can issue Form 1099 reporting on top of it. Consistent with our earlier recommendations, we recommend that the IRS allow for a look-through approach by the digital asset broker to determine the character and source of these income streams on secondary sales of NFTs. In addition, we recommend that the IRS provide a presumption rule or safe harbor for brokers that are unable to determine the character and source of these income streams due to the unique difficulty associated with NFTs.

iii. Examples should be added to the proposed regulations that distinguish the tax reporting that applies to primary sales of NFTs vs secondary sales of NFTs as well as the tax reporting that applies to the revenue sharing income streams. As discussed above, we recommend that the primary sales of NFTs are reportable as a payment to the artist (or other party minting the NFT) on a Form 1099-DA but in a single aggregation and marked as a "merchant payment" to indicate the transaction is not a capital asset reportable on Form 8949 by the taxpayer. We recommend that the secondary sales of NFTs (where the artist or other party minting the NFT is no longer involved in transferring inventory) are reportable on Form 1099-DA as a sale or exchange of a digital asset, subject to transaction level reporting and cost basis information reporting.

Information Reported by Brokers

5. As indicated in Part I.D of the Explanation of Provisions, digital asset brokers would be required to report both the date and the time of a sales transaction. While we do not disagree with reporting both the date and time, digital asset brokers will require guidance as to what reasonable methods they can use for assigning USD fiat currency pricing to each unique transaction. We recommend that the IRS allow for the broker to choose a reasonable pricing methodology that is convenient for them. For example, it is standard industry practice today for digital asset brokers to use a daily Volume Weighted Average Price ("VWAP") to value transactions. We will illustrate the practical result of using a daily VWAP with a broker that offers Token A and Token B on their platform. Customer Z exchanges one Token A for Token B at 9:45am when the USD price of Token A was $1.05. Later that same day, Customer Z exchanges one more of Token A for Token B at 12:45pm when the USD price of Token A was $1.10. At the end of the day, the daily VWAP was $1.08. For purposes of Form 1099-DA reporting, the two exchange transactions are a sale reported as: 1) Sale of Token A, 1 unit, 09:45 UTC, Proceeds of $1.08, and 2) Sale of Token A, 1 unit, 12:45 UTC, Proceeds of $1.08. The practical reason for this recommendation is that many digital asset brokers do not record the USD fiat currency value of transactions in their internal ledger record keeping. This then requires them to apply pricing at the end of the year, when preparing Form 1099 filings, and applying USD pricing down to the minute (or even the second) requires an incredible amount of infrastructure and computational power which is particularly relevant for exchanges of one digital asset for another. Daily VWAP pricing is also an industry standard practice for other business purposes outside of Form 1099 reporting.

Adjusted Cost Basis

6. As referenced in proposed regulation 1.6045-1(d)(6)(iii)(A), digital assets are not subject to wash sale adjustment rules. We noted that this was not discussed in the commentary or explanation of provisions and therefore leaves open the possibility of the regulation changing in the future. We recommend explicitly addressing the intentions of the IRS and U.S. Treasury regarding wash sale adjustment rules applying to digital assets (or not) in the future. Digital asset brokers have a monumental and expensive task ahead of them to design operating models, hire resources, and make build-vs-buy decisions about their cost basis, withholding, and reporting technology infrastructure. As such, having a view towards the future of wash sale adjustments will be a critical factor in these tactical decisions. We also recommend providing written clarity that even though wash sale adjustment rules do not apply to digital assets, they still apply to tokenized securities such as, by example, 1940 Act Funds discussed in our response to question A.2 and A.3.

Other

7. We recommend that the IRS clarify that in the case where a digital asset service provider does not come into scope of the definition of broker under these proposed regulations, they may still be obligated to report certain transactions with their counterparties as payers (rather than brokers) under other sections of the Internal Revenue Code (such as 6041). In our experience, most digital asset service providers do not have the in-house expertise to recognize that even where they are out of scope of the digital asset broker definition that they may still be in scope as a payer for other Form 1099 obligations.
8. We recommend that the IRS provide written guidance regarding rule making for timely deposits of tax withholding by digital asset brokers. Digital asset brokers have the unique issue that their business operates 24 hours a day, 7 days a week, and 365 days of the year. This becomes an issue for the digital asset broker to be able to ensure timely deposits of tax with the IRS. For example, we recommend issuing guidance regarding when a "day" ends (time and time zone) for purposes of timely deposits of daily

depositors. Additionally, clarity will be needed as to whether the IRS will measure timely deposits based on days or by 24 hour rolling periods. We recommend measuring based on days.

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We at Ledgible thank you again for the opportunity to comment on these important proposed regulations.

Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance. You may contact us at policy@ledgible.io. We would be happy to discuss our comments in further detail.

Jessalyn Dean
VP of Tax Information Reporting

Gabriel Brin
VP of Tax & Accounting Product

Kell Canty
CEO and Co-Founder