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November 13, 2023

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

> **Re: Reg 122793-19:  Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions**

Dear Sir or Madam:

On behalf of Block, Inc.[1] (NYSE: SQ) (formerly, Square, Inc.) (hereinafter as "Block"  or "we"), thank you for the opportunity to provide comments in response to your notice of proposed rulemaking for "Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions" in respect to the Infrastructure Investment and Jobs Act of 2021 (hereinafter as "proposed regulations").[2]

Block is a global technology company with a focus on financial services. Made up of Square, Cash App, TIDAL, and TBD, we build tools to help more people access the economy. Square makes commerce and financial services easy and accessible for sellers with its integrated ecosystem of technology solutions. With Cash App, anyone can easily send, spend, or invest their money in stocks or bitcoin. Afterpay brings Square and Cash App together, connecting consumers and businesses. Artists use TIDAL to help them succeed as entrepreneurs and connect more deeply with fans. TBD is building an open

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[1] For more information on Block, visit block.xyz.
[2] REG 122793-19, 88 Fed. Reg. 59576 (Aug. 29, 2023).

source platform and developer infrastructure that enables everyone to access and participate in the global economy.

Block offers these comments in no priority order on several main points:

1. **Facilitative services**: The proposed regulations' definition of "facilitative services" is exceptionally broad and does not explicitly recognize the various entities in the industry that do not effectuate a transaction or know information about the transaction itself.  As such, we recommend the term to be clarified to explicitly exclude node operators, developers, and self-hosted wallet providers due to the inherent technological nature of a node operator.

2. **Payment Processors**: Payment processors should not be considered brokers under the proposed regulations but rather should continue to report digital assets transactions for goods and services under existing Form 1099-K reporting obligations under Section 6050W.

3. **Reporting:**
   ○ The reporting requirements do not take into account multiple parties in the same transaction reporting the same information, causing dual reporting, possible inaccurate reporting, and taxpayer confusion.
   ○ There should be a de minimis amount included for reporting.

4. **Timeline:** There should be an alignment of effective dates regarding when a digital asset is treated as a "covered security" for purposes of cost basis reporting and when the cost basis information for digital assets dispositions are required to report on Form 1099-DA, making both effective dates January 1, 2026.

5. **Responsible Innovation:** The digital asset reporting proposal goes beyond what is required for digital assets reporting in other areas of the world.  The broadness of this proposal impacts the US competitiveness and the development of future responsible innovation here in the US.

**IIJA and Proposal Overview**

The digital asset reporting provision in the Infrastructure Investment and Jobs Act of 2021 ("IIJA"), expands reporting under section 6045 to require certain digital asset brokers to submit information returns relating to digital asset transactions. Under the IIJA proposal, a

person "who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person" is a broker subject to reporting requirements. The IIJA also provides a definition for digital assets for purposes of section 6045 reporting.[3]

1. **The proposed regulations' definition of "facilitative services" is exceptionally broad and does not explicitly recognize the various entities in the industry that do not effectuate a transaction or know information about the transaction itself.**

When defining a digital asset broker, the proposed regulations provide that persons acting as digital asset middlemen are subject to reporting; the term digital asset middleman is not in the statute.[4] The proposed regulations state that a digital asset middleman is any person providing facilitative services that are in a position to know the customer's identity and the nature of the transaction effectuated by customers. The proposed regulations define "facilitative service" as "any service that directly or indirectly effectuates a sale of digital assets, such as providing a party in the sale with access to an automatically executing contract or protocol; access to digital asset trading platforms ..."[5]  The proposed regulations, however, also provide a narrow exception from required broker reporting for persons "validating distributed ledger transactions (whether through proof-of-work, proof-of-stake, or any other similar consensus mechanism) without providing other functions or services if provided by a person *solely engaged* in the business of providing such validating services."[6]

Below we describe several critical participants in the digital asset industry that would be digital asset middlemen under the proposed regulations, and subject to reporting requirements, but do not generally know or have access to information relating to the customer's identity and the nature of the transaction, and therefore should be carved out from reporting requirements under revised rules.

*Node operators*

Node operators are a category of industry participants that should be excluded from the broker reporting requirements.

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[3] IIJA, Pub. L. No. 117-58,135 Stat. 429, 1339 (2021), § 80603.
[4] Prop. Reg §1.6045-1, Preamble, pg. 37.
[5] Prop. Reg §1.6045-1(a)(21)(iii)(A)
[6] Prop. Reg. §1.6045-1(a)(21)(iii).

Nodes are communication hubs responsible for validating transactions and relaying information on the blockchain. Any individual can participate in the blockchain network by operating a node. Node operators use a very small amount of computational power to verify transactions, performing validation services.

At Block, we work within the Lightning Network[7], a layer two protocol on the bitcoin blockchain, to enable peer to peer payments of bitcoin in a more efficient way than a traditional blockchain transaction that requires more time and energy. Nodes on the Lightning Network do not custody or control the sender's bitcoin and are also incapable of redirecting that bitcoin. They simply relay transfers from their node to another, ensuring transactions can be sent across the network. They do not have any information about the individual completing the transaction or about the individual accepting the transaction nor do they have the ability to change any fees associated with the transactions. Lightning routing nodes do not allow users to convert one cryptocurrency for another, do not accept or exchange any digital assets other than bitcoin, and there is no Lightning token issued or needed to route payments. Any time a transaction occurs between two lightning nodes, a valid on-chain bitcoin transaction is generated reflecting the new balance between them (even though it's not broadcasted and recorded on the blockchain). The final balance of the transactions between nodes is only recorded once the node's channels are closed and the final balances are verified and recorded by miners on the bitcoin blockchain.

If captured as a digital asset middleman providing a "facilitative service" under this proposal, a node operator would need to gather and report information about every transaction that passes through their node – information that is not accessible and that is not possible to collect about the transaction. This not only creates an unnecessary burden on node operators, but it would also raise privacy concerns for consumers because they would have to disclose information to node operators (who could be any individual) that have no reason to know their personally identifiable information. Requiring node operators to report will also increase the likelihood that taxpayers would receive multiple information statements for the same transaction.

As previously discussed, the proposal states, "Because some persons providing these services or products may not be in a position to know the identity of the parties making a sale and the nature of the transaction, proposed §1.6045–1(a)(21)(iii)(A) specifically excludes from the definition of facilitative service persons solely engaged in the business

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[7] "The Bitcoin Lightning Network: Scalable Off-chain Instant Payments," J. Poon, T. Dryja, January 14, 2016. Found at https://lightning.network/lightning-network-paper.pdf.

of providing distributed ledger validation services—whether through proof-of-work, proof-of-stake, or any other similar consensus mechanism—without providing other functions or services."[8] We believe node operators should be excluded from the definition of facilitative service as they are "a similar consensus mechanism" providing distributed ledger validation services who may not be in a position to know the identity of the parties making the sale.

For those reasons, final regulations should clarify that node operators are not captured in the proposed definition of facilitative service. Clarity on this issue would strengthen the provision. Further, such clarification aligns with Treasury's stated intent to not include distributed ledger validation services. **Therefore, we recommend that node operators are explicitly excluded to avoid any confusion and misapplication of the reporting requirements.**

### *Developers*

Developers are another category of participants in the industry that we believe the proposal should expressly exclude from broker reporting requirements.

In the proposal, a person is in the position to know the identity of the party that makes the sale if that person maintains "sufficient control or influence over the facilitative services provided so as to have the ability to set or change the terms under which its services are provided to request that the party making the sale provide that party's name, address, and taxpayer identification number, in advance of the sale."[9]

Developers play a crucial role in decentralized protocols by designing, building, and maintaining the software that powers these networks. For purposes of this letter, we outline some of the responsibilities we see for developers. These could include the designing of the protocol (setting the structure), writing the codes underlying the protocol, engaging with the community to gather feedback, incorporate improvements for open source protocols, and educating the community and other developers about the protocol. Developers play a key role in our products. One example is Spiral who's full-time engineering team exclusively focuses on making it substantially easier for developers to build great Lightning-enabled bitcoin applications by releasing the Bitcoin Development Kit, Design Community and the Lightning Development Kit.[10]

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[8] Prop. Reg. §1.6045-1(b)(2)(ix).
[9] Prop. Reg. §1.6045-1(a)(21)(ii)(A).
[10] For more information about Spiral, including these kits and community, please see: https://spiral.xyz/#projects.

Because a developer's primary role as described above is to build out the protocol and the developer community, these developers do not have "sufficient control or influence" over the facilitative services nor do they have access to the customer information or information about transactions. **As the Treasury Department and the IRS ask for more examples of those without "sufficient control or influence", developers are one example in this industry and as such, should be explicitly excluded from this proposal.**

### *Self-hosted Wallet Providers*

Digital asset software and hardware providers of self-hosted wallets also do not fit within the definition of a facilitative service under the proposal. Self-hosted wallets are software or hardware solutions, more akin to a leather wallet that holds a range of important credentials, whether a local library card, an identification card, or credit or debit cards that enable the user to access funds. The difference with a self-hosted wallet, however, is it does not hold coins, but rather one's private keys, which enable the user to control and access their digital assets on the distributed ledger.

The self-hosted wallet provider does not effectuate trades nor have the ability to access or verify the relevant transaction data for reporting. The Treasury Department and IRS have already taken that into account given that the digital asset wallet hardware and software are already exempted under the proposed regulation.[11] Our concern focuses on those self-hosted wallets that provide users with access to trading platforms from the wallet platform.

Under the proposal, a person is "in a position to know the nature of the transaction potentially giving rise to gross proceeds from a sale if that person maintains sufficient control or influence over the facilitative services provided so as to have the ability to determine whether and the extent to which the transfer of digital assets involved in a transaction gives rise to gross proceeds."[12]

At Block, we are creating a self-hosted wallet, Bitkey.[13] Bitkey users are able to seamlessly access partner exchanges and platforms to move their funds between their self-hosted wallet and their account. All purchases and transfers are solely conducted by

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[11] Prop. Reg. § 1.6045-1(a)21(iii)(A)
[12] Prop. Reg. § 1.6045– 1(a)(21)(ii)(B).
[13] For more information about Bitkey, please see:  https://bitkey.build/

these partners' platforms.[14] All information about the transactions is known by the exchanges or platforms.

Including self-hosted wallet providers simply because they may provide a technical entry point into an exchange or platform's services does not qualify self-hosted wallets as "facilitative services".  Bitkey, our self-hosted wallet, is an example of a wallet that does not effectuate a sale or transaction, despite connecting to partner exchanges or platforms.

Additionally, Bitkey does not have "sufficient control or influence over the facilitative services provided," meaning that the customer has the control to effectuate the sale or purchase of bitcoin directly with the exchange or platform. Additionally, self-hosted wallet providers, like Bitkey, do not have access to customer or transaction information. As such, **we would recommend that Treasury and the IRS explicitly exempt self-hosted wallet providers (such as Bitkey described above) from the "facilitative service" definition.**

2. **Payment processors should not be considered brokers under the proposed regulations but rather should continue to report digital assets transactions for goods and services under existing Form 1099-K reporting obligations under Section 6050W.**

Before talking about the proposal itself, it is important to differentiate between digital assets used as a payment and digital assets used as an investment. Many digital assets, like bitcoin, can be used as payments or as investments.[15]  It is important to first identify how they differ to understand why they should be treated differently.

Bitcoin was originally created with the intention of serving as a decentralized digital currency. As a payment method, it allows individuals and businesses to transact directly without intermediaries. It can be used to buy goods and services, both online and in physical stores.  One of the advantages of this function is the ability to transact quickly and at low costs, particularly for cross-border transactions.

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[14] For information on these partnerships, please visit: https://bitkey.build/coinbase-and-cash-app/.
[15] For purposes of this comment letter, we're focusing on how bitcoin as a payment differs from bitcoin as an investment; however, our comments should be interpreted as applying to digital assets as a whole.

This use case counters how bitcoin is used as an investment. Many people see bitcoin as a store of value. They buy, hold and sell it with the expectation that its value will increase over time.

As we previously discussed, IIJA and the proposed regulations highlight the need for digital asset reporting for tax purposes, focusing on the role of a "broker" in the buying and selling of digital assets. In that realm, the use case of digital assets as an investment fits into this category.

Based on this, we highlight below how payment processors should not be considered part of this proposal.

A payment processor facilitates transactions for goods and services between various parties, such as merchants, customers, and financial institutions, ensuring that funds are transferred securely and efficiently. Block's Square provides point-of-sale solutions (both hardware and software) for processing payments for small businesses.[16] Square also enables mobile card readers to be attached to smartphones and tablets, so that businesses can accept payments anywhere they are so they no longer need a "brick and mortar" location. As digital payments continue to evolve, it is important to highlight the challenges payment processors may encounter under this proposal.

There are multiple parties involved when processing a payment transaction.[17] Payment processors maintain detailed records of all transactions for both merchants and customers. The specific data they collect can include and varies per payment processor: cardholder data, billing information, transaction data (type of transaction, amount, date and time), customer information (based on the transaction data), receipts and other necessary data related to security and fraud.

For tax purposes, payment processors are currently required to file Form 1099-K for each payee (the individual merchant or business receiving payments for goods and services) when the payee's transactions meet certain thresholds. The purpose of Form 1099-K is to ensure that businesses and individuals accurately report their income for tax purposes. It helps the IRS track electronic payment transactions and identify potentially underreported income.

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[16] For more information on Square, visit https://squareup.com/.
[17] See Square: What is credit card processing and how does it work? at
https://squareup.com/us/en/the-bottom-line/managing-your-finances/credit-card-processing

Prop. Reg. sections 1.6045-1(a)(22)(i)(B) and 1.6045-1(b)(1)(vii) provide that any person who in the ordinary course of a trade or business that stands ready to effect sales of digital assets that also acts as a third party settlement organization facilitating payments using digital assets is treated as a digital asset payment processor and subject to reporting under Section 6045. The proposal's requirements for payment processors seem to be <u>in addition to</u> the Form 1099-K reporting requirements under Section 6050W.  This will create undue burden and confusion to taxpayers and dual reporting to the IRS for the same transactions. Unless there is a pre-existing business relationship between the digital asset payment processor and the purchaser of goods and services, the digital payment processor, as a "broker" under the proposed regulations, would now be required to solicit Form W-9 or other tax documentation from all purchasers in order to properly report the disposition on Form 1099-DA and avoid backup withholding. This information is not currently required from purchasers and may halt development of digital assets as an efficient and secure payment system. In many cases, the digital asset payment processor will have no relationship with the purchaser and no line of sight to the purchaser's cost basis of the digital assets being used to purchase the goods and services. Mandating payment processors to collect tax documentation and cost basis information when payment is made in digital assets but not when the payment is made in fiat is unreasonable and significantly inhibits growth of digital assets as payment methods in the US.

**<u>Therefore, Block recommends that payment processors be excluded from the definition of "broker" under the proposed regulations.</u>**

3. **Reporting Concerns of the Proposal**

- **The reporting requirements do not take into account multiple parties in the same transaction reporting the same information, causing dual reporting, possible inaccurate reporting, and taxpayer confusion.**

We could foresee taxpayer confusion with dual reporting as a result of this proposal, particularly if those entities we describe above are not excluded from the definition of "facilitative services".  One example would be that of a self-hosted wallet provider. If included under this proposed regulation, the self-hosted wallet provider must first connect with the exchange or platform for the transaction information, determine the cost basis for the transactions, the information about the transaction and the parties of the transaction, and then report information to both the taxpayer and the IRS with the form that is identical to that provided by the exchange or platform to the IRS and the taxpayer.

This will inevitably lead to multiple forms to both the IRS and to the taxpayers and result in undue burden to the IRS and taxpayer confusion. **Therefore, we recommend reporting to be from the exchanges or platforms that "see" the buy or sell digital asset transaction. We also recommend the IRS engage with the digital asset industry on a taxpayer education campaign about these new forms and requirements.**

- **There should be a de minimis amount included for reporting.**

Under the proposed regulations, there is currently no de minimis amount for reporting. This may result in significant amounts of tax reporting to the IRS.  For example, within CashApp, an individual may purchase a fractional amount of bitcoin. This could mean that an individual could spend $1 one day and $100 the next.  The same is true for goods and services; however we would recommend that payment processor obligations be satisfied under the 1099-K requirements (as mentioned above).  Without a de minimis threshold, brokers may incur a significant burden to fully comply with the obligations, taxpayers may be confused by receiving these forms for otherwise standard transactions, and the IRS will receive a significant number of forms.[18] **We recommend including a de minimis amount for reporting of these transactions.**

4. **There should be an alignment of effective dates regarding when a digital asset is treated as a "covered security" for purposes of cost basis reporting and when the cost basis information for digital assets dispositions are required to report on Form 1099-DA, making both effective dates January 1, 2026.**

While many companies, including Block, may already be reporting gross proceeds from the sales of digital assets on Form 1099, the proposed regulations would require companies to track the cost basis for all digital asset acquisitions on or after January 1, 2023, report gross sale proceeds on digital assets on or after January 1, 2025, and report cost basis and gain / loss information for digital asset sales transactions occurring on or after January 1, 2026 on Form 1099-DA.   Currently, there are various cost basis relief methods to calculate gain and loss under the cost basis reporting rules.  The proposal recognized a "first-in-first-out" (i.e "FIFO") method  as a default, as well as other alternative approaches, including "last in, first out" ("LIFO") and specific tax lot selection methods.

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[18] "IRS Prepping for at Least 8 Billion Crypto information Returns," Tax Notes, Jonathan Curry, October 26, 2023.

**Block recommends an alignment of effective dates regarding when a digital asset is treated as a "covered security" for purposes of cost basis reporting and when the cost basis information for digital assets dispositions are required to report on Form 1099-DA starting January 1, 2026.**

While Block recognizes that new Section 6045(g) of the Internal Revenue Code, as enacted under IIJA, statutorily modified prior law to explicitly treat digital assets as "covered securities" for cost basis reporting purposes if acquired on or after January 1, 2023, the effective date mismatch between this date) and the date when an exchange would be required to report cost basis information for digital assets transactions on Form 1099-DA (on or after January 1, 2026) will unnecessarily complicate cost basis reporting compliance and would not enable brokers who are required to report to timely build the reporting systems on the back end to ensure accurate cost basis reporting.

While some digital asset brokers may have systems in place to effectively track the cost basis for customers' "covered" buys and acquisitions, most brokers have no line of sight into customers' actual cost basis relief methods when digital assets are later sold. Therefore, as an example, if a digital asset broker decides to apply by default a FIFO cost basis relief method across their customer base for cost basis reporting purposes starting January 1, 2023, but have customers who apply an alternative cost basis relief method (such as LIFO or specific lot selection) for their digital asset sales for income tax purposes, it will be practically impossible for the broker to accurately report cost basis or gain/loss for those customers when required to do starting January 1, 2026 because the broker's cost basis relief method has been misaligned with their customers' over the course of three years. With the misalignment of effective dates, digital asset brokers end up immediately behind and unable to accurately comply with customer demands once cost basis reporting on Form 1099-DA is mandated.

This misalignment will not only result in inaccurate cost basis reporting to be filed with the IRS, but also inevitably lead to significant customer / taxpayer inquiries and disputes for both digital asset brokers and the IRS.  Digital asset brokers must be provided more time to build better cost basis tracking and reporting systems to better align with taxpayers' cost basis positions on their digital assets and provide more accurate reporting to the IRS and taxpayers. This can be accomplished if the dates are aligned to the January 1, 2026 effective date.

It is also important to note that subjecting retroactive cost basis reporting under the proposed regulations is wholly unprecedented in light of previous U.S. tax information

reporting requirements. When cost basis reporting under Section 6045 was previously enacted for traditional securities (such as stock equities) in 2008,[19] the covered security and cost basis reporting effective dates were fully aligned for brokers. This alignment of effective dates allowed traditional brokers the time to build the systems necessary to better align the brokers' applied basis relief method(s) with their customers', and ultimately report cost basis and gain/loss more accurately on Form 1099-B for both the IRS and taxpayers. Similarly, aligning the effective dates in the case of digital assets to January 1, 2026 will also allow digital asset brokers more time to build better cost basis tracking and reporting systems to better align with taxpayers' cost basis positions on their digital assets and provide more accurate reporting to the IRS. Additionally, this will importantly provide brokers of digital assets and the IRS the time necessary to develop an education campaign for customers and taxpayers to understand the forms they receive and their respective tax obligations.

5. **The digital asset reporting proposal goes beyond what is required for digital assets reporting in other areas of the world. The broadness of this proposal impacts the US competitiveness and the development of future responsible innovation here in the US.**

The proposed regulations are much broader than any digital asset reporting requirements around the world. When the OECD released standards for tax reporting of digital assets, they specifically exempt those in the industry that do not have knowledge of transactions.[20] This includes not only the miners, stakers, and validators that the current proposal accounts for, but also includes self-hosted wallet providers, developers, and node operators. Including these participants in digital asset reporting, when they do not technologically have access to transaction information risks putting the United States at a disadvantage. Innovators will follow regulatory models that support the technology they are creating and ensure job growth. Innovations, whether they are created by small start-ups or large companies, are important to the economy - they create job growth, allow individuals to work more efficiently and effectively, and can provide financial opportunities to those that may not be able to access them otherwise.

**As such, Block recommends that Treasury and the IRS narrow the definition of a broker to exclude all of those entities in the industry that have neither a contractual**

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[19] P.L. 110-343, Energy Improvement and Extension Act of 2008, Sec. 403.
[20] OECD's Crypto-Asset Reporting Framework and Amendments to Common Reporting Standard, October 2022. Found at:
https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf.

**relationship with persons processing transactions nor reason to know the nature of the transactions being processed.**

**Conclusion**

Thank you again for the opportunity to provide comments.  While intended to provide information to the IRS on digital assets purchases and sales, the proposed regulations greatly expands the persons required to report and should be clarified and narrowed to cover only persons with direct knowledge of the transaction's characteristics while balancing the need to reduce the tax gap through enhanced information reporting, protecting taxpayer privacy, and harnessing US innovation in this technology. We look forward to continuing to work with you as you finalize this proposal.

Should you have any questions, please do not hesitate to contact me or Melissa Netram, our Global Head of Bitcoin Policy, at mnetram@block.xyz.

Sincerely,

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