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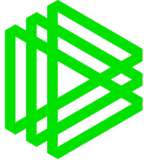

Via Electronic Submission and Mail

November 10, 2023

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

Re: Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions

Dear Sir or Madam:

Paradigm Operations LP ("**Paradigm**" or "**we**")[1] appreciates the opportunity to comment on the proposal by the U.S. Department of the Treasury (the "**Treasury Department**") and Internal Revenue Service (the "**IRS**") to extend the information reporting rules in Internal Revenue Code ("**IRC**") § 1.6045-1 to persons who, in the ordinary course of a trade or business, act as agents, principals, or digital asset middlemen for others to effect sales or exchanges of digital assets for cash, broker services or other property, or provide digital asset payment processing services. Paradigm respectfully submits that the proposed regulations on gross proceeds and basis reporting for digital asset transactions (the "**Proposed Rule**"),[2] if adopted, would expand the application of tax information reporting requirements beyond what Congress intended when it granted such authority to the Treasury Department and IRS in the Infrastructure Investment and Jobs Act of 2021, P.L. 117-58 (the "**Act**").

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1 Paradigm is a registered investment adviser that manages funds focused on crypto and related technologies at the frontier. Paradigm invests in, builds, and contributes to companies and protocols with as little as $1M and as much as $100M or more. More information about Paradigm is available online. *See* Paradigm, https://www.paradigm.xyz/.

2 *Gross Proceed and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions*, 88 Fed. Reg. 59576 (Aug. 29, 2023) ("**Proposing Release**").

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We write to highlight what we believe to be the four most problematic areas within the Proposed Rule:

(1) Congress opted to modify the term "broker" under the Act only to the extent necessary to clarify that IRC § 6045 applies to persons that "effectuate" digital asset transactions. In contravention of this intent, the Treasury Department and IRS would institute an expansive definition of the term "broker" that includes any "digital asset middleman." The term "digital asset middleman" would bring many non-custodial (or "**unhosted**") digital asset software providers that do not "effectuate" digital asset transactions, such as non-custodial digital wallet software providers, decentralized finance (or "**defi**") protocol development companies and foundations, and non-fungible token (or "**NFT**") marketplace providers (collectively, "**Non-Custodial Software Providers**"), within scope of the "broker" definition.

(2) The proposed "digital asset middleman" definition has no reasonable limitation because it would include any person that provides "facilitative services." Virtually every non-custodial hardware and/or software provider in the ecosystem may be deemed to be a "broker" under this definition because such persons facilitate the effectuation of users' digital asset transactions and are "in a position to know" the personally identifiable information of users interacting with the product offering (regardless of whether a direct customer relationship exists or not).

(3) The Proposed Rule is arbitrary and capricious because it notably departs from and contradicts prior Treasury Department guidance and reasoning. The Treasury Department's Financial Crimes Enforcement Network ("**FinCEN**") previously concluded that Non-Custodial Software Providers cannot be said to directly or indirectly effectuate digital asset transactions. The Treasury Department and IRS provide no reasoned explanation for this failure to treat like cases alike. The Administrative Procedure Act (the "**APA**") requires that the Treasury Department and IRS articulate the reasons for the contradictory conclusions expressed in the Proposed Rule.

(4) The Proposed Rule would institute a sweeping public-private cooperative surveillance program that would undermine the privacy and security of digital asset users and discourage Americans from participating in digital commerce. Paradigm supports workable rules for digital asset transaction tax reporting, but strongly believes the Proposed Rule would go too far. Such an invasive regulatory scheme would not be technology neutral but instead reflect a bias against digital assets and blockchain technologies.

In response to the issues noted above and described more fully herein, we urge the Treasury Department and IRS to remove the concept of a "digital asset middleman" from the definition of "broker" or otherwise limit the definition of "broker" to persons that directly effect transactions on blockchains and other distributed ledger networks on behalf of others, consistent with the Act's statutory text and Congressional intent. In the event that the Treasury Department and IRS choose to finalize the Proposed Rule, we urge the Treasury Department and IRS to include a two-year good faith compliance grace period for all digital asset ecosystem participants affected by the rule, during which time the Treasury Department and IRS would not take any enforcement action against such ecosystem participants for compliance violations, so long as the participants can evidence a "good faith" effort to comply with the rule.

Paradigm appreciates the opportunity to address these issues and urges the Treasury Department and IRS to reconsider the Proposed Rule.

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I. The Proposed "Broker" Definition Contravenes Congressional Intent

Contrary to the express intention of Congress, the Proposed Rule would establish a comprehensive tax administration framework for nearly all providers of digital asset products and services, irrespective of whether such providers have the capability to "effectuate" digital asset transactions. As a result, the Proposed Rule exceeds the Treasury Department and IRS's statutory authority under the Act in violation of the APA.[3]

Section 80603 of the Act amended IRC § 6045 to include, as a new category of "broker," "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." Congress's unambiguous intent was to subject transactions involving digital assets to the existing framework for broker reporting. The Joint Committee of Taxation described the Act's amendment to the IRC § 6045 "broker" definition as a change that "clarifies existing law."[4] The Act, in lieu of providing for a broader definition of "broker" or fundamentally changing the application of IRC § 6045 as it relates to transactions involving digital assets, modified the definition of "broker" only to the extent necessary to ensure that existing IRC § 6045 applied to digital asset transactions. In doing so, the Act ensured that persons involved in the sale of digital assets would qualify as brokers using the same standards as persons involved in non-digital asset transactions.

This Congressional intent is evidenced by a Senate floor colloquy on August 9, 2021, in which Senators Portman and Warner clarified:

> The [Act] makes it clear as to who counts as a broker within this matter. Under the [Act], a broker is defined as "any person who (for consideration) is responsible for regularly providing any service *effectuating transfers of digital assets on behalf of another person*." For tax purposes, *this means a sale on behalf of someone else . . . . The purpose of this provision is not to impose new reporting requirements on people who do not meet the definition of brokers*.[5]

The Treasury Department acknowledged this intent in a February 11, 2022 letter addressed to certain Senators, which stated that the regulations under the Act would "be based on principles broadly similar to those applicable under current law for broker reporting on securities transactions."[6] However, the Proposed Rule disregards Congress's intent and exceeds the Treasury Department and IRS's statutory authority by establishing "digital asset middleman" as a new category of "broker" and creating new standards that would apply to many persons that do not "effectuate" transfers of digital assets on behalf of users under any common usage of the term.

Congress did not intend for the Act to expand the authority of the Treasury Department and IRS to impose information reporting requirements on software providers that do not directly effectuate transactions on behalf of customers. Yet, by including the concept of a "digital asset middleman" in the "broker" definition, the Treasury Department and IRS seek to impose a prescriptive regulatory regime on developers of non-custodial digital asset software and mandate significant (and, in many cases, impossible to

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[3] Under the APA, courts "shall . . . hold unlawful and set aside agency action, findings, and conclusions" that are "in excess of statutory jurisdiction, authority, or limitations," or "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A), (C)–(D).

[4] Congressional Record 167: daily ed. August 3, 2021, p. S5702.

[5] Legislative Session, Congressional Record Vol. 167, No. 144, Page S6069 (emphasis added).

[6] Letter from Jonathan C. Davidson, Assistant Secretary for Legislative Affairs, U.S. Treasury Department, to Senators Portman, Warner, Crapo, Sinema, Toomey and Lummis.

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implement) changes to existing business models that would undermine the very purpose and design of such software.

II. The Proposed "Digital Asset Middleman" Definition Has No Reasonable Limitation

By broadly construing the term "effectuate" to include acting as a "digital asset middleman," the Treasury Department and IRS leave open the possibility that virtually every developer of a hardware or software component or service that is indirectly involved in the consummation of a digital asset transaction may be deemed a "broker," absent an express exemption. The Proposed Rule defines a "digital asset middleman" as any person that provides "facilitative services" with respect to the sale of digital assets wherein the nature of the services arrangement is such that the person "ordinarily would know or be in a position to know" the identity of the party that makes the sale and the nature of the transaction potentially giving rise to gross proceeds from the sale.[7] The proposed definitions of "facilitative services" and "position to know," and, therefore, "digital asset middleman" are infinitely regressive and have no reasonable limitation.

A. Facilitative Services

The Treasury Department and IRS have historically treated as "brokers" only those persons with a close proximity to a sale by virtue of effecting sales as an agent for a party to the sale. In contrast, the Proposed Rule defines the term "effect" to include "facilitative services that effectuate sales of digital assets by customers." This expansive interpretation of the term "effectuate" is contrary to the ordinary meaning of the term and contravenes the Treasury Department's authority under the statute. Congress used the term "effectuate" rather than "facilitate," demonstrating a clear and unambiguous choice that the reporting requirements apply solely to persons that actually effectuate digital asset transactions. It did not provide the Treasury Department with discretionary authority to apply the requirement to persons that facilitate the effectuation of digital asset transactions.

The term "effectuate" is not defined in the Act and therefore we look to its ordinary meaning and common usage.[8] Merriam-Webster Dictionary defines the term "effectuate" to mean "to cause or bring about (something) : to put (something) into effect or operation."[9] Similarly, Black's Law Dictionary defines the term "effect" to mean "[t]o bring about; to make happen."[10] As discussed above, nothing in the Congressional record supports the view that "effectuate" would include facilitation. The inclusion of the concept of a "digital asset middleman" that facilitates the effectuation of transactions not only exceeds the Treasury Department and IRS's statutory authority but also would result in a broad swath of persons being deemed "brokers" that have no actual ability to cause or bring about transactions in digital assets.

There is no reasonable limitation on the concept of facilitation within the context of digital asset transactions. For example, a person requires a computer or mobile device to transact in digital assets. Any given personal computer or mobile device will have been developed by a single manufacturer but incorporate third-party hardware components. The personal computer or mobile device will run an operating system, which is software that is likely to have been developed by a third-party software

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[7] Proposing Release at 59633.

[8] *See* ANTONIN SCALIA & BRYAN GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 69 (2012) ("Words are to be understood in their ordinary, everyday meanings—unless the context indicates that they bear a technical sense.").

[9] Merriam-Webster Online, effectuate, *available at* https://www.merriam-webster.com/dictionary/effectuate (last accessed October 18, 2023).

[10] BLACK'S LAW DICTIONARY (11th ed. 2019), effect.

developer. The operating system may include its own web browsing software, but most users opt to download their preferred third-party web browser. An internet service provider must provide the user with an internet connection so that the user can use the web browser. If the user wishes to transact in digital assets using the web browser, the user will typically require a third-party non-custodial digital wallet browser extension or plug-in. Finally, the user may choose to access a defi protocol or NFT marketplace web application to more easily interact with onchain smart contracts and thereby purchase a digital asset from another person in a peer-to-peer onchain transaction. The Proposed Rule leaves open the possibility that every hardware and software provider all the way up the chain would be deemed to facilitate the user's digital asset transaction and thereby be subject to "broker" reporting obligations.

Yet, by design, non-custodial software does not "effectuate" transactions on behalf of digital asset users. The very purpose of such software products is to make it easier for digital asset users to effectuate their own transactions directly onchain without any intermediation by the developer of such software. Non-Custodial Software Providers merely publish software code, which might run on a local computer or on a blockchain's emulated computer (known as a "virtual machine") and, oftentimes, a graphical user interface (or "front-end") that presents information about the state of a blockchain to users and enables users to use such information to directly effectuate transactions onchain. Each of the nodes within a blockchain network runs a local copy of the blockchain's virtual machine and therefore the smart contract protocols that function on the virtual machine are not operated by any single software provider.

Non-custodial digital wallet software is merely code that helps the user of such software self-manage their private key credentials and create and broadcast transactions to nodes on the relevant blockchain network. Although the Proposed Rule attempts to provide a workable exclusion for non-custodial digital wallet software providers, the Proposing Release clarifies that such providers would nevertheless be deemed to provide a facilitative service "if the software also provides users with direct access to trading platforms from the wallet platform."[11] Virtually every available non-custodial digital wallet software product enables users to access third-party software protocols to trade and otherwise use their digital assets. Such protocols do not and should not cause the wallet software itself to be deemed to effectuate transactions on behalf of the wallet owner. Only the holder of the private key to such digital wallet has the ability to authorize and effectuate such transactions. Moreover, users would be able to access such protocols indirectly and perform the very same transactions (akin to having the option to access an online store through a website or mobile application). However, such users would be subject to the risk of using an unverified webpage that may be fraudulent and place their digital assets at risk of loss. Software developers should not be discouraged from offering American users a safe and secure user experience.

Moreover, the Proposing Release implies that a person that holds "a significant amount of governance tokens" associated with a software protocol or a group of such persons may be deemed to provide facilitative services by taking "actions that benefit the platform" and "maintain practical control."[12] Paradigm does not believe that it would be appropriate or within the statutory authority of the Treasury Department and IRS to regulate governance token holders as "brokers." While every smart contract protocol is different, it is not typical for governance token holders to have the ability to maintain practical control over users' transactions through the protocol.

As discussed above, a smart contract protocol is comprised of one or more deterministic computer programs that are deployed and executed through a blockchain's virtual machine. Each user of such a smart contract protocol effectuates their own transactions in connection with these protocols by signing such transactions with the private key associated with the user's digital wallet. The virtual machine operates like

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[11] Proposing Release at 59586.

[12] *Id.* at 59587.

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a global, single-instance computation engine, but in reality there is an instance of the virtual machine running on each validator node's physical machine. The validator nodes validate each user's transaction and the resulting contract execution. The blockchain records changes in the state of the network that result from the transaction and contract execution, in accordance with network consensus rules.

Governance token holders may have the right to vote on proposals related to limited modifiable elements of smart contract code, but governance token holders do not have the ability to interfere with users' signing of transactions or validator nodes' execution of smart contract code. It is also common for governance token holders to elect not to vote on proposals or to delegate their voting rights to an unaffiliated third party, such as a student organization. Further, persons may buy and sell governance tokens, like any digital asset, on a frequent basis, and, as a result, whether such persons are brokers would depend on the day of the week or hour of the day. This would not be a workable tax administration framework.

B. Position to Know

As discussed above, the Treasury Department and IRS have historically only treated as "brokers" those persons in close proximity to a sale. As a result of such proximity, those persons are apt to be subject to information reporting obligations as they are more likely, in the ordinary course of their business, to have access to reportable information. The Proposing Release would require all persons that offer facilitative services and are in a "position to know" the identity of their customers to collect and report information about their customers. Notwithstanding such proximity and potential access to reportable information, such persons are only treated as "brokers" to the extent that they "ordinarily would know" reportable information. The Proposed Rule would materially deviate from historical Treasury Department and IRS regulatory practice by expanding this standard for purposes of the "digital asset middleman" definition to include persons that are in a "position to know."

Under the Proposed Rule, a person would be in a "position to know" the identity of the party that makes the sale of a digital asset if "that person maintains sufficient control or influence over the facilitative services provided 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 upon request."[13] The Proposed Rule clarifies that any person with the mere "ability to change the fees charged for facilitative services" would be in a "position to know."[14] The Proposing Release further explains that the software developers of any upgradable protocol are deemed to "have the ability to obtain information about their customers by updating their protocols as they do with other upgrades to their platforms."[15]

Such a "position to know" standard has no reasonable limitation. Indeed, virtually every Non-Custodial Software Provider would be in a "position to know" under this standard because they could theoretically modify the terms of service or fees for a protocol, digital wallet software or front-end interface, as applicable. The mere theoretical ability to modify terms or fees would be sufficient, irrespective of whether this would require a governance vote of digital asset holders, a feat of engineering, significant economic and human resources, a complete overhaul of a cyber-security program, or other impracticable measures. Even a person that deploys a protocol or other software that is not technologically upgradable is in scope because the person could in theory deploy a new version of the protocol or software. The Proposing Release assumes that compliance would be as simple as adding a form to a company webpage, but this is not the case. Although it may be possible to alter terms, fees or other limited parameters, the economic

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[13] *Id.* at 59586.

[14] *Id.* at 58587.

[15] *Id.*

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cost of implementing the technological changes necessary to comply with the Proposed Rule would likely put many ecosystem participants out of business. Indeed, Non-Custodial Software Providers would only know with certainty that they are not in a "position to know" under the Proposed Rule upon reaching insolvency attempting to develop a technological solution to comply with Proposed Rule.

III. The Treasury Department's Departure from Prior Treasury Department Reasoning With Regard to Non-Custodial Digital Asset Software is Arbitrary and Capricious

"[T]he great principle that like cases must receive like treatment is . . . black letter administrative law."[16] The Treasury Department has failed to treat like cases alike in promulgating the Proposed Rule and articulating its intended application in the Proposing Release. The Treasury Department's determination that Non-Custodial Software Providers can effectuate transactions in digital assets on behalf of software users for tax administration purposes but not anti-money laundering purposes without providing a reasoned explanation for such distinction is an arbitrary and capricious exercise of administrative power under the APA.[17]

Administrative agencies have the flexibility to "change their existing policies as long as they provide a reasoned explanation for the change."[18] Agencies that depart from prior norms have a duty to provide a reasoned explanation for such departure and distinguish prior actions involving similar facts.[19] When agencies seek to articulate legal standards on a case-by-case basis, they must provide a satisfactory explanation for their actions, including a "rational connection between the facts found and the choice made," when they arrive at or approach different results—to lend predictability and intelligibility to agency actions, promote fair treatment, and facilitate judicial review.[20] No such explanation providing a rational connection between the facts found and the choice made is in the Proposing Release.

The Treasury Department is comprised of multiple bureaus that are responsible for carrying out specific operations assigned to the Treasury Department, including, among others, the IRS and FinCEN. The Treasury Department, by way of FinCEN, has long recognized that providers of non-custodial digital asset software products and services do not effectuate transactions on behalf of non-custodial software users.[21] Indeed, FinCEN established a clear bright line between custodial digital asset service providers,

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16 *Baltimore Gas & Elec. Co. v. FERC*, 954 F.3d 279, 286 (D.C. Cir. 2020) (cleaned up).

17 The APA empowers courts to set aside agency actions that are found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. 5 U.S.C. § 706(2)(A).

18 *See Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2217, 2125 (2016) ("Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change.").

19 *See Atchison, Topeka & Santa Fe Railway Co. v. Wichita Board of Trade*, 412 U.S. 800 (1973) (asserting that an agency has a "duty to explain its departure from prior norms."); *see also Westar Energy, Inc. v. FERC*, 473 F.3d 1239, 1241 (D.C. Cir. 2007) ("A fundamental norm of administrative procedure requires an agency to treat like cases alike."); *see also Colo. Interstate Gas Co. v. FERC*, 850 F.2d 769, 774 (D.C. Cir. 1988) (stating that dissimilar treatment of evidently identical cases is the quintessence of arbitrariness and caprice).

20 *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (holding that the National Highway Traffic Safety Administration's (the "**NHSTA**") rescission of a passive restraint requirement in Standard 208 was arbitrary and capricious because, among other things, the NHSTA failed to address why an alternative requirement was not a sufficient amendment before rescinding the passive restraint requirement); *see also* *Baltimore Gas*, 954 F.3d at 286.

21 *See* FIN-2019-G001, Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies, May 29, 2019 ("**2019 FinCEN Guidance**"), *Application of FinCEN's Regulations to Virtual Currency Software Development and Certain Investment Activity*, Jan 30, 2014; FIN2014-R007, *Application of Money Services Business regulations to the rental of Computer Systems for Mining Virtual Currency*, Apr. 29,

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which generally are "money transmitters" subject to registration as a money services business ("**MSB**"), and non-custodial digital asset service providers, which generally are not money transmitters subject to registration as an MSB. FinCEN reasoned that a user of non-custodial software "do[es] not require an additional third party to conduct transactions" because the user "interacts with the payment system [(*i.e.*, blockchain)] *directly* and has *total independent control over* the value [(*i.e.*, digital assets)]."[22] In contrast, the Proposing Release suggests that non-custodial digital asset service providers can "directly or indirectly effectuate a sale of digital assets" by merely providing a user with "access to" a smart contract protocol that enables the user to transact peer-to-peer or peer-to-contract directly on the blockchain without any intermediation by or assistance of the service provider.[23]

Paradigm submits that the Treasury Department and IRS have failed to explain this departure from FinCEN's thorough analysis and reasoning supporting the contrary conclusion that Non-Custodial Software Providers do not "effectuate" digital asset transactions because the non-custodial software user directly effectuates its own transactions independently. FinCEN's distinction between custodial and non-custodial digital asset products and services has provided sensible clarity to the digital asset industry and offered a path for software developers to innovate and develop new products and services within a reasonable regulatory framework.[24] FinCEN has not, for example, generally required that Non-Custodial Software Providers register as MSBs and perform anti-money laundering and know-your-customer screening on users as is generally required in the case of custodial digital asset service providers.

FinCEN has reasoned that a service provider with "total independent control" over the service user's digital assets can effectuate sales or transfers of such digital assets and therefore must register as an MSB.[25] In contrast, FinCEN explained that a service provider that provides software used by a party to a peer-to-peer transaction that does not have total independent control over the party's digital assets is not required to register as an MSB.[26] For example, FinCEN stated that a service provider that offers a "trading platform that only provides a forum where buyers and sellers of [digital assets] post their bids and offers (with or without automatic matching of counterparties), and the parties themselves settle any matched transactions through an outside venue (either through individual wallets or other wallets not hosted by the trading platform)" is not a money transmitter required to register as an MSB.[27]

In analyzing each type of blockchain transaction under the federal anti-money laundering laws and regulations, FinCEN discovered a fundamental reality of blockchain technology–it is impossible for any person to directly or indirectly effectuate a transaction in digital assets on a blockchain network without control of the private key to the digital wallet that contains such digital assets. Accordingly, FinCEN correctly concluded that service providers that merely develop software that users utilize to independently

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2014; FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, Mar. 18, 2013.

[22] *See* 2019 FinCEN Guidance at 16 (emphasis added).

[23] *See* Proposing Release at 59586.

[24] FinCEN has not, for example, generally required that Non-Custodial Software Providers register as MSBs and perform anti-money laundering and know-your-customer screening on users as is generally required in the case of custodial digital asset service providers.

[25] *See* 2019 FinCEN Guidance at 15-16.

[26] *See id.* at 16-17.

[27] *See id.* at 24.

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transact directly onchain cannot be said to directly or indirectly effectuate digital asset transactions on behalf of such users.

In contrast, the Treasury Department and IRS liken Non-Custodial Software Providers to centralized electronic commerce platforms like Amazon, eBay and StubHub, and make little distinction between custodial and non-custodial digital asset products and services. This approach runs contrary to historical Treasury Department analysis and, if adopted, would not lend predictability and intelligibility to Treasury Department actions, promote fair treatment, or facilitate judicial review. The APA requires the Treasury Department and IRS to adequately explain the basis for failing to treat like cases alike.[28]

IV. The Proposed Rule Would Compromise the Privacy and Security of Digital Asset Users and Discourage Americans from Participating in Digital Commerce

Under the guise of tax administration, the Proposed Rule would institute a sweeping public-private cooperative surveillance program that would undermine the privacy of every digital asset user. The Treasury Department and IRS would deputize nearly every U.S. digital asset product and services provider, including Non-Custodial Software Providers, to invade the privacy of their users and collect large swaths of personally identifying information, such as each user's name, home address and Social Security number. As a result, digital wallet addresses would no longer be pseudonymous once used in connection with any U.S. digital asset software product or service. Unlike persons who transact peer-to-peer in cash using physical wallets, persons who transact peer-to-peer in digital assets using digital wallets would no longer have an expectation of privacy.

It would be unimaginable for the Federal government to require leather goods retailers to perform comprehensive financial surveillance on each American who purchases from such a retailer a leather wallet designed for compatibility with paper money, credit cards, debit cards, access badges, and other gateways to taxable transactions. Hardly any Americans would purchase or use such a wallet if they had to provide personally identifying information to the retailer and agree to share transaction records with the retailer each time that they add funds to their wallet or make a purchase or sale. It would be even more unthinkable for the Federal government to also require the wallet owner to provide such information to their local newspaper every time that they purchase goods directly from a seller that lists goods for sale in the newspaper's classified ads section. The very idea of requiring anybody to provide personally identifying information and a record of each time they open their wallet to a third party that is simply in the business of manufacturing and selling wallets or printing classified ads is comical. Yet the Treasury Department and IRS seek to do just this in the context of digital assets.

Moreover, the vast majority of Non-Custodial Software Providers are not subject to any comprehensive regulatory framework that would require, among other things, that the provider implement a cyber-security program, business continuity and disaster recovery program, maintain a comprehensive insurance policy, or undergo software code audits by a third party auditing firm. This is for good reason – these are requirements imposed by regulators on financial institutions and intermediaries that carry customer accounts and custody customer assets. It would be unreasonable for a regulator to expect a small software development shop to comply with such onerous requirements. However, the Treasury Department and IRS would require such small software development shops to collect users' Social Security numbers without any guarantee that such persons have the technological or operational capability to safeguard such

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[28] *See Connecticut Light & Power Co. v. NRC*, 673 F.2d 525, 530 (D.C. Cir. 1982) (explaining that the "purpose of the comment period is to allow interested members of the public to communicate information, concerns, and criticisms to the agency during the rule-making process. If the notice of proposed rule-making fails to provide an accurate picture of the reasoning that has led the agency to the proposed rule, interested parties will not be able to comment meaningfully upon the agency's proposals.").

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information. Not only would the Proposed Rule jeopardize the privacy of digital asset users, it would create "honeypots" of personally identifying information and thereby place digital asset users at risk of identity theft.

The Proposed Rule reflects a Luddite bias against digital commerce that would discourage the adoption of innovative technologies and jeopardize America's competitiveness with foreign nations that have welcomed these privacy-preserving peer-to-peer payment technologies with open arms.

V. Recommendations and Alternative Considerations

The Treasury Department and IRS should consider revising the Proposed Rule in consideration of the unique characteristics of digital asset transactions and the role of Non-Custodial Software Providers in such transactions.

We strongly recommend that the Treasury Department and IRS remove the "digital asset middleman" concept from the definition of "broker." The Proposed Rule goes beyond simply applying IRC § 6045 to digital asset transactions, but instead fundamentally redefines the term "broker" to cover persons that would not be deemed brokers but for the fact that such persons are within the digital asset industry.

If the Treasury Department and IRS are not inclined to remove the concept of a "digital asset middleman" in its entirety, we suggest that the Treasury Department and IRS impose limitations on what qualifies as a "facilitative service" and who is in a "position to know." We recommend that the Treasury Department and IRS limit facilitative services to include only those services performed for a party to the sale of a digital asset that directly effectuate transactions on blockchains and other distributed ledger networks on such user's behalf.

The Treasury Department and IRS should also consider removing the "position to know" standard in its entirety, or providing that a person will not be in a "position to know" where such person cannot reasonably obtain reportable information. The technology underlying digital asset transactions is complex and rapidly evolving. In certain cases, persons that would otherwise be deemed to be in a "position to know" may be subject to technological limitations rendering them unable to obtain reportable information. Imposing a "reasonable" limitation protects the government's interest in incentivizing persons involved in the digital asset ecosystem to obtain and provide reportable information without causing such persons to be in violation of law as a result of technological impossibilities.

Finally, we understand based on discussions with Paradigm portfolio companies that many digital asset ecosystem participants are not presently technologically equipped to collect the information required to be collected under the Proposed Rule. If the Treasury Department and IRS finalize the Proposed Rule, we urge the IRS to include a two-year good faith compliance grace period for all digital asset ecosystem participants affected by the rule, during which the Treasury Department and IRS will not take enforcement action for compliance violations, so long as the ecosystem participant evidence a good faith effort to comply with the rule. Such reprieve will permit the digital asset industry sufficient time to develop and implement the technology required to comply with the Proposed Rule.

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Paradigm appreciates the Treasury Department and IRS's consideration of our comments and would be pleased to engage with the Treasury Department and IRS as the Proposed Rule develops. If you have questions or would like to discuss these comments further, please reach out to us at agrieve@paradigm.xyz or mjohnson@paradigm.xyz.

Sincerely,

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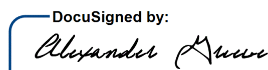

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Alexander Grieve
Government Affairs Lead, Paradigm

DocuSigned by:

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Matthew Johnson
Head of Tax, Paradigm

cc: Roger Wise
Michael Selig
Joshua Baskin
Michael James
Willkie Farr & Gallagher LLP