

Compliance in the Crypto-Sphere: A Call to Action As of 10.19.21

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1. Introduction

Tracking legislative and regulatory developments can be a challenge as compliance officers focus on day-to-day issues and risks at their companies. Although it can be difficult to decipher when to adjust a compliance program and regulatory strategy for expected changes, it is often clear when a compliance officer should engage and study an evolving industry trend or legislative or regulatory focus. The recent developments about tax treatment for digital assets is such a case.¹

This article will give a brief primer of the current state of those developments with a lens towards compliance officers' interests, so they can study and consider the potential impact for their risk assessments and regulatory strategy. We believe, at a minimum, the recent developments are a bellwether for 2022 and should be addressed in impacted compliance officers' planning for priorities and resources as relevant. It is also an opportunity to add the topic to annual training so, in part, the company can determine its role in advocating for the industry to avoid regulation by enforcement. Although the headlines covered in this article have focused on tax treatment of digital assets, the point to consider as we study the developments is whether, more importantly, efforts will lead to new legal definitions and regulatory perspectives regarding digital assets that will impact compliance programs.² Blockchain and digital asset innovation covers a vast continuum of governance and compliance from banking and securities regulatory oversight to lightly regulated state money transmitters to fintech companies that operate as software companies. Arguably, such developments, without industry input or adequate understanding of the impact of such changes, can lead to unintended consequences for these diverse innovators.

Take away #1 - Products and services are vast. One size does not fit all scenarios and it will serve compliance officers well if regulators study and understand the products before fitting the new innovations into legacy laws, rules and regulations (“Regulations”) or regulating digital assets by enforcement.

2. Current State

With more United States citizens using cryptocurrencies by the day, both regulators and members of Congress have sprung to action crafting industry altering legislation for the cryptocurrency and blockchain industry. From SEC enforcement actions³ to a digital asset provision in the Bipartisan Infrastructure Bill,⁴ regulation of the cryptocurrency and blockchain industry is at a critical juncture that will have a monumental impact on the future of the industry in the United States. Included in the current version of the Bipartisan Tax Infrastructure Bill (“the Bill”), which was passed in the Senate on August 10, 2021, is language that drastically expands the definition of a broker to include **“any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person.”**⁵ Interpreted as written, IRS reporting requirements for the digital asset ecosystem could extend far beyond brokers working at centralized exchanges (who have been diligently working though these issues with

1. [WSJ Political Force Article; StableCoin Regulatory Debate.](#)

2. The regulatory environment is evolving quickly. Gensler comments - Oct 5 <https://www.sec.gov/news/testimony/gensler-2021-10-05>; Consideration of an Executive Order - <https://www.coindesk.com/policy/2021/10/08/white-house-considering-executive-order-on-crypto-oversight-report/>; Coinbase posted its blueprint for crypto regulations. <https://blog.coinbase.com/digital-asset-policy-proposal-safeguarding-americas-financial-leadership-ce569c27d86c>; Andreessen Horowitz proposes clarifying laws <https://a16z.com/wp-content/uploads/2021/10/Andreessen-Horowitz-Senate-Banking-Proposals.pdf>.

3. <https://archive.is/3iTOg#selection-441.12-441.254>; <https://www.sec.gov/litigation/admin/2021/33-10961.pdf>; <https://www.sec.gov/litigation/admin/2021/34-92607.pdf>; <https://www.sec.gov/litigation/litreleases/2021/lr25157.htm>

4. <https://www.cNBC.com/2021/08/11/crypto-lawmakers-fought-over-the-infrastructure-bill-heres-whats-next.html>

5. Infrastructure Investment and Jobs Act, H. R. 3684, 117th Congress (2021), 2332. <https://www.congress.gov/bill/117th-congress/house-bill/3684/text>

the IRS). Indeed, this broad definitional expansion could be interpreted to cover a wide range of actors within the cryptocurrency ecosystem including:

- software wallet developers
- hardware wallet manufacturers
- multi-signature service providers
- liquidity providers
- DAO token holders
- crypto miners

This expansion is especially problematic given that not all of the people and entities listed above have access to information that a broker is required to report because they play no meaningful role in facilitating such transactions. The law thus would effectively require these newly designated “brokers” to gather sensitive financial information that they neither presently obtain nor need, for the sole purpose of passing that information along to the government. That would be a novel, impractical, and likely unconstitutional endeavor.

Indeed, the impact that this expanded definition will have on data security and privacy in the cryptocurrency and blockchain ecosystem cannot be understated. Requiring entities to collect personal, financial information that they normally would not collect would not only create a honey-pot of valuable information for malicious cyber criminals but also unnecessarily violate American citizens’ fundamental right to privacy. In this manner, given the ambiguity and potential breadth of the digital asset provision within the Bill, the proposed expansion of the term “broker” threatens to turn what should be a “reporting” requirement into what is actually a surveillance requirement.

The Bill also defines “digital assets” broadly as **“any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.”**⁶ This definition is exceptionally broad and, without further clarification from Treasury, risks allowing the agency to arbitrarily determine what assets qualify as digital assets and thus be subjected to an array of regulatory obligations. In essence, this lack of definitional clarity has the risk of spurring mass confusion and uncertainty in the digital asset marketplace.

Prior to the passage of the Bill, Senators Rob Portman (R-OH) and Mark Warner (D-VA) conducted a colloquy to clarify the scope and intent of the digital asset provision. During the colloquy, Senator Portman explained, “The Treasury Department, the nonpartisan Congressional Joint Committee on Taxation, and others believe that the current language is clear enough that the reporting requirements only cover brokers...We want to be sure that miners and stakers and others who play a key role in validating transactions now or in the future, or hardware and software sellers for digital wallets will not be subject to the rules for those activities. Again, you will need to provide the information reporting only if you are functioning as a broker.” While this colloquy is beneficial from a compliance perspective, this type of clarification is not legally binding in a United States court of law.

Even with the expression of confidence that the term broker is sufficiently clear, compliance officers may wish to consider whether this “one size fits all” definition will appropriately address the unique fraud concerns that come with this burgeoning technology, cause a host of unintended consequences or impede industry’s ability to flourish in the United States. An alternative approach would be to limit the discretion of the Secretary in favor of a tailored

6. Infrastructure Investment and Jobs Act, H. R. 3684, 117th Congress (2021), 2332-2333. <https://www.congress.gov/bill/117th-congress/house-bill/3684/text>

definition of digital assets and narrowing the regulatory requirements associated with this definition to its use cases. This approach would track precedent in other financial services industries including banking, investment advisory, or securities and commodities activities.

Because the Bill still needs to be voted on in the House of Representatives, the fate of these definitions is still in flux. Should the Bill fail to pass in the House, it will have to return to the Senate to be voted on again. At that point, amendments to the definitions within the digital asset provision of the Bill could be proposed. If the Bill is passed in the House, there are still legislative avenues that can be taken to amend these definitions. Additionally, none of these definitions are set to go into effect until 2023, so there will likely be several iterations of the definition of “a broker” and “a digital asset” in the near future. Although the bill is focused on tax ramifications, it is an important issue for compliance officers to follow because the IRS regulations will inform other conduct regulations, rules and laws. We have seen this impact with retirement investment services and ERISA and 401(k) requirements.

Take away #2 - The definition of a broker and a digital asset along with many other facets of the cryptocurrency and blockchain ecosystem are in a state of regulatory flux; many foundational definitions and regulatory frameworks that will decide the fate of this industry in the United States are being established at this critical juncture. Compliance Officers should consider whether their companies should engage with industry efforts to help the decision-makers (regulators, legislatures, industry groups) create definitions that are appropriately tailored to address the risks associated with this ecosystem.

3. Compliance Officer Resources

To help compliance officers understand the latest developments, below are highlights we recommend compliance officers review. We have also provided an appendix of resources for those who want to research the topic in detail. The views expressed in these articles are those of the publications, not NSCP.

Wall Street Journal | The Editorial Board | A Bipartisan Cryptocurrency Crackup | August 10, 2021 (Subscription required)

The Senate passed its infrastructure bill on Tuesday but not before a cryptocurrency crackup that is all too typical of today’s Washington. This is what happens when insiders write bills that they release at the last minute on issues they don’t understand. The White House wants more tax reporting of cryptocurrency transactions, not without reason. The IRS treats virtual currencies as property, meaning that people who sell their coins owe tax on their gains. But many don’t report crypto income on their tax returns. Some don’t know they have to, but some are intentionally dodging taxes.

Politico | Victoria Guida | Washington Wakes Up to Crypto Influence Amid Infrastructure Fight | August 9, 2021

“This has definitely been a wake-up call to crypto,” said Kristin Smith, executive director of the Blockchain Association, an industry lobbying group. “But on the flip side, I think Washington is starting to see that crypto is more of a force than anybody ever anticipated.”

CNBC | Taylor Locke | The Senate Just Rejected the Compromise Crypto Tax Amendment to the Infrastructure Bill | August 9, 2021

Clarifying the provision would not affect the reporting requirements on crypto exchanges like Coinbase that operate on behalf of customers, according to the Blockchain Association, a crypto trade association that works to change public policy at the federal level.

The Blockchain Association also expressed concern following the rejection: “As written, the infrastructure bill contains harmful IRS reporting requirements that many in the crypto ecosystem lack the capabilities to comply with. As a result, many crypto players will be forced to move overseas, leaving future jobs and economic growth on the table.”

Bloomberg | Laura Davison & Mackenzie Hawkins | Change to Crypto Provision in Infrastructure Bill Blocked | August 9, 2021

Kristin Smith, executive director of the Blockchain Association, said in a statement that the trade group and its member organizations will be “engaging with members of the House of Representatives to ensure the unclear and unworkable aspects of this provision are removed once and for all.”

Take away #3 - Compliance officers should consider how they can be proactive on behalf of their companies whether that involves joining industry organizations, looking for and subscribing to new industry resources and/or if appropriate, discussing whether the company should take a proactive role to influence legislative and/or regulatory developments.

4. Conclusion

In conclusion, compliance officers are increasingly faced with questions about how their firm’s compliance program is (or will be) impacted by cryptocurrency. And, as legislators and regulators prepare to make decisions about applicable Regulations, now is a great time for compliance officers to engage and educate. This article is meant to offer a jumping off point for that exploration. The more knowledgeable that compliance officers, and our legislators and regulators are about blockchain, the better opportunity to identify and address the appropriate material risks and build a sound and sustainable governance and compliance framework that prevents fraud and promotes the stability all stakeholders agree is needed.

It is also the time for impacted compliance officers to study and determine their company’s regulatory strategy and risk tolerance so management isn’t surprised or unprepared when inevitable developments occur. The resources herein should be used as a jump start for such planning and coordination. ■

Resources Appendix

Washington Post | Todd Frankel, Jeff Stein, Jacqueline Alemany, & Hamza Shaban | **How Cryptocurrency Became a Powerful Force in Washington** | August 7, 2021

After the initial bipartisan infrastructure legislation containing cryptocurrency provisions was unveiled, the sector's nascent lobbying force sprang into action. The Blockchain Association, a Washington-based trade group whose membership has more than quadrupled since 2018, immediately began to team up with other crypto groups and businesses, such as Coin Center and Digital Currency Group. They coordinated lobbying efforts over Google Meet video calls and encrypted messages on Signal. They used Google Sheets to track congressional office contacts.

"This is a whole new level of coordination and effectiveness that the cryptocurrency industry has been able to have in Washington," said Kristin Smith, executive director of the Blockchain Association.

Wall Street Journal | Andrew Ackerman & Paul Kiernan | **Cryptocurrency Compromise Emerges for Infrastructure Bill** | August 5, 2021 (Subscription Required)

After learning of the provision in the infrastructure deal last week, the Blockchain Association and other cryptocurrency officials pressed lawmakers and aides to scrap or modify the measure.

A social-media ad released by the association said the provision "is threatening to drive the potential benefits and uses of crypto networks overseas," and, if implemented, "will affect the future of the internet."

Politico | Kellie Mejdrich, Victoria Guida, & Brian Faler | **Cryptocurrency Tax Changes Spark Clash Between White House, Key Democratic Senator** | August 4, 2021

Coinbase and numerous industry groups quickly issued statements supporting the amendment effort, including the Blockchain Association, Coin Center, Ribbit Capital, and Square, as well as the Association for Digital Asset Markets.

"Senators Wyden, Lummis, and Toomey are right that this language would place unworkable requirements on a nascent industry and we support their proposed amendment to the provision. Clarifying the provision to address our concerns would not affect the reporting requirements on crypto exchanges that operate on behalf of customers," the Blockchain Association, Coinbase, Coin Center, Ribbit Capital, and Square said in a joint statement.

However, to help pay for the bill's trillion-dollar price tag, senators included a provision in the bill that would target America's budding crypto industry with hastily conceived and misguided mandates that have never been publicly debated. If it passes as written, this provision would stifle a key driver of 21st-century growth, send jobs overseas and could violate constitutional privacy rights, impacting everyday Americans across the country.

Bloomberg | Laura Davison & Mackenzie Hawkins | **Senators Reach Bipartisan Crypto Deal Amid Vote Uncertainty (2)** | August 9, 2021

The Blockchain Association, a Washington-based trade group, backed the compromise announced by Portman and Lummis. The group's executive director, Kristin Smith, said in a statement that while the deal "leaves work to be done, the Blockchain Association fully supports this improvement to the original language."

CNBC | Taylor Locke | There are 2 Competing Crypto Tax Amendments to the Senate’s Infrastructure Bill—Here’s What Each Would Mean for the Industry | August 6, 2021

Removing protections for these groups could also potentially force many developers out of the U.S., Blockchain Association executive director Kristin Smith wrote in a statement. That could, in turn, roil the crypto markets and impact investors with stake in the industry.

The Hill | Rebecca Klar | Cryptocurrency Clash Complicates Infrastructure Bill’s Path Forward | August 6, 2021

The Blockchain Association tweeted Thursday urging supporters to call their senators to vote “yes” for the Wyden, Toomey and Lummis amendment, and the association released a statement Wednesday including more than 100 stakeholders in the cryptocurrency ecosystem urging Senate leaders to support it. The association’s executive director, Kristin Smith, called the alternative Senate proposal “terrible.”

CNBC | Tanaya Macheel | Senators File Crypto Broker Amendment to Infrastructure Bill After Industry Backlash | August 4, 2021

Clarifying the provision to address concerns about who would be deemed a broker would not affect the reporting requirements on crypto exchanges like Coinbase that operate on behalf of customers, according to the Blockchain Association, a crypto trade association that works to change public policy at the federal level.

The group said it supports the amendment introduced Wednesday, in a joint statement with the crypto policy-focused nonprofit Coin Center, Coinbase, Square and venture capital firm Ribbit Capital.

“The development of crypto, and financial innovation generally, has enormous potential for the American economy and the American people through increased job creation and GDP growth,” they said. “It should not be subject to potentially devastating legislation without public participation and public comment.”

Forbes | Hailey Lennon | Crypto Provision In Infrastructure Bill May Force Bitcoin Miners And Blockchain Companies To Flee U.S. | August 3, 2021

Kristin Smith, Executive Director of Blockchain Association, noted to me, “The Blockchain Association Tax Working Group has long been working on information reporting policy solutions so that traditional cryptocurrency exchange customers can more easily pay taxes. However, the provision in the bipartisan infrastructure package is written in a way that could be interpreted to apply to persons in the crypto ecosystem far beyond traditional cryptocurrency exchanges, such as miners, stakers, and other participants. It is critical that this provision be fixed before the legislation moves forward.”

CNBC | Provisions, Language of US Infrastructure Bill Can Upset Crypto Sector; Here’s Why | August 3, 2021

The Bill is an effort to regulate uncollected taxes generated by crypto, which according to Charles P. Rettig, the IRS Commissioner, could be anywhere between \$28 billion and \$30 billion. However, the draft does not affect IRS-regulated platforms such as Coinbase, or places where people can buy cryptocurrency like Square, PayPal, and Robinhood. Such platforms will not be affected as they adhere to reporting guidelines.

The Blockchain Association said the draft’s language poses an “imminent threat” to the embryonic crypto industry. According to the association, tax evasion from crypto could be much less than what is projected by the IRS.

Bloomberg | Maria Luiza Rabello | **Blockchain Association Urges Senate to Clarify Crypto Language** | August 2, 2021

The Blockchain Association sees language issues in the proposal that attempts to pay for a portion of the infrastructure package with a new digital asset tax information reporting provision. Provision is written in a way that could be interpreted to apply to persons in the crypto ecosystem who don't have access to the information required for reporting, Kristin Smith, Executive Director of the Blockchain Association, says in a statement.

CNBC | Tanaya Macheel | **How Language in the Infrastructure Bill Could Roil the Crypto Markets** | August 2, 2021

The biggest worry is that the language would “detract people from wanting to invest or participate in crypto networks in the United States,” Smith told CNBC. Jake Chervinsky, a lawyer experienced in crypto-related securities litigation and government enforcement defense matters who is now general counsel at the decentralized finance (DeFi) firm Compound Labs, said it would also be detrimental to existing businesses that would be unable to comply.

Forbes | Jason Brett | **New Language For Crypto Tax Reporting Excludes Decentralized Exchanges, Miners Still Vulnerable** | August 2, 2021

The Blockchain Association has been tweeting updates as well, with Kristin Smith the Executive Director of the Blockchain Association noting this was, ‘not a drill’ earlier this week to let the cryptocurrency and blockchain industry aware of the dangers involved in how the bill language was written and who could be impacted.

CNBC | Taylor Locke | **From the Senate’s Infrastructure Bill Proposal to Record Trading Volume for NFTs: 5 Key Things that Happened in Crypto this Past Week** | August 2, 2021

Still, the Blockchain Association urges for more changes. “While some minor improvements have been made, the latest language still poses fundamental concerns and questions about certain terms and definitions used in the provision,” Kristin Smith, executive director of the Blockchain Association, said in a statement. “[T]his provision is written in a way that could be interpreted to apply to persons in the crypto ecosystem who don't have access to the information required for information reporting.”

Bloomberg Law | Allyson Versprille | **Crypto Industry Says Tax-Reporting Plan Hits Wrong Players (1)** | August 2, 2021

“It's hands-down the single greatest legislative threat that we've seen gain momentum,” Kristin Smith, executive director of the Blockchain Association, said on Bloomberg QuickTake Monday. She said her group will be pushing for amendments to the bill prior to its passage in the Senate. If unsuccessful, the association will have another shot when the House takes up the measure. The Senate hopes to pass the measure this week.

Washington Times | Kery Murakami | **Washington Ready to Tax Cryptocurrency Trades, Eyes \$28 Billion to Help Pay for Infrastructure** | August 1, 2021

The definition of a broker in the proposal is too broad and could include software developers and others involved in cryptocurrency transactions, the association says. That would potentially drive companies vital to cryptocurrency development out of the business in the U.S., said Kristin Smith, executive director of the Blockchain Association. “It's unfortunately what happens when legislation moves too quickly,” she said.

Politico | Kellie Mejdrich & Brian Faler | **Cryptocurrency Industry Fears Big Tax Hit in Infrastructure Bill** | August 3, 2021

Blockchain Association Executive Director Kristin Smith expressed frustration with the last-minute scramble to write the legislation, saying it could impose new requirements on “all sorts of

different actors in the ecosystem.” “We think it would have the effect of potentially driving a lot of these actors and businesses and individuals involved in crypto overseas and really stifling the innovation in this space here in the United States,” she said.

New York Times | Daily Political Briefing | Why President Biden’s Infrastructure Deal Still Faces a Bumpy Road | July 30, 2021 (Subscription Required)

The cryptocurrency industry is up in arms over a clause aimed at raising nearly \$30 billion by imposing more tax reporting requirements on transactions. This could have “unintended consequences that strike at the heart of innovation,” said Kristin Smith of the Blockchain Association industry group.

Bloomberg | Laura Davison, Joe Light, & Allyson Versprille | Crypto Surprise Rattles Industry in Rare Bipartisan Tax Plan | August 29, 2021

“Instead of rushing through an untested provision with vast unintended consequences, we encourage Congress to work with industry to find language that works for all stakeholders,” said Kristin Smith, who heads the Blockchain Association, a Washington-based trade group.

MarketWatch | Chris Matthews | Crypto Allies Rally Against ‘Ignorant’ New Tax Rules in Bipartisan Infrastructure Deal | August 29, 2021

Kristin Smith, executive director of the industry group Blockchain Association, called the bill “hastily drafted” and argued in a statement that while “improvements to our nation’s infrastructure are important,” the provision would subject companies, like those who manufacture hardware for storing digital assets, to IRS reporting requirements they may not be able to comply with, because they don’t have visibility into their customers’ transactions. “Instead of rushing through an untested provision with vast unintended consequences, we encourage Congress to work with industry to find language that works for all stakeholders, keeping America at the forefront of crypto innovation,” she said.

Op-Eds

The Hill | Kristin Smith | The “Compromise” Crypto Amendment is No Compromise at All | August 6, 2021

The problem with the infrastructure bill’s original crypto provision was that it imposed stringent reporting requirements across the entire industry that would ensnare innovators in red tape. By redefining most crypto stakeholders as “brokers,” the bill would require nearly everyone – including software developers and hardware manufacturers – to collect and store personal details about everyone that uses their products and report that information to the IRS.

Morning Consult | Kristin Smith | Hidden Provision in Infrastructure Bill Exposes Americans’ Financial Privacy | August 4, 2021

The Senate reached a deal to make long-overdue investments in our nation’s infrastructure, and many provisions, such as increasing broadband, will help drive America’s economic leadership.