WEB3 WORKING GROUP

**Comments to the Department of Treasury on "Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions" ("Proposed Regulations") REG–122793–19**

The Honorable Lily Batchelder
Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

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To Whom It May Concern:

Web3 Working Group is a leading nonprofit organization in the decentralized technology space. It educates and champions the growth and advancement of decentralized physical infrastructure networks (DePIN) and the broader web3 ecosystem. Web3 Working Group seeks to position the United States at the forefront of emerging web3 technologies.

Web3 Working Group submits the following comments on the proposed Treasury Rules "Gross Proceeds and Basis Reporting by Brokers and the Determination of Amount Realized and Basis for Digital Asset Transactions."

Regulatory clarity is crucial for America to lead in the web3 industry. As other countries worldwide create rules for this space, they attract more innovation and investment. Nearly two years after the Infrastructure, Investment, and Jobs Act of 2021 aimed to define the tax treatment of various digital assets and activities, we are pleased to see the Treasury Department provide guidance and hope it will allow the US to continue to lead the technology sector.

Given the length and complexity of the proposed rules, Web3 Working Group will not provide feedback on many sections that deserve attention. Instead, we will focus on the section we believe would most adversely affect the DePIN sector—the tax treatment of digital assets when used to purchase a good or service.

The DePIN sector offers an alternative to centrally controlled internet infrastructure. Many protocols in this sector allow companies or individuals to purchase these services in a decentralized manner, as opposed to purchasing exclusively from large companies like Microsoft or Amazon Web Services. Examples include the Akash network, which facilitates cloud computing rentals, the Filecoin and Arweave networks, which facilitate decentralized data storage, both metered and permanent, Helium, which enables the purchase of internet

service, and IoTex, which enables cryptographically secure geolocation tracking for logistics and a number of other use-cases.

Beyond the technology impact of their decentralized nature, these networks are also different from current web analogs because purchasing the service doesn't depend on credit cards. The functionality, security, and economics of these services revolve around the network's native token and how its issuance is designed before release. For instance, the Arweave network for decentralized persistent storage uses the Arweave token, or AR. The users who provide the storage on the network get paid in those AR tokens, but to give them incentive to provide the service before there were many users of it (the boot-strapping problem), the protocol provides a subsidy in the form of newly created tokens, which reduces over time as adoption grows.

There are multiple reasons for building systems around these tokens. For instance, the token structure allows users to pay for and receive services without a middleman or payment processor. Without a native token, a centralized middleman would be necessary, negating the decentralized network's purpose. Native tokens also incentivize individuals to participate in and grow the network during a project's startup phase. Many of these protocols are designed to release new tokens to network workers as a protocol-derived subsidy for their work. Without this option, aligning incentives and launching a project would be challenging. Bitcoin, for example, released the first 50% of its supply in the first 4 years of mining rewards, as a way to increase the incentive for miners to participate in decentralizing the work involved.

Given the necessity of native tokens for the DePIN sector's growth, Web3 Working Group is concerned about the reporting requirements for tokens being used to purchase service from a decentralized network.

The Digital Asset Payment Processors section proposes reporting requirements for regular business transactions in digital assets. The section states, “In both cases, the customer has disposed of its digital assets in a transaction that ordinarily is a gain (or loss) recognition transaction. These proposed regulations would require digital asset payment processors to provide information on those dispositions.”

To determine the gain or loss on a transaction, the proposed rules state that for each transaction, an individual or payment processor would need to know the digital asset's cost when purchased for dollars, the price of the digital asset when exchanged for a good or service, the fair market value of the property or service received, and the transaction fee's cost. The equation would be:

**Cost of the digital asset + change in the digital asset's price - fair market value of the asset - transaction fee**

Compare this with how it works for current web service providers where a company sells compute power to individuals and businesses using credits. Instead of billing in dollars at the month's end, they sell credits for purchasing compute power. If someone bought credits and the compute power price decreased allowing the credits to buy more compute power, would

that be a capital gain for the customer? Of course not, they would simply be getting a better deal on the service.

The fact that these two scenarios would be treated differently for tax purposes disadvantages web3 and the DePIN sector, giving the upper hand to the centralized infrastructure of web2 and big tech companies even though they offer the same end service to consumers, despite DePIN offering greater transparency and efficiency. This threatens to undermine American innovation and investment in the DePIN space with little to no benefit for federal tax revenue.

The proposed rules do not provide a De Minimis exemption for regular digital asset purchases. In many cases, DePIN protocols charge micropayments for services on a short-period metered basis, so the degree of reporting in the proposed rules would quickly become overwhelming. As currently written, those wanting to purchase persistent storage on the Arweave network would need to determine the average AR token purchase price, the AR token price at the time of service purchase, the fair value of the storage space sold to them, and the transaction fees. Additionally, the 24/7, 365-day fluctuation of digital asset prices makes determining the digital asset's price at the sale time challenging.

Given that services like storage space might be purchased repeatedly over time, determining the AR tokens' value when bought and used would be challenging for most users. Moreover, how do we determine the “fair market value” of services on the Arweave network? Current data storage market vendors sell their service as an ongoing month by month contract service. No one in the current technology landscape offers “permanent” file storage, like the Arweave network and a few other emergent web3 protocols, so how would fair market value be found for that service?

Further, how is a user expected to find the fair market value of web hosting, or video distribution, or any service that is normally subsidized by capturing and selling data about their users? This proposed requirement would make it so onerous as to in practice prevent the adoption of this new technology in the US, unless it allows for some degree of De Minimis exemption.

<u>We suggest the Treasury consider three solutions:</u>

1) Provide a De Minimis exemption for small everyday transactions, which are unlikely to significantly impact an individual's tax standing.
2) Establish a safe harbor rule, allowing a digital asset's price during that day to be cited without knowing the exact price at the sale time.
3) When tokens are spent to purchase services related to their native token, no change in tax status should accompany those service purchases.

Web3 Working Group is not suggesting that DePIN tokens have no tax obligations. Capital gains taxes are still appropriate when DePIN digital assets are not used for services, but are exchanged for dollars. Additionally, if those providing DePIN services exchange the digital assets

they earn for their work for dollars, this action should be treated as personal or business income, depending on individual tax circumstances.

With these proposed changes, America can create a level playing field for the DePIN sector to fairly compete, ensuring continued innovation and investment stays in America. Without these clarifications, many projects will move overseas, leaving American consumers and service providers at a disadvantage.

Web3 Working Group thanks you for your time and consideration and welcomes any questions or clarifications.