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INFRASTRUCTURE BILL'S NEW REPORTING REQUIREMENTS MAY HAVE SWEEPING IMPLICATIONS FOR CRYPTOCURRENCY ECOSYSTEM

To Our Clients and Friends:

On November 15, 2021, President Biden signed into law HR 3684, the "Infrastructure Investment and Jobs Act" (the "Act"), commonly referred to as the "infrastructure bill." The Act allocates funding and other resources focused on roads and bridges, water infrastructure, resilience, internet and cybersecurity, among other areas (a full summary of the Act from Gibson Dunn is forthcoming).

The 1039-page Act also contains three pages adding new reporting requirements for certain cryptocurrency transactions that have little to do with infrastructure, but could have potentially dramatic implications for millions of United States businesses and consumers who have embraced cryptocurrency for its efficiency, transparency, and accessibility.

Here are the key takeaways for the Act's expanded "cash" reporting provision applicable to cryptocurrencies:

- The Act extends traditional reporting requirements for certain transactions involving over $10,000 in physical cash to transactions involving a newly defined category of "digital assets," including cryptocurrencies.

- Depending on how this new reporting obligation is interpreted and implemented, it could require businesses to collect new types of information and report to the IRS details of crypto transactions, in circumstances that bear little resemblance to cash purchases—or face civil and criminal penalties for failing to do so. An expansive application could have sweeping and unintended consequences for the cryptocurrency industry, potentially driving crypto transactions towards unregulated services and private wallet transactions, defeating the core policy objectives behind these requirements.

- To avoid these consequences, it will be critical for stakeholders in the cryptocurrency ecosystem to advocate for regulators to adhere to the traditionally narrow scope of the cash-reporting requirement when it comes to digital assets, to educate legislators and regulators alike on the privacy and democratic values served by peer-to-peer blockchain technologies, and to explain the pitfalls of creating disincentives for consumers to participate in the regulated system of digital transactions.

In the coming months and years, there will be critical opportunities for industry participants to shape legislation and regulation on these issues. Gibson Dunn represents many clients at the forefront of crypto and blockchain innovation and stands ready to help guide industry players through these complex challenges at the intersection of regulation, public policy, and technology.

I. "Cash Reporting" Requirements Extended to Digital-Asset Transactions Greater than $10,000

The Act amends the anti-money-laundering "cash reporting" requirements of 26 U.S.C. § 6050I to encompass transactions in "digital assets."

Section 6050I requires businesses that "receive" over $10,000 in cash (or other untraceable instruments like cashiers' checks and money orders) to file a Form 8300 with the IRS, which includes the name, address, and taxpayer identification number, among other information, of both the payer and the beneficiary (usually the recipient) of the transaction. Because the "receipt" of physical cash generally involves an in-person transaction, Section 6050I historically has been applied mainly to transactions involving the in-person purchase of goods or services, such as when a person pays cash for jewelry, a car, or legal representation. *See* 26 C.F.R. § 1.6050I-1. Importantly, Section 6050I does *not* apply to transactions at financial institutions, which are subject to parallel requirements under the Bank Secrecy Act. *See* 31 U.S.C. §§ 5312, 5313. Nor does it apply to traceable electronic transactions involving credit cards, debit cards, or peer-to-peer payment services like PayPal and Venmo.

The Act forays into the digital world by amending Section 6050I's definition of "cash" to include "digital assets," thereby requiring persons that "receive" greater than $10,000 worth of digital assets in the course of their trade or business to file Form 8300 reports. The Act broadly defines digital asset as follows: "*Except as otherwise provided by the Secretary*, the term 'digital asset' means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary." Sec. 80603(b)(1)(B) (emphasis added). That definition potentially could encompass a broad range of digital assets, including traditional cryptocurrencies and even non-fungible tokens ("NFTs"). Likewise, the Treasury Secretary's authority to "provide[]" "otherwise" would allow the Secretary to exempt certain digital assets or scenarios.

The Act does not alter the information that must be reported for digital-asset transactions on Form 8300, but the Secretary and the IRS may seek to clarify how Form 8300 applies to digital-asset transactions through regulation. This discretion will be important because, as discussed below, there are potential pitfalls in applying reporting requirements that were designed for retail purchases in cash to transactions involving cryptocurrency.

Failure to comply with Section 6050I can result in civil penalties of up to $3 million per year—with much higher penalties possible if the failure is due to "intentional disregard" of the filing requirements. 26 U.S.C. §§ 6721, 6722. In addition, willful violation of Section 6050I is a federal felony, with violators facing up to 5 years imprisonment and corporate violators facing fines of up to $100,000. *Id.* § 7203.

This new reporting requirement will not take effect until 2024. The delayed effective date gives time for the Treasury Secretary and the IRS to consider whether to issue regulations clarifying: (1) the scope of the definition of digital assets; and (2) the reporting requirements for digital-asset transactions above

$10,000. It also provides time for parties affected by the legislation to engage in the rulemaking process to shape the outcome of these regulations.

In addition to the amendment to Section 6050I, the Act also expands existing IRS Form 1099 reporting obligations by amending the definition of "broker" under 26 U.S.C. § 6045 to include businesses "responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." Sec. 80603(a)(3). This amendment would appear to apply to cryptocurrency exchanges, peer-to-peer money transmission services, and financial institutions that support cryptocurrency transactions. Its reach beyond that is unclear and regulations are expected to be issued addressing the scope of the new provision. As discussed in Part III, members of Congress have expressed interest in amending the newly expanded definition of broker, suggesting that there may be future legislation addressing this issue.

II. **Real-World Consequences**

The Act's new requirement for businesses to collect and report personal information about the parties to certain cryptocurrency transactions greater than $10,000 could have unintended consequences, but much will depend on how this new reporting obligation is implemented. More broadly, the Act highlights the challenges of applying old-world legislative concepts to emerging technologies that are not well understood.

As discussed, Section 6050I's cash-reporting requirements traditionally have applied mainly to in-person and otherwise untraceable cash payments for goods and services. Those requirements, and the rationales underlying them, do not map cleanly onto digital assets, which are transacted online and in a public and traceable manner by virtue of blockchain technology. If forthcoming regulations clarify that Section 6050I, as amended, will cover only "cash-like" digital-asset transactions—such as the use of bitcoin to pay for goods and services (like a car) in person—then the Act may have a more limited impact on the cryptocurrency industry. Even then, though, there will be many gaps for the Secretary and the IRS to fill in attempting to translate a reporting scheme designed for mostly in-person, cash transactions in the physical world to the cryptographic world of digital-asset transactions.

If, however, the implementing regulations sweep more broadly and seek to encompass parties that "receive" cryptocurrency as payments in online or peer-to-peer transactions (or the intermediaries that facilitate those transactions), the Act could have sweeping consequences for the future of the new and rapidly evolving cryptocurrency technology.

Privacy, efficiency, and decentralization are the core features driving the proliferation of blockchain technology. Blockchain enables radical transparency with respect to every transaction through a publicly available distributed ledger, and it is built on technology that enables secure and trusted peer-to-peer transactions without the costs and other implications associated with centralized intermediaries. This appeals to privacy-conscious consumers, as well as those who may have faced barriers to access to the traditional financial system, for reasons of cost or due to the need to pass credit requirements or other hurdles.

To the extent that the regulations under the Act require online businesses receiving payments in cryptocurrency (versus via a fiat-linked wallet or credit card) to collect and report new forms of information, this would put cryptocurrency at a fundamental disadvantage relative to other forms of traceable currency that have not been subject to cash reporting requirements. Moreover, requiring and reporting extensive information about the parties to a cryptocurrency transaction could alienate privacy-conscious customers or those who have embraced the simplicity and agency inherent in managing transactions directly from their digital wallet. Unlike consumers of traditional banking products, digital-asset customers have readily accessible alternatives to transact digital assets using any number of private and unlicensed services that operate outside the system of regulated transactions. Given this, an expansive and unprecedented application of cash reporting requirements to cryptocurrency transactions could have the effect of driving digital-asset consumers away from industry participants operating inside the U.S. and global regulatory system and towards a rapidly expanding market of unencumbered alternatives.

The Act also presents challenges for a new category of digital asset "brokers." Digital-asset brokers with customers outside the United States may have complex reporting, withholding, and other compliance challenges that could encourage users to move their cryptocurrency activities to non-U.S. competitors. Moreover, a broad implementation of the cash reporting provision could overlap with the new broker reporting rules, creating duplicative and burdensome reporting for the same transactions (*e.g.*, where a transferor broker facilitates and reports a transaction under Section 6045 and a transferee broker facilitates and reports the same transaction under Section 6050I).

In addition, if the Act is interpreted to apply to certain participants in decentralized finance ("DeFi") transactions, it could pose an existential threat to the burgeoning industry. At present, it is unclear whether many DeFi participants could gather the information necessary to report digital-asset transactions over $10,000. In some decentralized exchanges (DEXs), for example, there is no way for a business that receives a digital asset from a liquidity pool to trace the asset to particular individuals or entities. Nor is there a centralized third party that could collect this information—indeed, the distinguishing feature of many DEXs is that they rely on automated smart contracts. If the Act's reporting requirements nevertheless are interpreted to apply in this context—for example, by requiring smart-contract developers to modify DeFi protocols to collect customer information—the effect might be to handcuff this emerging industry.

To avoid these or other consequences that could unintentionally burden cryptocurrency moving forward, it will be critical to develop early and strategic advocacy with the IRS and Treasury during rulemaking, and to educate regulators and legislators alike on the distinguishing and beneficial features of blockchain technology and the dangers of disincentivizing customers to use licensed and regulated institutions to host and enable their digital assets and transactions.

III. **Looking Forward**

Congress and regulators are increasingly active in regulating blockchain and cryptocurrency technology, but in many cases lack critical context and understanding of the benefits and application of this

technology to address long-running policy objectives, including access to capital, particularly for unbanked and underbanked communities.

Near Term

In the short term, opportunities will exist to shape the Treasury Department's rulemaking to implement the Act. Before the recently passed cryptocurrency provisions take effect in 2024, the Treasury Secretary and the IRS are expected to clarify the scope of Section 6050I as applied to digital assets, including the definition of "digital assets," the scenarios that give rise to reporting requirements, and the particular reporting requirements for digital assets. Such a rulemaking would represent both a risk and an opportunity for companies, consumers, and other stakeholders in the cryptocurrency space. It will be critical for industry participants to ensure that in applying Section 6050I to digital assets, the Secretary and the IRS adhere to the traditional and narrow understanding of that provision, and do not inadvertently sweep in online or peer-to-peer digital-asset transactions. It likewise will be important to ensure that any regulations properly account for the private, traceable, and decentralized nature of cryptocurrency transactions.

Moreover, the current Congress is not done passing legislation that could impact cryptocurrency businesses and consumers. The $1.7 trillion reconciliation bill, officially known as the Build Back Better Act, is expected to address cryptocurrency again and may pass Congress before the end of the year. Though the exact provisions continue to be negotiated, the current bill would address the tax treatment of certain cryptocurrency transactions. For example, the reconciliation bill may subject cryptocurrency transactions to the "wash sale rule" (which prohibits reporting a tax loss by selling a security at a loss but then buying the same security within 30 days), and constructive sale rules (which prevent a taxpayer from deferring gains by holding opposing positions on a security). There may be opportunities to advocate for legislative changes to avoid some of the pitfalls created by the Act.

This is an area of intensive congressional focus, and there will be many opportunities to educate legislators and shape legislation. For example, recent reports indicate that Senate Finance Committee Chairman Ron Wyden (OR-D) and Senator Cynthia Lummis (WY-R) are planning to introduce legislation that would narrow the definition of "broker" included in the Act. (The Block) Senator Pat Toomey (R-PA) also has stated that he would work to amend the definition of broker so as to exempt miners and other parties not involved with directly handling customers' cryptocurrency transactions. Senator Toomey conceded that Congress will "have to do it in subsequent legislation" if the infrastructure bill was not amended before its passage (Yahoo Finance). Others in Congress have also noted the need to amend the current definition. In August, the bipartisan co-chairs of the Congressional Blockchain Caucus—Rep. Tom Emmer (R-MN-6), Rep. Darren Soto (D-FL-9), Rep. David Schweikert (R-AZ-6), and Rep. Bill Foster (D-IL-11)—called for "amending this language."

Long Term

In the longer term, it may be necessary to lobby Congress to modify legislation and advocate before federal agencies to influence rulemaking. As described above, it is quite likely that Congress will continue to pass legislation addressing cryptocurrency and other digital assets. And regardless of these

potential legislative developments, the Act alone will require substantial rulemaking from the Treasury Department and the IRS to address critical definitions and specifics regarding reporting requirements.

That said, any long-term developments need not be adversarial. There will continue to be opportunities to work on these complicated issues and align the goals of federal and state lawmakers and clients when it comes to this important new technology.

As things stand today, there is a rapidly expanding patchwork of federal and state legislation and regulation, as legislators and regulators struggle to map traditional financial regulatory structures onto digital assets. At the federal level, the SEC, CFTC, OFAC, and FinCEN all have asserted enforcement authority over various, sometimes overlapping sectors of the cryptocurrency industry. And these same businesses often are subject to dozens of state licensing requirements, leading some to advocate for a centralized federal approach.

This complex regulatory framework—which was developed for banking in the twentieth century—is unlikely to effectively handle the needs of the government, businesses, and individuals in the twenty-first century with respect to cryptocurrency and other digital assets. It therefore will be essential to work closely with federal and state legislators and regulators to develop a coherent regulatory structure for digital assets that will promote, rather than hinder, innovation. As the Congressional Blockchain Caucus Co-Chairs explained in their August 2021 letter: "Cryptocurrency tax reporting is important, but it must be done correctly" and must "ensure that civil liberties are protected."

Gibson Dunn stands ready to help guide industry players through the most complex challenges that lay at the intersection of regulation, public policy and technical innovation of blockchain and cryptocurrency. If you wish to discuss any of the matters set out above, please contact Gibson Dunn's Crypto Taskforce (cryptotasforce@gibsondunn.com), or any member of its Financial Institutions, Global Financial Regulatory, Public Policy, Administrative Law and Regulatory, Privacy, Cybersecurity and Data Innovation, or Tax Controversy and Litigation teams, including the following authors:

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