

IRS-Imposed DeFi Tax-Reporting Obligations May Be Dead for Good

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Gibson Dunn attorneys say the disapproval of a rule that would have imposed more tax-reporting requirements on all DeFi participants helps preserve decentralization and privacy by making it harder to make similar rules in the future.

For many industries, the only thing better than a repealed regulation is one that an agency can't resurrect. And that's exactly what the crypto industry may have gotten, thanks to a resolution that gets rid of a Treasury Department and IRS rule that would have subjected decentralized finance participants to onerous tax-reporting requirements for digital-asset transactions.

The bipartisan resolution, passed by Congress under the Congressional Review Act and signed by President Donald Trump earlier this month, could prevent the agencies from issuing any other rules imposing tax-reporting obligations on DeFi developers without express congressional authorization. The move helps preserve DeFi's core values of decentralization and privacy by making it more difficult for future administrations to impose similar requirements on DeFi.

Under the now-defunct DeFi rule, developers of apps that provide access to decentralized trading protocols, including certain digital wallets, would have been deemed "brokers" that must collect private information about their users and report it to the federal government. The resolution wipes away those requirements, which alone is a significant win for businesses and individuals who value the efficiency and privacy offered by DeFi.

But there's more. Under the Congressional Review Act, the resolution also prohibits the agencies from issuing a "new rule that is substantially the same" as the DeFi rule unless "specifically authorized" by Congress. In other words, the resolution not only nullifies the DeFi rule but also limits the agencies' regulatory authority going forward.

How significant is this forward-looking limitation? At the very least, the agencies can't re-issue an identical DeFi rule under a new presidential administration. But the agencies also may lack authority to issue a new rule that imposes different reporting obligations on a different set of DeFi participants—even if they had that authority before the resolution.

Although courts haven't yet weighed in on this aspect of the Congressional Review Act, the act's text and agency practice suggest that, at a minimum, the agencies can't issue new rules that have retained the essence of the rule Congress repealed.

The word "substantially" means "concerning the essentials of something." Consistent with that ordinary meaning, the Department of Labor and the Securities and Exchange Commission have previously taken the position that, to comply with any resolution in the Congressional Review Act, a new rule must take a "fundamentally different approach" and abandon the "central" agency "determinations at the heart" of the rule Congress disapproved.

Under that standard, the Treasury and the IRS would have a difficult time defending a new rule that imposed tax-reporting requirements on any DeFi participants. The DeFi rule's essence was that DeFi participants are "brokers." That questionable interpretation was immediately challenged in litigation as fundamentally inconsistent with the defining characteristic of DeFi—namely, that DeFi eliminates intermediaries such as brokers.

Congressional debates and committee reports leading up to the resolution suggest that Congress arrived at the same conclusion. Sen. Ted Cruz (R-Texas), who introduced the resolution in the Senate, argued that the Biden administration's attempt to expand the definition of 'broker' was "untenable" and "incoherent."

A report by the House Committee on Ways and Means similarly explained that the DeFi rule regulated DeFi businesses that fall "outside the explicit scope of the" statute. Proponents of the resolution didn't quibble on the margins about which DeFi participants qualified as brokers or what information must be collected

and reported; they told the agencies that they got it wrong by trying to regulate this space at all. Any other administrative attempt to impose broker-reporting requirements on DeFi firms would leave unchanged the essential core of the DeFi rule, and thus would likely violate the Congressional Review Act.

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