Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels | London

September 8, 2023

Via Electronic Submission: responses@finance.senate.gov

The Honorable Ron Wyden, Oregon
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510-6200

The Honorable Mike Crapo, Idaho
Ranking Member
Committee on Finance
United States Senate
Washington, D.C. 20510-6200

Re: Chairman Wyden, Ranking Member Crapo Solicit Policy Input on Taxation of Digital Assets

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the United States Senate Committee on Finance ("**Committee on Finance**" or "**Committee**") on how Congress can address uncertainties surrounding the tax treatment of digital assets.[2] Digital assets have seen a rapid increase in interest in recent years from retail *and* institutional investors. To satisfy this demand, the global alternative asset management industry has begun to make significant digital assets-related investments.[3,4] However, barriers to entry remain, and, in a survey of the industry, regulatory uncertainty, including tax uncertainty, has been identified as one of the greatest obstacles to investing.[5]

In keeping with increasing demand, foreign governments have expressed ambitions to make their respective jurisdictions the "global hub for crypto-asset technology."[6] These governments are

[1] Managed Funds Association ("**MFA**"), based in Washington, D.C., New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

[2] Letter from Ron Wyden, Chairman, S. Comm. on Finance, & Mike Crapo, Ranking Member, S. Comm. on Finance, to Members of the Digital Asset Community and Other Interested Parties (July 11, 2023) ("**Open Letter**"), https://www.finance.senate.gov/imo/media/doc/20230710letterrequestforcommentsigned.pdf.

[3] An annual study conducted by PwC indicates that "29% of hedge funds surveyed are currently investing in crypto-assets…Hedge funds committed to the asset class have continued to add to their digital wallets – accounting for 7% of their AUM on average, compared to 4% last year." *5th Annual Global Crypto Hedge Fund Report (2023)*, PRICEWATERHOUSECOOPERS LTD., at 34 (July 2023) ("**Crypto Hedge Fund Report**"), https://www.pwc.com/gx/en/new-ventures/cryptocurrency-assets/5th-annual-global-crypto-hedge-fund-report-july-2023.pdf.

[4] To wit, on behalf of our members, we have submitted digital assets-related comments to tax authorities and accounting standard-setting bodies in the U.S. and abroad. *See* Letter from Managed Funds Association to Financial Accounting Standards Board (June 6, 2023), https://www.managedfunds.org/wp-content/uploads/2023/06/MFA-Proposed-Accounting-Standards-Update-Subtopic-350-60-Comment-Letter_06062023.pdf; Letter from Managed Funds Association to HM Revenue & Customs (Nov. 24, 2022), https://www.managedfunds.org/wp-content/uploads/2022/12/MFA-HMRC-Investment-Management-Exemption-Second-Comment-Letter.pdf; Letter from Managed Funds Association to HM Revenue & Customs (July 18, 2022), https://www.managedfunds.org/wp-content/uploads/2022/07/MFA-HMRC-Investment-Management-Exemption-Comment-Letter.pdf; Letter from Managed Funds Association to Treasury and the IRS (June 3, 2022), https://downloads.regulations.gov/IRS-2022-0007-0085/attachment_1.pdf.

[5] "Around a quarter of hedge funds that are currently investing in crypto-assets say that increased regulatory uncertainty in the US will have a major impact or may lead them to reconsider the viability of their crypto-assets strategy…The top four challenges cited by hedge fund managers are…Lack of regulatory and tax regime clarity." Crypto Hedge Fund Report, at 32, 40.

[6] William James, *Sunak: I want to make Britain a global cryptoasset technology hub*, REUTERS (April 4, 2022), https://www.reuters.com/article/britain-crytpo-regulations-sunak/sunak-i-want-to-make-britain-a-global-cryptoasset-technology-hub-idUKS8N2V606U.

exploring ways of enhancing the competitiveness of their tax systems to encourage further development of the digital asset markets in their jurisdictions, including issuing iterative guidance.[7] Notably, in March 2022, the Biden Administration issued the *Executive Order on Ensuring Responsible Development of Digital Assets* (the "**Executive Order**"), which aims to "reinforce United States leadership in the global financial system and in technological and economic competitiveness."[8] The Executive Order indicates that "[c]ontinued leadership in the global financial system will sustain United States financial power and promote United States economic interests."[9] The Executive Order calls on the Department of the Treasury ("**Treasury**") to submit a report which, in part, "addresses the conditions that would drive mass adoption of different types of digital assets…"[10]

We commend the Committee on Finance for recognizing that "[t]he rapid emergence of digital assets has raised novel regulatory issues, including the appropriate treatment under our federal tax law,"[11] and that "[t]his uncertainty creates complex reporting issues for taxpayers, and warrants examining how the [Internal Revenue Code] can provide clearer guidance for taxpayers on the treatment of digital asset transactions."[12] We further appreciate that the Committee has chosen to solicit public comment on a number of rules on which our industry places great reliance and with which our members are intimately familiar, including, among others, the Section 864(b)(2) trading safe harbors.[13]

We limit our comments to the trading safe harbors because guidance addressing the tax consequences of trading in digital assets is prerequisite to mass adoption of different types of digital assets. Specifically, Congress should legislate a new, separate trading safe harbor applicable to trading in digital assets and certain ancillary and closely related activities, putting trading in digital assets on equal footing with trading in other asset classes already covered by the trading safe harbors. Such legislation would further the policy goals of the Executive Order by promoting the competitiveness of U.S. capital markets at a time when other governments are actively pursuing similar safe harbor rules applicable to trading in digital assets. In the alternative, regulatory or administrative guidance should provide that the commodities trading safe harbor broadly applies to trading in digital assets. Such guidance would advance similar policy goals with relative efficiency and expedience.

I. Executive Summary

The issues presented in the Open Letter are of great concern to MFA and its members, and we appreciate this opportunity to share our views. The following is a summary of our positions set forth in this comment letter, which are explained more fully below.

Trading Safe Harbors (IRC Section 864(b)(2))

1. **The policies behind the trading safe harbor (of encouraging foreign investment in U.S. investment assets) equally apply to digital assets.[14]**

---

[7] *See*, *e.g.*, HM REVENUE & CUSTOMS, CRYPTOASSETS MANUAL, 2023 (U.K.).

[8] Exec. Order No. 14,067, 87 Fed. Reg. 14,143, 14,144 (March 9, 2022).

[9] *Id.*

[10] *Id.* at 14,147.

[11] Open Letter, at 1.

[12] *Id.*

[13] Unless otherwise indicated, all "Section" or "§" references are to the Internal Revenue Code of 1986, as amended (the "**Code**" or "**I.R.C.**"), or the Treasury Regulations promulgated thereunder.

[14] The Open Letter queries, "When should the policies behind the trading safe harbor (of encouraging foreign investment in U.S. investment assets) apply to digital assets?" Open Letter, at 1.

A. The legislative history to the Section 864(b)(2) trading safe harbors reflects Congress's concern that tax uncertainty inhibited foreign investors' financial management activities in the U.S.

B. The legislative and regulatory history to the Section 864(b)(2) trading safe harbors reflect the intention that the safe harbors would evolve to provide certainty to market participants trading in emerging asset classes and new financial products.

C. The policies behind the Section 864(b)(2) trading safe harbors warrant expansion to trading in digital assets.

2. A new, separate trading safe harbor should apply to trading in digital assets and certain ancillary and closely related activities.[15]

A. A new, separate trading safe harbor should apply to trading in digital assets.

B. A new, separate trading safe harbor should apply to certain activities ancillary or closely related to trading in digital assets, including staking.

3. In the alternative, the commodities trading safe harbor should broadly apply to trading in digital assets.[16]

A. Digital assets, including those for which there is only a spot market, should be considered "commodities" for purposes of the commodities trading safe harbor.

B. Centralized digital asset exchanges, including those which only facilitate digital asset spot trading, should be considered "organized commodity exchanges" for purposes of the commodities trading safe harbor.[17]

C. Our recommendations in respect of the commodities trading safe harbor can be accomplished through regulatory or administrative guidance; however, legislative action would be equally effective.

II. Trading Safe Harbors (IRC Section 864(b)(2))

1. The policies behind the trading safe harbor (of encouraging foreign investment in U.S. investment assets) equally apply to digital assets.

A. The legislative history to the Section 864(b)(2) trading safe harbors reflects Congress's concern that tax uncertainty inhibited foreign investors' financial management activities in the U.S.

Before the enactment of the (modern) trading safe harbors, Section 211(b) of the Revenue Act of 1936 provided, in part, that "the phrase 'engaged in trade or business within the United States'…does

[15] The Open Letter queries, "Another possibility is that a new, separate trading safe harbor could apply to digital assets. In that case, should the additional limitation on commodities eligible for the trading safe harbor apply? Why?" *Id.* at 2.

[16] The Open Letter queries, "If those policies should apply to (at least some) digital assets, should digital assets fall under IRC Section 864(b)(2)(A) (trading safe harbor for securities), IRC Section 864(b)(2)(B) (trading safe harbor for commodities), or should the answer depend on the regulatory status of the specific digital asset? Why?" *Id.* at 1.

[17] The Open Letter queries, "To the extent that the additional limitation on commodities for the trading safe harbor applies, how should the terms 'an organized commodity exchange' and 'transactions of a kind customarily consummated (in IRC Section 864(b)(2)(B)(iii)) be interpreted in the context of different kinds of digital asset exchanges?" *Id.* at 2.

not include the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian."[18] Treasury and the Internal Revenue Service ("**IRS**") later explained that the policy goal was simple: "Congress enacted the stocks and securities trading safe harbor in 1936 to provide *certainty* that foreign persons who merely trade stocks and securities would not be subject to the net income tax regime."[19,20]

The policy goal remained largely unchanged when, in 1966, Congress modified and renumbered the relevant part of former-Section 211(b)[21] as Section 864(b)(2)(A)(i) and, at the same time, also enacted the (A)(ii) safe harbor.[22,23] The latter, which provides safe harbor for trading in securities for the taxpayer's own account, whether by the taxpayer or an employee or agent, and whether or not any such employee or agent has discretionary authority, is thought to have been intended to resolve "confusion regarding the status of a foreign investor who has granted discretionary authority to a U.S. agent [which] may have acted to deter some foreign investment in the United States."[24,25]

The legislative history to the Foreign Investors Tax Act of 1966 ("**FITA**") overwhelmingly demonstrates Congress's concern that tax uncertainty inhibited foreign investors' financial management activities in the U.S. and overall participation in U.S. capital markets. Two years earlier, a task force, originally appointed by President John F. Kennedy and headed by then-Under Secretary of the Treasury

---

[18] Revenue Act of 1936, Pub. L. No. 74-740, 49 Stat. 1648, 1714-15 (1936).

[19] Trading Safe Harbors, 63 Fed. Reg. 32,164, 32,165 (June 12, 1998) (emphasis added).

[20] Additional, contemporaneous detail is limited; however, Treasury and the IRS further posited that,

> Congress' decision to include the safe harbor was premised on the fundamental assumption that ordinary income from U.S. stocks and securities would be appropriately subject to U.S. taxation through the withholding tax on fixed and determinable or annual and periodic income ('FDAP'), and that activities beyond the scope of the safe harbor would remain subject to net tax if the taxpayer was engaged in a trade or business or had an office in the United States.

Id. There is evidence to this effect and that administrability may have been a factor:

> In section 211(a) it is proposed that the tax on a nonresident alien not engaged in a trade or business in the United States and not having an office or place of business therein, shall be at the rate of 10 percent on his income from interest, dividends, rents, wages, and salaries and other fixed and determinable income…Such a nonresident alien will not be subject to the tax on capital gains, including so-called gains from hedging transactions, as at present, it having been found administratively impossible effectually to collect this latter tax.

S. REP. NO. 2156, 74th Cong., 2d Sess. 21 (1936); *see also Revenue Act, 1936: Hearings on H.R. 12395 Before the Comm. on Fin.*, 74th Cong. 76 (1936) (Testimony of L.H. Parker, Chief of Staff, Joint Comm. on Internal Revenue Taxation).

[21] Section 211(b) of the Revenue Act of 1936 was amended several times before being recodified as Section 871(c) of the Internal Revenue Code of 1954 and, later, further amended and renumbered as Section 864(b)(2). *See* P.L.R. 9041011 (July 6, 1990).

[22] Foreign Investors Tax Act of 1966, Pub. L. No. 89-809, 80 Stat. 1541, 1544 (1966); *see also* 63 Fed. Reg. at 32,165 ("The Foreign Investors Tax Act of 1966…built upon the same principles reflected in the Revenue Act of 1936.").

[23] The operative language—"the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian"—was modified by the removal of the word "commodities" (which, of course, was transposed into Section 864(b)(2)(B)(i)) and addition of "independent agent" to the list of relationships.

[24] Following the Tax Court's decision and Fourth Circuit's affirmance in *Adda v. Commissioner*, 10 T.C. 273 (1948), *aff'd*, 171 F.2d 457 (4th Cir. 1948), *cert. denied*, 336 U.S. 952 (1949), there was "confusion regarding the status of a foreign investor who has granted discretionary authority to a U.S. agent [which] may have acted to deter some foreign investment in the United States." S REP. NO. 1707, 89th Cong., 2d Sess. 16 (1966); H.R. REP. NO. 1450, 89th Cong., 2d Sess. 13 (1966).

[25] *See* C.C.A. 2015-01-013 (Sep. 5, 2014) ("Furthermore, the legislative history to FITA demonstrates that Congress sought to overturn the result in Adda for non-dealers (by enacting the (A)(ii) Safe Harbor)…").

Henry H. Fowler, submitted its report to President Lyndon B. Johnson,[26] recommending reforms to the taxation of foreign investors to promote foreign investment in the U.S.[27] Contemporaneous reporting indicates that President Kennedy "named the task force to study ways of…inducing foreigners to invest in the United States—either in American securities or in American businesses that operate overseas."[28] Treasury studied the recommendations of the task force and submitted to Congress proposed tax legislation, the recommendations of which, at the request of President Johnson, became the foundation of FITA.[29]

The task force ultimately found that,

> [t]here is a general feeling of confusion among foreign investors over the application to investment activities of the tests for engaging in trade or business. This confusion certainly fosters a fear among foreign investors that they may through inadvertence be deemed to have engaged in trade or business and thereby become subject to regular U.S. taxation on their income and gains.[30]

Later, Secretary of the Treasury Fowler commented that "the task force issued its report containing 39 recommendations," of which "those dealing with the taxation of foreign individuals and foreign corporations have the most significant and immediate impact."[31] Specifically, Secretary Fowler surmised that the trading safe harbors,

> should have the effect of removing much of the uncertainty which now surrounds the question of what amounts to engaging in trade or business in the United States. Uncertainty of this type is undesirable as a matter of tax policy and has the effect of limiting investment in the United States.[32]

Secretary Fowler's sentiment was shared by many market participants at the time.[33]

Thirty years later, Congress revisited the trading safe harbors once again out of concern that a narrow interpretation of the then-existing rules, and in particular, the former "principal office" requirement under the securities trading safe harbor, "operate[d] simply to shift certain administrative

---

[26] In December 1963, President Johnson reaffirmed President Kennedy's charge to the task force and asked that its report be submitted to him.

[27] TASK FORCE ON PROMOTING INCREASED FOREIGN INV. IN U.S. CORP. SECS. & INCREASED FOREIGN FIN. FOR U.S. CORPS. OPERATING ABROAD, REPORT TO THE PRESIDENT (Apr. 27, 1964) ("**Task Force Report**"); *see id.* at 21 ("Revision of U.S. taxation of foreign investors is one of the most immediate and productive ways to increase the flow of foreign capital to this country.").

[28] *Task Force Urges U.S. to Ease Tax on Foreign-Held Securities; Group Led by Fowler Offers Proposals to Encourage Foreigners to Invest*, N.Y. TIMES (April 28, 1964), https://www.nytimes.com/1964/04/28/archives/task-force-urges-us-to-ease-tax-on-foreignheld-securities-group-led.html.

[29] *See* S REP. NO. 1707, 89th Cong., 2d Sess. 9 (1966).

[30] Task Force Report, at 28.

[31] *Foreign Investors Tax Act of 1966: Hearing on H.R. 13103 Before the Comm. on Fin.*, 89th Cong. 29 (1966) (Statement of Henry H. Fowler, Sec'y of the Treas.) ("**FITA Hearings**").

[32] *Id.* at 33 (Statement of Henry H. Fowler, Sec'y of the Treas.).

[33] *See*, *e.g.*, *id.* at 60 (Statement of G. Keith Funston, President, New York Stock Exchange) ("The Exchange specifically endorses the language in Section 2 of the bill referring to 'Trading in Securities and Commodities,' as revised from the original Administration proposals."); *id.* at 251 (Statement of The Ass'n of the Bar of the City of New York, Comm. on Taxation) (same); *id.* at 270 (Statement of Thomas N. Tarleau, Partner, Willkie Farr Gallagher Walton & FitzGibbons) (on behalf of "private investment partnerships").

functions with respect to securities trading—and the associated jobs—offshore."[34,35] Conclusively, the trading safe harbors were enacted to alleviate tax uncertainty that formerly acted as a bar to foreign investors' financial management activities in the U.S.[36] The policies of the trading safe harbors should continue to facilitate such activities as a default, rather than hinder them or create further uncertainty.

B. The legislative and regulatory history to the Section 864(b)(2) trading safe harbors reflect the intention that the safe harbors would evolve to provide certainty to market participants trading in emerging asset classes and new financial products.

The legislative history to FITA also overwhelmingly demonstrates that both Congress and Treasury intended to cure the Code of "outmoded" rules that "were enacted many years and ago and [did] not reflect the changes in economic conditions which [had] occurred…"[37] That history further indicates that, at a minimum, Congress and Treasury were also concerned with the durability of FITA provisions intended to induce foreign investment in the U.S. Specifically, the Fowler-led task force expressed dual concerns for the inequity between foreign investors which, through sophisticated tax structuring, could avoid U.S. tax risk and those which could not, and for the cost-prohibitive nature of such tax planning.[38]

Accordingly, FITA took a broad approach to the trading safe harbors, with a natural bias against the finding of a U.S. trade or business. The regulatory history to the trading safe harbors espouses a similar principle. Albeit without much explanation, the first regulations effectively expanded the permissible activities to which safe harbor is given to "buying, selling (whether or not by entering into short sales), or trading in stocks, securities, or contracts or options to buy or sell stocks or securities, on margin or otherwise,…and any other activity closely related thereto…"[39] This language is a mainstay of the current securities trading safe harbor regulations.[40]

Treasury and the IRS subsequently proposed regulations in the late-1990s to adapt the trading safe harbors to increased trading in derivatives. Treasury and the IRS provided, as background:

---

[34] Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, 987 (1997)

[35] H.R. REP. NO. 148, 105th Cong., 1st Sess. 542 (1997) ("The committee believes that the elimination of this rule would facilitate the foreign investment in U.S. markets that the safe harbor was designed to promote.").

[36] *See* H.R. REP. NO. 1450, 89th Cong., 2d Sess. 55-56 (1966) ("Subparagraph (A)(i) [*sic*] of section 864(b)(2) provides generally that a nonresident alien individual or foreign corporation…is not engaged in trade or business within the United States by reason of trading in stocks or securities for the taxpayer's own account, *irrespective of where the activities instrumental to such trading are performed or how the actual trading transactions are effected[,]…whether the corporation or individual conducts the trading activities and effects the stock or security transactions himself or through his employees or uses agents in the United States, whether independent or dependent[,]…whether any such employee or agent, wherever located, is authorized to exercise his own discretion in trading activities conducted, or in effecting transactions, on behalf of his employer or principal*.") (emphasis added).

[37] FITA Hearings, at 30 (Statement of Henry H. Fowler, Sec'y of the Treas.) ("The Treasury Department agrees with the view expressed by the task force and in the House Ways and Means Committee report that many of the existing rules applicable to foreign investors in the United States are outmoded and inconsistent with sound tax policy and as a result deter foreign investment…These rules were enacted many years ago and do not reflect the changes in economic conditions which have occurred over the last 15 years.").

[38] Task Force Report, at 30 ("Adoption of our recommendations would remove the substantial deterrent to foreign investment in the United States posed by a certain unwillingness among potential foreign investors to undertake complicated procedures for minimizing U.S. taxes. These procedures are often necessary if the investor is to avoid tax burdens which limit the attractiveness of investment in the United States.").

[39] Definition of a "Trade or Business Within the United States" as Applied to Nonresident Aliens and Foreign Corporations, 33 Fed. Reg. 5089, 5090 (March 28, 1968).

[40] *See* Regulation section 1.864-2(c)(2).

> Since the promulgation of these regulations, the use of derivative financial instruments has increased significantly. This is due in large measure to the overall expansion and growing sophistication of global capital markets. Although guidance concerning the tax treatment of derivatives and notional principal contracts has been issued under other provisions of the Code…, the section 864(b) regulations have not been modernized to take into account the manner in which taxpayers customarily use derivative transactions.[41]

Treasury and the IRS implicitly recognized that the trading safe harbors were meant to evolve with global capital markets, including the emergence of asset classes and new financial products that were nonexistent at the time of enactment of the trading safe harbors. Indeed, foreign investors avail themselves of the trading safe harbors for trading in other asset classes and markets that were nonexistent in the late-1960s. For example, it is generally accepted that the secondary market for corporate loans began in either the late-1980s or early-1990s,[42] and that trading on and in the same fits comfortably within the securities trading safe harbor.

Yet, today, guidance related to the tax consequences of trading in digital assets has been sparse and limited to facts which either have a retail focus or address the most rudimentary circumstances. Investors are unable to obtain letter rulings or determination letters considering, for purposes of the trading safe harbors, whether an instrument is a security, whether a taxpayer effects transactions in the U.S. in stocks or securities, or whether an instrument or item is a commodity, a commodity is of a kind customarily dealt in on an organized commodity exchange, or a transaction is of a kind customarily consummated at an organized commodity exchange.[43] In the absence of both sufficient guidance and the ability to seek fact-dependent rulings, further legislation, regulation, or other guidance is necessary to meet the evolution of global capital markets and, in particular, the evolving digital asset ecosystem.

C. The policies behind the Section 864(b)(2) trading safe harbors warrant expansion to trading in digital assets.

Private funds with foreign or U.S. tax-exempt organization investors are frequently structured so that such persons are invested in a fund through an entity that is organized in a foreign jurisdiction and is treated as a corporation for federal income tax purposes. Investing through this "foreign feeder" allows tax-exempt organizations to avoid incurring unrelated business taxable income ("**UBTI**") as a result of the fund's borrowing, limits the risk that foreign investors will be treated as engaged in a U.S. trade or business, and limits the possibility that the fund's trade or business activities will taint foreign investors' unrelated income.

Funds typically commit to these investors that they will not knowingly make investments that would fall outside of the trading safe harbors. In our experience, uncertainty regarding the status of trading activity under the trading safe harbors has resulted, and will continue to result, in economically desirable transactions not being consummated out of concern that they would expose investors to unnecessary and serious tax risk, even though many believe that those activities should properly be within the parameters of the safe harbors. Moreover, uncertainty regarding the status of trading activity

[41] 63 Fed. Reg. at 32,164.

[42] Blaise Gadanecz, *The syndicated loan market: structure, development and implications*, BANK FOR INT'L SETTLEMENTS Q. REV. 75 (2004).

[43] *See* Rev. Proc. 2023-7, 2023-1 I.R.B. 305 (providing areas in which rulings will not be issued by IRS Associate Chief Counsel (International), *i.e.*, the International No-Rule List). The no-rule policy in this area dates back to 1991.

under the trading safe harbors historically has invited controversy,[44] whereas guidance establishing the parameters of the safe harbors comes at little to no cost to taxpayers or sound tax administration. Funds are unlikely to purposefully run afoul of established guidelines because of the commitments they make to investors and the punitive downside risk associated with not respecting those guidelines.

At the same time, foreign governments are actively addressing the uncertainty around trading in digital assets with comparable effect to the trading safe harbors. Recently, for example, the U.K. has amended its Investment Manager Exemption ("**IME**") to broadly apply to trading in "cryptoassets," with limited exceptions.[45] In consultation on the scope of the IME as applied to trading in digital assets, the U.K. anticipated attracting investment managers to locate and expand their financial management activities in the U.K. Indeed, in the absence of the trading safe harbors, IME, or their equivalent, avoiding a management presence in the relevant jurisdiction by establishing an offshore manager is often the only recourse to the tax risk presented by engaging in a strategy involving digital assets. Such management presence entails the retention and creation of highly qualified and compensated jobs.

Accordingly, guidance providing that the trading safe harbors broadly apply to trading in digital assets is not only warranted by the policies behind the safe harbors (principally, the attraction of economically desirable activity to the U.S., including the retention and creation of highly qualified and compensated jobs) but would reduce controversy and lessen the enforcement burden on taxpayers and the IRS. Such guidance would also reinforce U.S. leadership in the global financial system and in technological and economic competitiveness, consistent with the Executive Order.

2. A new, separate trading safe harbor should apply to trading in digital assets and certain ancillary and closely related activities.

A. A new, separate trading safe harbor should apply to trading in digital assets.

A new, separate trading safe harbor should apply to trading in digital assets. We again note that the trading safe harbors were meant to evolve with global capital markets, including the emergence of asset classes and new financial products that were nonexistent at the time of enactment of the safe harbors. In this regard, it is instructive that Treasury and the IRS, in addressing increased trading in derivatives in the late-1990s, declined to "specify into which statutory safe harbor any particular derivative transaction falls" and recognized that "a derivative…arguably might be classified as both a security and a commodity" and "a derivative transaction…arguably might be classified within both sections."[46] The same, overlapping regulatory status may also apply for purposes of the federal securities and commodities laws, notably, in respect of digital assets.[47]

A new, separate digital assets trading safe harbor may, therefore, have the benefit of allowing Congress to satisfy the policy goals behind the trading safe harbors while avoiding the need to make a fraught determination as to whether any particular digital asset is a security, commodity, both or neither. In doing so, Congress will have avoided creating any inference as to such regulatory classification for purposes other than the Section 864(b)(2) trading safe harbors. For this purpose, Section 803 of the "Lummis-Gillibrand Responsible Financial Innovation Act," which provides a new, separate trading

---

[44] *See*, *e.g.*, *YA Global Investments, LP, et al. v. Commissioner*, No. 14546-15 (T.C. filed June 4, 2015); *Large Business and International Active Campaigns: Financial Services Entities engaged in a U.S. Trade or Business Campaign*, INTERNAL REVENUE SERVICE, https://www.irs.gov/businesses/corporations/lbi-active-campaigns (last updated Aug. 8, 2023).

[45] *See* The Investment Manager (Investment Transactions) (Cryptoassets) Regulations 2022 (U.K.).

[46] 63 Fed. Reg. at 32,165; *see also* P.L.R. 8807004 (Nov. 10, 1987) (same).

[47] "[T]he fact that cryptocurrencies may be regulated under additional statutes such as…an 'investment contract' under the Securities Act of 1933, *see* 15 U.S.C. § 77b, does not mean that a cryptocurrency is not a 'commodity' within the meaning of the [Commodity Exchange Act]…" *U.S. v. Reed*, No. 20-cr-500 (JGK) (S.D.N.Y. Feb. 28, 2022).

safe harbor for trading in "crypto assets," including tailored "crypto asset exchange" and "customarily consummated" requirements, may serve as a good candidate, subject to our comments immediately below and further stakeholder input.[48]

A new, separate digital assets trading safe harbor may also have the benefit of definitionally excluding specific digital assets or types of digital assets in such a way that does not cede Congress's authority over major policy decisions to an independent agency or even to an exchange under an independent agency's product self-certification rules, as described further in Section 3.A, below.[49] Further, definitionally excluding specific digital assets is more workable than attempting to limit a digital assets trading safe harbor's scope by importing the commodities trading safe harbor's "organized commodity exchange" and "customarily consummated" requirements, the authorities under which are non-binding and frequently unavailing because of their unique facts, scant detail, or, with respect to digital assets, lack of descriptive value or a close analogue, as described further in Section 3.B, below.

For the purpose of excluding specific digital assets from a digital assets trading safe harbor, Congress may consider the U.K.'s deliberations and conclusions on this very matter for purposes of the U.K.'s trading safe harbor-equivalent, the IME. The U.K. determined to strike a balance between providing a definition which is sufficiently broad to allow for innovation and protecting the U.K.'s tax base, without creating rules that are too complex to be workable.[50] In doing so, the U.K. took a permissive approach whereby a digital asset qualifies under the IME unless it represents rights in respect of real property, the performance of personal services, or a digital asset created or issued by the foreign investor, an investment manager acting on behalf of that foreign investor, or a person connected with the foreign investor or its investment manager, among other exclusions.

B. A new, separate trading safe harbor should apply to certain activities ancillary or closely related to trading in digital assets, including staking.

A new, separate trading safe harbor should also apply to certain activities ancillary or closely related to trading in digital assets, including staking. Consistent with the trading safe harbors' intended evolution, the first regulations effectively expanded the permissible activities to which safe harbor is given to "any other activity closely related thereto (such as obtaining credit for the purpose of effectuating such buying, selling, or trading)."[51] Subsequently, the IRS has interpreted the "activity closely related" category broadly, including, for example, entering into securities lending transactions[52] and hedging transactions involving interest rate swaps.[53] Accordingly, similar policies behind a digital assets trading safe harbor should continue to facilitate activities that are either related to effecting transactions in digital assets (as was the case in the ruling covering securities lending transactions) or necessary to hedge or offset risks associated with trading in digital assets (as was the case in the ruling covering interest rate swap hedging transactions).

For the purpose of describing certain activities ancillary or closely related to trading in digital assets, a digital assets trading safe harbor should specifically permit foreign investors to participate in delegated staking. Staking is often the sole means to prevent an investment in digital assets from becoming diluted and devalued due to inflation. Staking involves the creation of new tokens; therefore,

---

[48] Lummis-Gillibrand Responsible Financial Innovation Act, S. _, 118th Cong. § 803 (2023).

[49] *See infra* n.57.

[50] HM REVENUE & CUSTOMS, CONSULTATION OUTCOME: EXPANDING THE INVESTMENT TRANSACTIONS LIST FOR THE INVESTMENT MANAGEMENT EXEMPTION AND OTHER FUND TAX REGIMES – SUMMARY OF RESPONSES, 2022, ¶ 2.42 (U.K.).

[51] *See* Regulation section 1.864-2(c)(2).

[52] *See* P.L.R. 9041011 (July 6, 1990).

[53] *See* P.L.R. 9204015 (Oct. 24, 1991).

any portion of un-staked tokens is continuously shrinking relative to the total supply. To offset against this potential dilution, investors will participate in staking and, in effect, participate in the necessary and predictable inflation in digital asset markets. Staking is thus best analogized to an inflation hedge, in much the same way the IRS viewed interest rate swaps used to hedge risks associated with a portfolio of securities for purposes of the securities trading safe harbor. For this reason, staking should be considered an activity ancillary or closely related to trading in digital assets.

Congress may consider specifically limiting a digital assets trading safe harbor's "activity closely related" category to delegated staking. Barring non-delegated staking, or operating a "node", from the safe harbor would be consistent with the central thrust of Section 864(b)—the performance of personal services generally constitutes the conduct of a U.S. trade or business. Operating a node resembles, and involves some of the hallmarks of, the performance of personal services. For example, operating a node requires the continuous or near-continuous running of software, monitoring, and maintenance. In return, the operator of a node may receive "network fees", composed of a base fee set by the network and possibly a priority fee (likened to a tip) to incentivize verifying and processing specific transactions on the network. Accordingly, non-delegated staking arguably should be excluded from a digital assets trading safe harbor as similar to the performance of personal services.

3. In the alternative, the commodities trading safe harbor should broadly apply to trading in digital assets.

In the alternative, or even during such time as Congress continues to consider legislation to address the taxation of digital assets, Treasury and the IRS should issue guidance that the commodities trading safe harbor broadly applies to trading in digital assets. Such guidance falls within the purview of regulatory or administrative guidance, could be issued with relative efficiency and expedience and at no cost to sound tax administration, and would function as a stopgap for any competitive shortfalls associated with other governments actively pursuing similar safe harbor rules applicable to trading in digital assets.

The commodities trading safe harbor generally has three criteria: (i) the personal property in which trading occurs is a "commodity"; (ii) the commodity must be of a kind customarily dealt in on an "organized commodity exchange"; and (iii) the transaction must be of a kind customarily consummated at such a place. Currently, limited guidance supports the position that trading in Bitcoin ("**BTC**") and Ether ("**ETH**"), but no other digital asset, qualifies under the commodities trading safe harbor.[54]

A. Digital assets, including those for which there is only a spot market, should be considered "commodities" for purposes of the commodities trading safe harbor.

There is generally no uniform definition of "commodity" in the Code or regulations thereunder—various sections either leave the term undefined or provide a definition that is no more than a tautology.[55] Section 864(b)(2) falls under the former, leaving the term undefined.[56] In letter rulings, however, the term "commodity" has been defined by reference to whether the personal property

[54] *See* Rev. Rul. 73-158, 1973-1 C.B. 337 (providing that the word "commodities" in Section 864(b)(2)(B) is used in its ordinary financial sense and includes all products that are traded in and listed on commodity exchanges located in the U.S.).

[55] *See* Section 475(e)(2) (defining the term "commodity," in part, as "any commodity which is actively traded…").

[56] Regulation section 1.864-2(d)(3) does provide that "the term 'commodities' does not include goods or merchandise in the ordinary channels of commerce." Digital assets are hardly "goods or merchandise" as understood in this context.

underlies futures contracts traded on Commodity Futures Trading Commission ("**CFTC**")- regulated U.S. commodity exchanges, such as the Chicago Mercantile Exchange ("**CME**").[57]

Accordingly, Bitcoin and Ether are considered "commodities" in the "ordinary financial sense" because cash-settled Bitcoin and Ether futures trade on CFTC-regulated U.S. commodity exchanges. Based on the foregoing, there are strong arguments that digital assets that are substantially similar to Bitcoin and Ether,[58] or even digital assets that fall under the broad regulatory anti-fraud and anti-manipulation jurisdiction of the CFTC over commodity spot markets,[59] should be considered commodities for purposes of the commodities trading safe harbor. But, those arguments fall short of providing certainty, and private funds' participation in digital asset markets reflects that uncertainty—"the vast majority of respondents (91%) are invested in the two largest crypto-assets by market capitalisation and exchange volume: BTC and ETH…This could indicate that traditional hedge funds are being cautious and mindful of regulatory issues."[60]

To provide certainty to market participants, we recommend that Bitcoin, Ether, and digital assets "of a kind" with Bitcoin and Ether, or otherwise subject to the anti-fraud and anti-manipulation jurisdiction of the CFTC, should be considered "commodities" for purposes of the commodities trading safe harbor because they are part of a generic class in which futures trading exists.[61]

B. Centralized digital asset exchanges, including those which only facilitate digital asset spot trading, should be considered "organized commodity exchanges" for purposes of the commodities trading safe harbor.

There is also no definition of "organized commodity exchange" in the Code or regulations thereunder. Instead, regulations provide two generic examples—grain futures and cotton futures markets.[62] Letter rulings, too, may be seen as supporting the expanded view that non-U.S. commodity exchanges (thus, not regulated by the CFTC) may qualify as organized commodity exchanges.[63] And, conversely, one letter ruling has instructed as to what an organized commodity exchange is *not*—an informal self-regulating club.[64]

---

[57] *See* P.L.R. 8540033 (July 3, 1985) ("The fact that trading in cash settlement futures contracts is regulated by the CFTC rather than the Securities and Exchange Commission is evidence that a cash settlement contract should be considered a commodity in the ordinary financial sense.").

[58] *See See CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492, 497-98 (D. Mass. 2018) ("Congress' approach to defining 'commodity' signals an intent that courts focus on categories—not specific items...[T]he [Commodity Exchange Act] only requires the existence of futures trading within a certain class (e.g. 'natural gas') in order for all items within that class (e.g. 'West Coast' natural gas) to be considered commodities.").

[59] *See CFTC v. McDonnell*, *et al.*, 287 F. Supp. 3d 213, 228 (E.D.N.Y. 2018) ("Virtual currencies can be regulated by CFTC as a commodity."), *reconsideration denied*, 321 F. Supp. 3d 366 (E.D.N.Y. 2018); *In the Matter of: Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan,* CFTC Docket No. 15-29, 2015 WL 5535736 (Sep. 17, 2015) ("Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities.").

[60] Crypto Hedge Fund Report, at 37.

[61] *See supra* n.58.

[62] Regulation section 1.864-2(d)(1).

[63] *See* P.L.R. 8850041 (Sep. 19, 1988) (holding that futures, forwards, index futures, options, and spot contracts in certain currencies, some of which trade on non-U.S. exchanges, qualify under the safe harbor); *see also* P.L.R. 8527041 (April 8, 1985) (noting "that there is no requirement that such transactions in fact be consummated on an organized commodity exchange," only that the transactions are of a kind customarily consummated at such a place).

[64] *See* P.L.R. 8813012 (Dec. 23, 1987) (implying that a market described as an informal self-regulating club was not an organized commodity exchange but holding that certain spot and forward transactions effected on such market were commodities of a kind customarily dealt in on an organized commodity exchange).

Accordingly, we also recommend that centralized exchanges, including those which only facilitate digital asset spot trading, should be considered "organized commodity exchanges" for purposes of the commodities trading safe harbor. We see no principled basis on which to exclude digital asset spot trading on centralized exchanges from the commodities trading safe harbor where a particular digital asset is substantially similar to Bitcoin and Ether but either does not underlie a listed futures contract on a CFTC-regulated U.S. commodity exchange or does in fact underlie a listed futures contract on a non-U.S. commodity exchange.

Moreover, if indeed organized commodity exchanges are limited to CFTC-regulated U.S. commodity exchanges, the determination of which digital assets qualify under the commodities trading safe harbor, in effect, currently rests on such exchanges self-certifying or voluntarily submitting to the CFTC for approval new derivative products. The connection between whether there is sufficient demand and liquidity for an exchange (such as the CME) to list a futures contract on a certain digital asset and the determination that such digital asset is a "commodity" in its "ordinary financial sense" is tenuous at best. Due to uncertainty around the regulatory status of digital assets for purposes of the federal securities laws, it is uncertain whether and, if so, when such exchanges might list futures contracts on other digital assets. Yet, in the interim, U.S. leadership in the global financial system and in technological and economic competitiveness is likely to suffer in the absence of guidance.

At a minimum, if a limiting principle is deemed necessary, trading in digital assets underlying listed futures contracts on non-U.S. exchanges should qualify under the commodities trading safe harbor. Such position finds support in previous rulings,[65] and we see no policy reason why digital assets underlying futures contracts traded solely on non-U.S. exchanges, licensed and prudentially supervised by foreign regulators, should not qualify under the commodities trading safe harbor.

We note that there is no direct authority addressing the circumstances under which a commodity of a kind customarily dealt in on an organized commodity exchange would fail the third criterion—that the transaction be of a kind customarily consummated at such place. Letter rulings confirm that forwards and spot contracts can satisfy this criterion, despite not being traded on an organized commodity exchange.[66] To the extent that centralized exchanges are considered "organized commodity exchanges," trading in spot contracts on such exchanges would satisfy the customarily consummated criterion.

C. Our recommendations in respect of the commodities trading safe harbor can be accomplished through regulatory or administrative guidance; however, legislative action would be equally effective.

The incremental guidance described above falls within the purview of regulatory or administrative guidance. For this reason and the relative efficiency and expedience of administrative guidance, we have previously advocated for Treasury and the IRS to issue such guidance.[67] However, we readily admit that legislation would be equally, if not more, effective, and we would be pleased to see viable legislation, providing that a new, separate trading safe harbor applies to trading in digital assets, advanced in Congress, as discussed in greater detail in Section 2, above.

As an alternative, guidance providing that the commodities trading safe harbor broadly applies to trading in digital assets would advance similar policy goals to a digital assets trading safe harbor, albeit in a more limited fashion. Such guidance would alleviate concerns with respect to trading in digital assets other than, but "of a kind" with, Bitcoin and Ether, as discussed in greater detail in Section 3, above. These digital assets are commonly referred to as Layer-1 tokens because they are native to

[65] *See supra* n.63.

[66] *See supra* n.64.

[67] Letter from Managed Funds Association to Treasury and the IRS (June 3, 2022), *supra* n.4.

Layer-1 blockchains. A Layer-1 blockchain validates and supports its own network without requiring support from another network.

Yet, this guidance would leave unaddressed activities ancillary and closely related to trading in digital assets, such as staking, and transactions in so-called Layer-2 tokens. The latter are native tokens of Layer-2 projects or networks which are separate blockchains that extend Layer-1 blockchains to address scalability, transaction speed, and cost limitations inhering in Layer-1 blockchains. Much like staking, transactions in Layer-2 tokens can be viewed as an activity essential to effecting transactions in digital assets more broadly and, thus, should fit comfortably within a digital assets trading safe harbor.

Rather than as an alternative to a digital assets trading safe harbor, guidance providing that the commodities trading safe harbor broadly applies to trading in digital assets may best serve as a stopgap as Congress continues to consider legislation to address the taxation of digital assets. Such guidance would ensure that U.S. capital markets remain competitive at a time when other governments are actively pursuing similar safe harbor rules applicable to trading in digital assets.

* * *

We appreciate the opportunity to submit feedback to the Committee on Finance, and we would be pleased to meet with Committee staff to discuss our comments. If Committee staff have questions or comments, please do not hesitate to contact Joseph Schwartz, Director and Counsel, Regulatory Affairs, Erik Johnson, Vice President, U.S. Government Affairs, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jillien Flores

Jillien Flores
Executive Vice President
Head of Global Government Affairs
Managed Funds Association