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VIA E-MAIL

Erika Njienhuis
Natasha Goldvug
United States Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Adrienne Griffin
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington DC 20224

Re: Application of 1099 DA to Tokenised Securities and Other Digital Initiatives

Dear Ms. Njienhuis, Ms. Goldvug, and Ms. Griffin:

Introduction

The Association of Global Custodians ("AGC")[1] serves as a non-partisan advocacy organization representing our members' common interests on regulatory and market structure through interaction with legislative and regulatory authorities and financial industry organizations. The AGC Tax Committee appreciates the opportunity to provide written feedback to the US Treasury Department and Internal Revenue Service regarding the final regulations concerning Gross Proceeds and Basis Reporting by Brokers and Determination of Amount Realized and Basis for Digital Asset Transactions – we shall refer to these rules throughout this paper as the "1099-DA regulations".

[1] The Association is an informal group of 12 member banks that provide securities safekeeping and asset servicing functions to cross-border institutional investors worldwide, including investment funds. In providing global custody services, AGC members routinely seek appropriate withholding tax relief on behalf of custody clients by processing millions of such claims in the aggregate each year, affecting substantial amounts of cross-border portfolio investment flows in and out of countries worldwide.

Should the use of distributed ledger technology automatically create a digital asset?

The character of an asset or financial contract does not change simply because of the method used to record or transfer ownership. Whether those records are written on parchment, paper or maintained digitally using one or more computers, neither the underlying asset nor the legal rights and obligations associated with the contract fundamentally change simply because of the medium used. It is therefore surprising the definition of "digital asset" prima facie extends to any digital representation of value recorded on a cryptographically secured distributed ledger – in essence, any asset that utilises blockchain or similar technology to record its ownership and involves brokers or middlemen in its sale is scoped into the new reporting regime, unless expressly excluded under an exception.

While we cannot predict the future, if the cost of distributed ledger technology ("DLT") reduces to the point where it is cheap enough to be deployed for everyday purposes, many potentially reportable transactions could be imagined:

- If a local government authority utilises DLT to record ownership in real estate, would real estate agents or conveyancers be required to report the ordinary sale of a house under 1099-DA? If mortgage charges are also recorded on this DLT, would the repayment of that loan also be a reportable transaction?

- If a supermarket utilises DLT to maintain stock control and sales records and links this to their automated check-out registers, would it need to report the sale of groceries under 1099-DA and collect information concerning each customer? Would an apple recorded on a blockchain become a digital asset? And is a supermarket not a broker of those goods, purchasing from a wholesaler or farmer and selling to a consumer?

While we recognise the policy challenges opaque, decentralised stores of value present for tax authorities, a very broad approach to the definition of a digital asset potentially results in the need to constantly create new exceptions as the technological use cases expand. If the intention is to simply create an all-encompassing reporting regime that can cover anything so long as there is the use of cryptographically secured distributed ledger technology, we would query whether the benefits justify the costs.

One use case expected to arise often in practice is a token created to track record ownership with respect to an equity or debt security where, from an express contractual and legal disclosure perspective the issuer certifies the primary legal record of ownership are the books and records of the issuer or the issuer's transfer agent, while the token represents only secondary evidence of record ownership. This legal conclusion may be certified in an external legal opinion obtained with respect to both public and private offerings. While it may be feasible to analyze tokens under the rules applicable to the Limited-access, regulated network exemption described below, it is clear these tokens don't constitute "assets" digital or otherwise, and don't operate to unilaterally transfer ownership of the underlying security (they can't be sold or transferred independent from the underlying security, and can't be presented and redeemed to collect the underlying security).

The Limited-access, regulated network exemption

We note and welcome the inclusion of an exception for dual classification assets cleared or settled on a limited-access, regulated network. Practically, we believe this means the use of DLT to record ownership of a "traditional" security or commodity – commonly referred to as "tokenisation" – will not trigger reporting under 1099-DA, assuming all relevant requirements are met.

The most common tokenisation use cases considered by industry concern the issuance, trading, transfer and/or settlement and clearing of a security while leveraging DLT as the record of ownership. For example, the issuance of debt instruments leveraging DLT or the tokenisation of securities which are then posted as collateral to secure other financial contracts such as derivatives or securities lending. We believe these use cases are out of scope of 1099-DA so long as the institutions involved in the brokerage, custody, clearing and settlement of the securities are duly authorised and registered financial institutions.

For completeness, it is noted that the provider of the DLT itself may not be a financial institution, but this would not seem to frustrate the application of the exception so long as the participants in the network are the types of financial institutions described.

Of particular interest is the third type of limited-access, regulated network discussed in the preamble to the 1099-DA regulations: "a cryptographically secured distributed ledger controlled by a single person that is a registered dealer in securities or commodities, a futures commission merchant, a bank or similar financial institution, a real estate investment trust, a common trust fund, or a 1940 Act Fund, that permits the ledger to be used solely by itself and its affiliates (**and not to any customers or investors**) to clear or settle sales of assets." (emphasis added). The language in bold gives rise to some uncertainty regarding intention. One could raise two analogous examples to clarify the extent of this exception:

- A retail bank utilises blockchain to "tokenise" loans it issues to its individual customers. It is assumed that such a use case would qualify for the limited-access, regulated network even though the bank only faces its customers. The customers themselves are not utilising the blockchain, though their loans are recorded on it.

- A fund utilises blockchain to maintain a record of its investors and the purchases and redemptions of their interests in the fund. Again, we assume this would qualify for the exception.

It would seem perverse that either example fails to meet the requirements of the exemption simply because there is one financial institution operating a DLT, rather than a consortium. We would welcome clarification on the above use cases.

Further to this point and particularly with regards to securities issued by investment funds, there may be a number of directly interested parties who will want access to the digital network from an informational perspective with no ability to execute sales and transfers, and these parties will not always be a regulated entity for purposes of the Limited-access, regulated network exemption from 1099-DA reporting. For example, in connection with a large investment fund, in addition to the issuer there may be distributors, investment managers, depositories, fund administrators and fund transfer

agents who have a direct interest in the record ownership data stored on blockchain network and therefore need direct access to that data, and not all of these entities will meet the definition of a regulated entity. This should not cause the arrangement to become ineligible for the Limited-access, regulated network exception.

Digitally native issuances of traditional securities and commodities continue to meet the policy rationale for an exemption

While we welcome the limited-access, regulated network exemption, one of the key preconditions to accessing that exemption is the existence of a dual classification asset that is brought within scope of being digital because of the use of blockchain to tokenise or record ownership. This exception is predicated on the DLT running side by side with traditional custody and clearing systems. Additionally, as detailed below, the exemption indicates that the digital asset must be a digital asset "solely because the sale of such asset is cleared or settled on a limited access regulated network". Thus, it does not appear to apply in the case where it is a digital asset for reasons other than it solely trading/settling on a LARN. For example, a digital asset, including a digitally native asset, which might be *capable* of clearing and settling outside a single limited access regulated network appears to be outside this definition.

It is, however, unclear why a “digitally native” issuance of a traditional security or commodity should fail to qualify for an exemption. It would seem clear that the key policy requirements continue to be met:

- The underlying asset is one that is already contemplated within existing tax reporting legislation and is subject to reporting; and

- DLT is simply a new method used to aid in the trading, clearing and safekeeping of the asset.

One live example we can provide is the new issuance of a digital, green bond. The Government of the Hong Kong Special Administrative Region has issued a public offering of around HK$6billion worth of digital green bonds denominated in HK dollars (HKD), Renminbi (RMB), US dollars (USD) and euro (EUR). The Digital Green Bonds are issued in digitally native format on a blockchain platform, without the need to first issue in traditional central securities depositories and subsequently convert the bond into digital format and are listed on the Hong Kong Stock Exchange. International investors have the option to access the Digital Green Bonds via their accounts with Euroclear or Clearstream.

In practice the green bonds operate no differently to a traditional issuance, but being issued in a digitally native format, they would not be a digital asset solely because they are cleared or settled on a limited access regulated network and therefore would not benefit from this exemption to Form 1099-DA reporting. This would seem a perverse outcome, when viewed from a policy lens. Thus, removing the limitations around qualifying solely because the asset clears or settles on a limited access regulated network would allow this exception to function in-line with the intended policy.

The AGC appreciates your consideration of our concerns in this letter. Should you wish to discuss these items further or require further information, then we would be pleased to work with you.

Sincerely yours on behalf of the Association,

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