(for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."

Lawmakers and tax professionals alike have been concerned about the broadness of the broker definition, worrying that it could capture individuals who aren't acting in the traditional broker sense, such as miners, stakers, validators, and those who provide software or hardware wallets for users to hold their cryptocurrency.

Senate Finance Committee member Rob Portman, R-Ohio, published Davidson's letter in a post on Twitter, saying he appreciated Treasury "affirming" his stance that the reporting requirements should apply only to brokers. ■

Tax Pros Burst Overeager Cryptocurrency Community Bubble

by Nathan J. Richman and Mary Katherine Browne

Some cryptocurrency proponents enthusiastically welcomed the news that the government offered to settle a cryptocurrency staker's tax claim, but tax professionals said it might not mean much, at least not yet.

On February 3 Joshua and Jessica Jarrett filed a notice in their tax refund case, *Jarrett v. United States*, No. 3:21-cv-00419 (M.D. Tenn. 2021), notifying the court of two letters they'd exchanged with the Justice Department.

In the first, the Justice Department states that the attorney general authorized the full refund that the Jarretts were suing over — $3,793 plus interest for tax year 2019. It says little else.

In their response letter, dated January 25 and stating that the government's letter was from December 20, 2021, counsel for the Jarretts noted that the government attorneys had prepared a draft stipulation stating that the case was over. The plaintiffs' letter disagreed that the dispute was concluded and complained that the government wouldn't say why the Jarretts were getting their 2019 tax refund.

Without something official about how cryptocurrency staking rewards are taxed, the Jarretts could face the same denial in later tax years despite the proffered refund, so instead of accepting it, they plan to continue pressing their case, their letter concluded.

On February 10 the magistrate judge overseeing some aspects of the case issued an order noting that the Justice Department plans to file a motion to dismiss for mootness and calling for submission of a proposed schedule for briefing that motion by February 25. The order followed a case management conference from earlier that day.

The Jarretts sued for a tax refund in May 2021 to challenge the IRS's treatment of cryptocurrency staking rewards. Cryptocurrencies like Bitcoin, Ethereum, and Tezos (the coins at issue in the Jarretts' case) operate on distributed ledgers with system users, rather than a central authority, validating transactions before adding another block cementing the record of those transactions to the blockchain.

There are two main systems used in cryptocurrency validation protocols: proof of work and proof of stake. Proof of work, commonly known as mining, has validators competing to solve immensely complex math problems — by throwing enormous amounts of computing power at them — for the right to validate a block of transactions. Bitcoin is the most well-known system using proof-of-work validation.

Proof-of-stake protocols require validators to pledge some of their tokens to prove the validity of the transactions reported in the block they would add to the chain.

Both types of validators can receive newly issued tokens for their work as well as direct remuneration for their efforts.

Since 2014 the IRS has been clear (Notice 2014-21, 2014-16 IRB 938) that it views all convertible cryptocurrencies as property rather than currency for tax purposes, and that tokens received as a reward for mining are compensation for services, and thus income, in the hands of the miners.

Hope or Hype?

The Jarretts' refund suit is based on the argument that proof-of-stake rewards aren't compensation for services, but newly created property, and that the stakers operating within the existing system are the creators.

The Proof of Stake Alliance issued a release to coincide with the Jarretts' filing of the two letters. That release called the brief Justice Department statement "a sign that the IRS may no longer attempt to tax tokens created through staking" and fed an initial wave of news stories claiming that the IRS had changed its position on cryptocurrency or adopted a position on proof-of-stake token rewards.

The release contributed to that impression by calling the government's decision not to litigate the under-$4,000 refund claim "an early sign suggesting that the IRS will not tax property created through staking until it is sold." In the release, Alison Mangiero of the Proof of Stake Alliance said, "The IRS doesn't just lay down in court, especially in cases that could affect millions of taxpayers on a very basic point of law. It means they've got a losing argument."

But other observers quickly pointed out that Mangiero and the alliance might be reading too much into the Justice Department's decision not to litigate the Jarretts' claim for the amount of refund at issue or in the venue they had chosen.

> ***'From a legal perspective, the IRS decision is a nothingburger that could even help the IRS, if the agency's aim is to more aggressively collect taxes on staking rewards,' Marian said.***

In a LinkedIn post, Roger M. Brown of Chainalysis Inc. wrote, "I would be hesitant to conclude that the IRS now believes staking (or mining) rewards are not taxable upon receipt. I suspect there is more to this development, as the IRS takes a number of factors into account in deciding which cases to litigate (including factors which are non-technical tax related)." He highlighted both the small amount at issue and the venue of the Jarretts' case in a Tennessee federal district court.

After questioning the excited interpretations of the Jarretts' February 3 filings on Twitter, Omri Marian of the University of California Irvine School of Law shared his thoughts on February 8 via CoinDesk. Many of the initial reactions were incorrectly treating the Justice Department's decision to issue the Jarretts a refund as legal precedent, he wrote.

"From a legal perspective, the IRS decision is a nothingburger that could even help the IRS, if the agency's aim is to more aggressively collect taxes on staking rewards. This possibility is why the Jarretts intend to refuse the refund and pursue the case. Had the refund been a 'victory,' they would have walked away with the money," Marian said.

Marian illustrated his point with an example: When a prosecutor, perhaps from lack of funds or interest, declines to prosecute a particular car thief, that doesn't erase the crime of grand theft auto.

The small amount of the refund claim is likely a significant part of the government's decision to concede the Jarretts' refund, according to Marian. He suggested that the Jarretts' lawyers had already expended more than $100,000 worth of effort on the case.

Marian argued that there are two reasons for those celebrating the Jarretts' refund to instead be very afraid. On one hand, the IRS may have abandoned the Jarretts' case as a vehicle for litigating the tax treatment of staking rewards in order to better argue that they are taxable in another case in another court, he said. On the other hand, any delay could give the IRS more time to issue guidance saying staking rewards are taxable before a court has a chance to consider the issue in a vacuum, he added.

Dangerous to Advise on *Jarrett*

Tax professionals who spoke with *Tax Notes* also cautioned taxpayers against finding anything of value in the recent developments.

Larry A. Sannicandro of McCarter & English LLP said he thinks it would be a huge mistake to gauge the IRS's substantive tax or litigation positions on the basis of settlements to which the agency is a party. "We are certainly not advising clients that the government's position in *Jarrett* means anything," he said.

Sannicandro noted that there are several reasons the government could have offered to settle the case outside the merits, from not wanting to continue the case because of potential consequences for other tax periods to preventing the taxpayer from asserting other issues that may lead to a higher dollar amount.

"Who knows why they decided to settle this issue? The only folks who know are the litigating attorneys and the person who has settlement authority," Sannicandro said. "The government can settle cases for any reason it wants."

Jamison Sites of RSM US LLP agreed, saying it isn't unusual for the Justice Department to instruct a settlement. "Maybe they don't like the facts of the case, they don't like the venue, maybe they prefer Tax Court. There could be a whole host of issues of why they were instructed to issue the refund that could have nothing to do with the merits of the case," he said.

There is also the issue of the Federal Rules of Evidence. Under Rule 408, compromise offers and negotiations are inadmissible as evidence unless used for impeaching a witness because of bias or prejudice, negating a contention of undue delay, or proving an effort to obstruct investigation.

Sannicandro confirmed that the government's offer to settle has no litigation value not only for Jarrett but also for any other proof-of-stake litigation, stating that "Rule 408(a) would clearly suggest that a court . . . could not draw an adverse inference against the government for having settled the issue in another case."

Sites pointed out that while the crypto community is technologically sophisticated, it's less adept with tax law. "Information is often through tweets and soundbites. This is a community that firmly believes that like-kind exchange treatment should apply to exchanges of Bitcoin and Litecoins. . . . I think the consensus amongst tax professionals is that like-kind exchange treatment probably doesn't apply outside very unique situations," he said.

Pushing for Precedent, Not Setting It

Travis W. Thompson of Sideman & Bancroft LLP pointed out that the whole point of the plaintiffs rejecting the settlement offer is the lack of precedent — and that's what this case is all about.

"I 100 percent believe that plaintiff's counsel rejected the offer and is moving forward with the case so they can create that precedent that crypto owners can take for the future and force the IRS's hand," Thompson said.

> ***Thompson pointed out that the whole point of the plaintiffs rejecting the settlement offer is the lack of precedent — and that's what this case is all about.***

Like Marian, Thompson noted that the controversy amount is a mere $4,000, but that some of the most experienced lawyers in the United States are working on the case. "In many ways this adds to the romanticism of this case and the fact that merits of the case stand above the amount and the importance of the law itself," he said.

Sites also pointed to the importance of precedent, theorizing that one of the reasons the government offered to settle was that it intends to come out with its own policy and doesn't want a judge to decide policy in the area.

"If this case is dismissed, the taxpayer and taxpayers in general will have no new guidance in the proper tax treatment of staking income," Sites said.

Sites also noted that the digital asset community is passionate and tends to react quickly to developments. He pointed to its strong reaction to the recently passed Infrastructure Investment and Jobs Act (P.L. 117-58) and the changes to section 6045, which define cryptocurrency as a specified security and subject to the same reporting requirements as stocks and bonds.

Because of the potential precedent of the case, all eyes are on *Jarrett*. "This is a high-profile case from the blockchain side, and most other industries would not be aware of a district court case on a tax issue for $4,000," Sites said.

When *Tax Notes* asked for comment, the IRS responded, "Federal law prohibits the IRS from discussing specific taxpayers and generally the IRS does not discuss pending litigation."

The plaintiffs in *Jarrett* are represented by attorneys with Consovoy McCarthy PLLC and Fenwick & West LLP. ■

Senate Republicans Attack Treasury for Pillar 2 Surrender

by Andrew Velarde and Stephanie Soong Johnston

Senate Finance Committee Republicans are assailing Treasury for what they view as a lack of transparency and a U.S. surrender on pillar 2 negotiations that could cost American businesses greatly.

In a February 16 letter to Treasury Secretary Janet Yellen, 14 Finance Committee Republicans expressed concern over the possibility that the U.S. global intangible low-taxed income regime is not a qualified income inclusion regime under the OECD standard.

"Despite the United States having the world's only global minimum tax, Treasury continues to take the position that Congress should make the U.S. global minimum tax harsher before other countries take any action. It is one thing for the Administration to advocate for higher taxes as part of its domestic tax agenda, but quite another to explicitly negotiate an international agreement that would subject U.S. companies to double taxation unless Congress acts accordingly," the letter states. "Rather than mounting a pressure campaign against Congress, the focus should be on whether other countries enact a global minimum tax in the first place."

Pillar 2 of the OECD's two-pillar plan to modernize global corporate taxation would apply to large multinational enterprises with annual group revenue exceeding €750 million and rely primarily on the global anti-base-erosion rules, which comprise the income inclusion rule and the undertaxed payments rule. The former would apply a top-up tax to an in-scope MNE's income that is taxed below the 15 percent effective tax rate, and the latter would apply to any top-up tax that is not collected under the income inclusion rule by denying deductions that are taxed under the minimum rate. The OECD released the pillar 2 model rules in December 2021. The plan follows up on the base erosion and profit-shifting project.

A February 17 release from Finance Committee Republicans asserts that it is clear that other countries believe the current GILTI regime does not comply with pillar 2.