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Re: Cryptoasset Reporting Framework, Common Reporting Standard amendments, and seeking views on extension to domestic reporting

The Crypto Council for Innovation ("CCI"), a global alliance of industry leaders focusing on digital assets, appreciates the opportunity to provide feedback to His Majesty's Revenue & Customs (HMRC) on "Cryptoasset Reporting Framework, Common Reporting Standard amendments, and seeking views on extension to domestic reporting" (the "Proposal").

CCI members span the digital asset ecosystem and include some of the leading global companies and investors operating in the industry. CCI members share the goal of encouraging the responsible global regulation of crypto to unlock economic potential, improve lives, foster financial inclusion, protect security, and disrupt illicit activity. CCI believes that achieving these goals requires informed, evidence-based policy decisions realised through collaborative engagement between regulators and industry. It also requires recognition of the transformative potential of crypto in improving and empowering the lives of global consumers.

CCI appreciates and applauds HMRC's aim to establish a framework which will foster responsible innovation, by providing people and businesses the confidence and clarity they need to plan and invest for the long-term. To that end and to further assist HMRC, CCI has answered the individual questions specifically below, however we would like to underscore three particular points related to the scope of CARF:

- CCI supports the exclusion of e-money products from the CARF regime, however would like to see this exemption extended to stablecoins which are pegged to a single fiat currency.
- CCI welcomes further guidance to clarify the extent to which NFTs which are not used for payment or investment purposes are captured by the scope of the CARF.

- CCI is concerned that including all parties said to be 'effectuating Exchange Transactions is incredibly broad, potentially duplicative and unduly onerous, without additional guidance from HMRC as to what might be excluded (as a minimum). If widely defined, parties said to be effectuating Exchange Transactions would include those not actually undertaking the relevant activity itself but merely making it easier for others to do so.

Please see below for the answers to each individual question.

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Question 1: Do you consider the scope of, and definitions contained within, the OECD CARF rules to be sufficiently clear? Are there any areas where additional guidance would be helpful?

<u>Treatment of NFTs</u>

CCI notes the intention of the CARF to capture “certain non-fon fungible tokens (NFTs)” within the definition of cryptoassets as expressed in paragraph 11 of the introduction. While the CARF rules themselves do not expand upon this point, we note that in the commentary to the rules (Section 3 - Commentary on Section IV: Defined terms, paragraph 12) it states that “NFTs that are traded on a marketplace can be used for payment or investment purposes and are therefore to be considered Relevant Crypto-Assets”.

Pursuant to the same paragraph, which states “It is important to consider the nature of the NFT and its function in practice and not what terminology or marketing terms are used” CCI wishes to challenge the notion that by virtue of an NFT being on a marketplace, it must therefore be considered a Relevant Crypto-Asset. Further, we ask HMRC to consider clarifying that an acceptable interpretation of paragraph 12 be:

- NFTs that are traded on a marketplace <u>and</u> can be used for payment or investment purposes should be considered Relevant Crypto-assets. NFTs which cannot be used for payment or investment purposes should not be, irrespective of their listing on a marketplace, automatically considered a Relevant Cryptoasstes and instead should be subject to a case-by-case RCASP review.

Non-fungible token is a broad umbrella term, under which there sits many different tokens representing very different use cases. In many cases, NFTs are not predominantly used for payment/investment purposes (irrespective of their listing on a marketplace), but rather are used for things such as digital collectibles and identity credentials. Aside from NFTs which directly represent an interest in a financial product, which is a minority of NFTs, the majority of NFTs are fundamentally different to cryptoassets. For example, NFTs may provide the holder a right with respect to a digital file (such as a digital image, digital music, a digital sports trading card, etc.). Furthermore, NFTs are not interchangeable so cannot be traded the way cryptoassets are. NFTs also do not display the other characteristics of cryptoassets or digital assets such as being a store of value or a medium of exchange.

It is for these reasons that NFTs are frequently excluded from the regulatory perimeter, such as in the FATF recommendations[1], and there continues to be a lack of global consensus regarding the extent to which NFTs should be captured within the definition of cryptoassets given their unique attributes and differences.

As such, CCI welcomes further guidance from HMRC to clarify the inclusion of NFTs in the CARF regime which are not used for payment or investment purposes.

Additionally, on a practical note, we would welcome guidance on what an RCASP is practically required to do when conducting a case by case consideration to determine that an NFT 'cannot' be used for payment or investment purposes. Other than legal prohibitions, this appears to be a challenging bar to prove. A more realistic articulation of this would be 'is unlikely to be used for' or 'is not intended for use in' payment or investment purposes.

<u>Scope of 'effectuating exchange transactions'</u>

CCI notes that the scope includes "any individuals or entities that, as a business, provide a service effectuating 'Exchange Transactions' for or on behalf of customers". This definition is incredibly broad, and therefore potentially both duplicative (potentially requesting multiple reports on the same transaction from entities if widely defined) and unduly onerous (as it could capture unintended individuals or entities), without additional guidance from HMRC as to what might be excluded (as a minimum).

- It is important to note that, if widely defined, parties said to be effectuating Exchange Transactions may not actually be undertaking the relevant activity itself. For this reason, the expanded scope inappropriately includes parties that do not, in fact, effectuate sales, but merely make it easier for others to do so. Below, we have included several examples to further illustrate this point with regards to the term "effectuating" for consideration.
  - **Wallet Provider:** A wallet provider, as a software and/or hardware technology provider, does not possess knowledge of the transaction details or the identities of the parties involved. This is because wallets do not actually 'hold' coins; they merely provide a secure method for users to manage their private keys, which prove ownership, and therefore enable the use of coins that exist on the blockchain. A wallet provides a user interface and technical connections to third-party platforms, but it does not itself "effectuate" Exchange Transactions, as the user remains in control at all times
  - **DeFi Protocols:** For illustration purposes, DeFi protocols can be compared to SMTP (Simple Mail Transfer Protocol), which is used for emails. SMTP, like TCP/IP, merely provides the underlying infrastructure used by email providers

[1] https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Updated-Guidance-VA-VASP.pdf.coredownload.inline.pdf , p.24. "Digital assets that are unique, rather than interchangeable, and that are in practice used as collectibles rather than as payment or investment instruments, can be referred to as a non-fungible tokens (NFT) or crypto-collectibles. Such assets, depending on their characteristics, are generally not considered to be VAs under the FATF definition."

such as Gmail and Yahoo. No ordinary person would suggest that SMTP protocols are "effectuating" the emails sent by these applications or email providers. Similarly, DeFi protocols provide the underlying infrastructure for decentralised applications - once developers launch the smart contracts that constitute decentralised protocols, the protocols function in an autonomous manner and self-execute user commands without the need for third parties. Specifically, in DeFi protocols, the absence of a customer relationship, compensation, and privity of contract indicates that the protocol designer does not have a sufficient customer relationship to warrant reporting requirements. While developers might retain certain control over a protocol, at least in its earliest stages, the developers do not have the unilateral ability to alter a decentralised protocol, to reverse transactions, or to otherwise control the smart contracts. For these reasons, protocol developers (including DeFi protocol developers) cannot “effectuate” transactions, i.e., have a causal effect on transactions over a blockchain network that, in its optimal and most decentralised state, can operate without the need for developers at all. Most importantly, developers cannot possibly comply with these reporting requirements, and imposing them on developers could result in the perverse outcome that they build their applications without any governance rights, which'd fundamentally undermine the benefits of decentralisation.

- **Price Discovery Services:** Providing services to discover the most competitive buy and sell prices may inappropriately fall under providing a service effectuating Exchange Transactions. However, providing pricing comparisons does not rise to the level of routing or making investment recommendations[2]. It is therefore difficult to see how such price discovery service providers, for example, a website offering pricing information, would be directly involved in effectuating digital asset transactions to the extent that they would need to be classified as “effectuating” Exchange Transactions.
- **Smart contract developers:** It is possible that effectuating Exchange Transactions could capture developers that create source code for smart contracts/decentralised protocols. Once developers launch a protocol, it functions in an autonomous, self-executing manner, meaning the developer does not directly "effectuate" transactions. While developers may initially retain certain limited control over a protocol to prevent hacks/exploits, they do not have the unilateral ability to alter a decentralised protocol, to reverse transactions, or to otherwise control the smart contracts.

<u>Treatment of wrapped tokens</u>

CCI welcomes further clarification on the treatment of wrapped tokens, as we are concerned that the current status is unclear. Specifically, we recommend that future guidance make clear that wrapping and unwrapping transactions are not Exchange Transactions.

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[2] As was concluded in the case Securities and Exchange Commission v. Coinbase, Inc. https://www.courtlistener.com/docket/67478179/105/securities-and-exchange-commission-v-coinbase-inc/

A wrapped token is a tokenised version of a crypto-asset that allows it to interact with a blockchain, other than its native blockchain. Crypto-asset holders mint wrapped tokens for various reasons, including, for example, establishing a money market in a crypto-asset, to provide liquidity to the holder of a crypto-asset that is locked as part of a proof-of-stake transaction, and to avail themselves of the functionality of another blockchain. In most cases, the underlying tokens are locked in a smart contract on their native protocol, and the user receives a tokenised representation of that asset on a different blockchain. In general, wrapped assets are treated as a continuing interest in the underlying asset.

CCI notes that the CARF commentary takes the position that the definition of a Relevant Transaction (within which Exchange Transactions fall) targets “those transaction[s] likely to give rise to taxation events (i.e. capital gains and income taxation).” From a UK tax perspective, we believe that the wrapping of a crypto-asset should not lead to its disposal for UK capital gains tax purposes, and therefore, it would be inappropriate for the wrapping of tokens to fall within the definition of an Exchange Transaction. It would also, due to the aggregated nature of information that market participants would have to provide under CARF, inflate the potential taxable transactions. This would hurt taxpayers and negatively impact the usefulness of reports to HMRC.

Treatment of staking activities

CCI welcomes further clarification on the treatment of staking activities. Specifically, we believe it would be inappropriate to treat staking activities as an Exchange Transaction for the purposes of the CARF.

The staking process does not typically require the staking participant to surrender control of their staked crypto-assets; although it is true that a staking participant may transfer their crypto-assets, in most cases the participant will remain the beneficial owner of those crypto-assets. Moreover, while a staking participant may receive tokens as a reward for participating in the staking process, that reward arises from the performance of the validation services, not in consideration for the staked tokens themselves. Such income would, if the validator is a Reportable User, otherwise be reportable as a Transfer other than Reportable Retail Payment Transactions.

Scope of ‘significant influence’

The consultation states that “individuals or entities with control or sufficient influence over a “decentralised” exchange may be acting as RCASPs”. This would seem to extend to individuals with voting rights, which would be unduly burdensome and unnecessary to achieve the policy outcome. As a result, CCI believes this wording should be clarified to exclude voting rights.

In many cases, voting rights only enable tokenholders to adjust certain minor parameters of the protocol or support an upgrade or implementation of a new protocol. The result of voting and

making governance decisions is, therefore, limited, and tokenholders are never able to "effectuate" transactions over the blockchain network or protocol nor should they be seen as having sufficient influence or control to bring them otherwise within the scope of CARF reporting.

Other Clarifications

CCI supports the exclusion of e-money products to prevent any overlap with existing requirements. However, we are concerned that in certain scenarios, the exemptions from CARF are too narrowly defined, resulting in few products being captured, and even fewer over time. Specifically, CCI notes that a specified electronic money product which is digital representation of a single fiat currency would be reportable under CRS but not CARF. CCI believes this definition should be extended to include stablecoins which are pegged to a single fiat currency.

Other jurisdictions have provided a detailed implementation framework manual. CCI supports the introduction of this for the UK implementation of CARF, which will assist the government and the public at large. Such a manual can provide additional clarity as well as assisting stakeholders when it comes to the implementation of CARF in the UK.

As a general matter, CCI supports the provision of Guidance regarding specific examples of business models and activities that would be included or excluded within the scope of the CARF and the amendments to the CRS. For example, CCI members would find it particularly useful to establish the types of stablecoins which would be reportable under the amendments to the CRS. CCI stands ready to support HMRC in creating such Guidance as helpful.

Question 2: Are there any areas where additional guidance would be helpful on the nexus criteria?

CCI is broadly supportive of the nexus criteria. One specific point of clarity that we would welcome is whether an RCASP needs to disclose to the non-reporting jurisdiction in cases where there is a clear strong link to a primary nexus (as per the requirements where an RCASP has an equal nexus in two or more jurisdictions).

Question 3: Are there any areas where additional guidance would be helpful on reportable information?

No comment.

Question 4: Do you agree with the government's proposal to align the timeframe with CRS reporting requirements?

CCI supports alignment with current CRS reporting timelines.

Question 5: Are there any areas where additional guidance would be helpful on the due diligence rules?

CCI requests that HMT confirm via guidance that a reasonableness test is conducted by ensuring that no existing information held by the RCASP is in conflict with the information being presented by the self certification. This helps reassert (as is stated in CARF Section 3) that "Providers are not expected to carry out an independent legal analysis of relevant tax laws to confirm the reasonableness of a self-certification". This would also help clarify the existing wording in CARF Section 3 of "it does not know **or have reason to know** that the self-certification is incorrect or unreliable" as this statement is potentially very broad.

CCI notes that CARF section 3 states: "If the Reporting Crypto-Asset Service Provider is not legally required to apply AML/KYC Procedures that are consistent with the 2012 FATF Recommendations (as updated in June 2019 pertaining to virtual asset service providers), it must apply substantially similar procedures for the purpose of determining the Controlling Persons." We would appreciate further clarity on what 'substantially similar' constitutes, and what (if any), evidence of the decision an RCASP needs to present/maintain.

Question 6: Do you agree that, in principle, penalties relating to CARF obligations should be consistent with the structure set out above?

No comment.

Question 7: Do you think that the penalty amounts in the MRDP are appropriate for the CARF?

While CCI does not object to the revision of the penalty provisions per se, it is important to ensure proportionality and appropriateness across the regime.

For firms that intentionally disregard the requirements, high penalties are already applied, and correctly so. However, it is not clear why the CARF is increasing its penalties without the commensurate increase in CRS penalties; it is crucial that there is consistency across the two regimes.

Further, CCI reiterates the importance of proportionality to HMRC. Many of the firms to whom these penalties apply will be small, and their fines will be a result of unintentional breaches rather than deliberate disregard. Notwithstanding particularly egregious issues, which should be dealt with swiftly irrespective of intent, CCI encourages HMRC to consider a scale of penalties that would impose meaningful fines but be proportionate with, rather than punitive to, the size of the business. For example, caps could be introduced relative to firm size.

Finally, CCI welcomes further guidance as to the applicability of overlapping penalties. For example, would HMRC charge a firm a penalty per late report, or would it simply charge a single

penalty to reflect that a firms' reporting requirements are overdue? This would also extend to daily penalties.

Question 8: What additional strong measures would be appropriate to ensure valid self-certifications are always collected for Crypto-Users and Controlling Persons?

No comment.

Question 9: What additional one-off or regular costs do you expect to incur to comply with the requirements of the CARF? Please provide any information, such as costs, staff time or number of reportable persons/RCASPs affected which would help HMRC to quantify the impacts of this measure more precisely.

CCI is concerned that these requirements represent a significant financial burden for RCASPS.

Based on the current OECD framework, an estimate by a well-established CRS vendor was provided to a CCI member. For CARF compliance for a RCASP with 100,000 accounts they estimated the cost to be $2,500,000 to $2,900,000 for Year 1 and $1,000,000 to $1,300,000 for years after that (continuing account documentation and reporting obligations). This includes collecting CARF self certifications for the 100,000 customer population as well as error follow-ups for invalid documents, portal registration, and annual filing submissions. This does not include the significant updates that would need to be made to internal systems to store and maintain CARF data as well as staff to coordinate the outsourced efforts.

Further, data systems will have to be built or significantly modified to accommodate the data elements necessary to determine reporting obligations for customers and capture the necessary reporting information, and annual reporting costs will be significant.

Question 10: Do you agree with the government's approach to Qualified Non-Profit Entities?

No comment.

Question 11: Do you agree with the proposal to have an election to ignore the switch-off and report under both regimes?

No comment.

Question 12: Do you consider the scope of, and definitions contained within, the rules to be sufficiently clear? Are there any areas where additional guidance would be helpful?

As outlined previously, CCI welcomes the provision of additional guidance from HMRC regarding specific examples of business models and activities that would be included or

excluded within the scope of the amendments to the CRS. For example, CCI members would find it particularly useful to establish the types of stablecoins which would be reportable under the proposals.

Question 13: Do you agree with government's proposal to introduce a mandatory registration requirement?

No comment.

Question 14: Do you agree that, in principle, penalties relating to CRS obligations should be consistent with those set out above?

No comment.

Question 15: Do you think that the penalty amounts in the Model Rules for Digital Platforms are appropriate for the CRS?

No comment.

Question 16: What additional strong measures would be appropriate to ensure valid self-certifications are always collected where required?

No comment.

Question 17: Do respondents have any comments on the assessment of impacts of these proposals?

No comment.

Question 18: What are your views on extending CARF by including the UK as a reportable jurisdiction? What impacts would this have on RCASPs in scope? Are there other issues, regulatory or legal, that will need further discussion?

CCI is supportive of extending CARF to include the UK as a reportable jurisdiction, but on a phased approach.

Question 19: What are your views on extending CRS by including the UK as a reportable jurisdiction? What impacts would this have on reporting entities in scope? Are there other issues, regulatory or legal, that will need further discussion?

CCI is supportive of extending CARF to include the UK as a reportable jurisdiction, but on a phased approach.

Question 20: If the UK were to decide to introduce domestic CARF and CRS reporting, what are your views on implementing to the same timeline as the international CARF/CRS2 package (information collected in 2026, exchange in 2027)?

CCI is supportive of a phased-in approach, with time for all parties acclimating to the collection and processing of data for non-residents and adding resident reporting in a later phase.