

New US Crypto Regulation Far More Invasive Than We Thought

US Congress intends to regulate crypto on a level far deeper than currently understood—They will:

- ✓ Designate Bitcoin, Ether, and their hard-forks as commodities and regulate their transactions accordingly;
- ✓ Create legal uncertainty for all other crypto projects and ICOs by allowing them to be labeled as securities;
- ✓ Ban the use of (unauthorized) stablecoins;
- ✓ Introduce prison sentences for the use of mixers and privacy coins;
- ✓ Rebrand smart-contracts that take longer than 24 hours to deliver as futures contracts and regulate them accordingly;
- ✓ Re-define legal tender and change the way money is created by the Federal Reserve; and authorize the issuing of a digital USD of which all transactions are recorded;
- ✓ Introduce foreign regulations into US law for all virtual asset service providers in the US (and with US clients).

In short: Congress wants to bring crypto-currencies under full oversight and control.

These new regulations introduce massive regulatory burdens on existing projects, ban and criminalize current normal activities, restrain innovation and free enterprise, and even introduce a transparent central bank digital digital currency that redefines money as we know it!

<What This Report Is About_

According to United States representative Don Beyer, congress should incorporate “digital assets into existing financial regulatory structures.”¹ As you will see, they intend to do just that. And it will change the way things are done for crypto forever...

This report provides an overview of the crypto legislation currently being put through US congress; it does not just look at the proposed bills, but rather at the wide range of laws that are to be amended.

Once all the puzzle pieces are put together, the big picture reveals shockingly strict regulations of crypto and a complete overhaul of the idea of “money.” This could have serious effects not only on the crypto sector, but also on the financial system as a whole.

Behind the excuses of preventing money laundering and ensuring investor protection, the use of crypto is transformed in something it was not supposed to be. Especially delicate is the fact that part of this legislation is drafted outside the US.

Disclaimer: *This report provides a high-level overview of the US laws that are to be introduced/amended by two new bills. Its depth is limited by the inadequate knowledge of the author of the large body of US law involved, and given that these bills are subject to amendments and have not even passed into law yet, none of this information can be considered legal or financial advice.*

<What Is Going On?_

On April 06, 2021, a “must pass” bill was introduced called the “*Infrastructure Investment and Jobs Act*”² (“Infrastructure Bill”). It passed in the House of Representatives and, after fierce debate, the Senate. Hidden in this bill, an amendment to the Internal Revenue Code was added. It introduced new reporting requirements and obligations for record keeping.

While this bill created a lot of public outcry, more recently, a real game-changing bill was introduced in the House on July 28, 2021, namely the: “*Digital Asset Market Structure and Investor Protection Act*”³ (“Digital Asset Bill”).

This bill proposes amendments to the Federal Reserve Act, the Bank Secrecy Act, Securities Exchange Acts, and the Commodity Exchange Act. It changes the definition of legal tender, and it introduces international crypto regulation into US law.

The next sections of this report look at each of these amendments...

<Commodities or Securities?_

The main take-away is that two different bodies of law will apply to crypto projects: commodities and securities laws. So far, only Bitcoin, Ether, and their hard-forks are confirmed to be commodities (see below). All other cryptos are subject to future guidance by market regulators:

*“Not later than 150 days after the date of the enactment of this section, **the SEC and CFTC shall jointly publish, for purposes of a 60-day public comment period, a proposed rulemaking that classifies each of the major digital assets.***

*Not later than 270 days after the date of the enactment of this Act, the SEC and CFTC shall jointly publish a final rule that classifies **each of the top 25 major digital assets** by (i) highest market capitalization and (ii) highest daily average trading volume as—*

(1) a digital asset; or

(2) a digital asset security.”⁴

Interpretation:

- Cryptos will be subject to two different regulatory regimes: commodities and security regulations.
- Services engaged with both digital assets (commodities) and digital asset securities (securities) could be subjected to both regulatory regimes.

<Commodities Regulation_

The Commodity Exchange Act regulates the trading of commodity futures in the United States. Passed in 1936, it has been amended several times since then.⁵ It provides federal regulation of all commodities and futures trading activities and requires all futures and commodity options to be traded on organized exchanges.

In 1974, the Commodity Futures Trading Commission (CFTC) was created to oversee the market. With certain exceptions, the CFTC has been granted exclusive jurisdiction over commodity futures, options, and all other derivatives that fall within the definition of a swap. Certain cryptos will be regulated as commodities.

Definition of “Commodity” Amended to Include Digital Asset:

First and foremost, Section 1a of the Commodity Exchange Act on definitions will be amended to read as follows:

*“The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, **digital asset (including Bitcoin, Ether, and their hardforks)**, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13-1 of this title) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.”⁶*

Digital Asset Definition

Next, the end of Section 1a of the Commodity Exchange Act will be amended by adding a clarification of what a digital asset is:

“(A) means an asset—

(i) that is created electronically or digitally through software code;

(ii) that is programmed with rules that—

(I) govern the creation, supply, ownership, use, and transfer of such digital asset; and

(II) are designed to resist modification or tampering by any single person or persons under common control;

(iii) that has a transaction history that—

(I) is recorded on a—

(aa) distributed digital ledger; or

(bb) digital data structure in which consensus is achieved through a mathematically verifiable process;

(II) is updated as soon as possible in accordance with the digital asset programming rules related to transactions and ownership; and

(III) after consensus is reached, is designed to prevent modification or tampering with the ownership or transaction history by any single person or persons under common control;

(iv) that is capable of being transferred between persons through a decentralized method without an intermediate custodian; and

(B) is a broad term which includes several other terms used to describe digital assets by market participants and regulators such as ‘virtual asset’, ‘virtual currency’, and ‘convertible virtual currency’ among others.”⁷

Smart Contracts with Delivery Time of More than 24 hours: Futures Contracts Banned for Retail Investors

A sharpening of the definition of retail commodity transactions could decrease the options for the use of smart contracts outside of regulated exchanges.

Currently, Section 2(c)(2)(D)(i) of the Commodity Exchange Act prohibits persons that are not “eligible contract participants” or “eligible commercial entities” to engage in agreements, contract or transactions in commodities on leverage, margin, or financed by the offeror, the counterparty, or a person acting in concert with the offeror or counterparty on a similar basis.⁸

Next, additional amendments mentioned in the SEC. 202 of the Digital Asset Bill applies this on transactions done by smart contract of which the delivery takes longer than 24 hours:

“(ii) *Exceptions*

(III) *a contract of sale that--*

*(cc) with respect to digital assets, results in **actual delivery** (including transfer of control over private keys) **not later than 24 hours after the transaction is entered into** and such delivery is accomplished by either-*

(AA) recording the transaction on the public distributed ledger for the digital asset; or

(BB) with respect to digital which are not recorded on a public distributed ledger for the digital asset, reporting the transaction to a CFTC registered digital asset trade repository; or”⁹

Dodd-Frank Act and Market Transparency

After the 2008 financial crisis, the Dodd-Frank Act introduced strict regulations for swaps. Naturally, these will also apply to digital assets as well.

The definition of swaps, as provided by the Commodity Exchange Act (section 1a(47)) is broad. For example, it could refer to any “agreement, contract or transaction” that “provides for any purchase, sale, payment, or delivery that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence.”¹⁰

Next, the Dodd-Frank bill authorizes the CFTC to:

- Regulate swap dealers by installing capital and margin requirements, require dealers to meet robust business conduct standards, and meet recordkeeping and reporting requirements.
- Increase transparency and improve pricing in the derivatives marketplace by requiring standardized derivatives to be traded on regulated exchanges or swap execution facilities and bring better pricing to the market place and lower costs for businesses and consumers.
- Lower risk to the American public by moving standardized derivatives to central clearinghouses.¹¹

Digital Asset Trade Repository

To meet the above mentioned market transparency requirement, the Commodity Exchange Act stipulates the need for a digital asset trade repository to collect information on SWAPS in order to provide the public with the correct market information:

*“The term ‘digital asset trade repository’ means any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, **contracts of sale of digital assets in interstate commerce entered into by third parties** (both on chain public distributed ledger transactions as well as off chain transactions) for the purpose of **providing a centralized recordkeeping facility for any digital asset**, but does not include a private or public distributed ledger or the operator of either such ledger unless such private or public distributed ledger or operator seeks to aggregate/include ‘off chain’ transactions as well.”¹²*

Interpretation Commodities Regulations:

- As of writing, only BTC and Ether (and their hard-forks) will be confirmed as commodities. All other cryptos could potentially be regulated as securities (what this means is explained next).

- The fact that novel technologies such as Bitcoin and Ether are to be subjected to a large body of law that developed around the trading of livestock and frozen concentrated orange juice could spell regulatory uncertainty for various business models in the industry.
- No “trading on margin” is allowed outside regulated entities, unless done by high-level investors called “eligible contract parties.” This could perhaps frustrate particular ideas about decentralized finance or OTC markets.
- Smart contracts that take longer than 24 hours to deliver could be considered futures contracts under the jurisdiction of the CFTC. That smart contracts can be labeled as futures contracts appears indeed to be the opinion of the CFTC.¹³

<Securities Regulations_

In the US, securities are regulated by the 1933 Securities Act. Additionally, the 1934 Securities Exchange Act further regulates the trade of securities, and established the SEC to oversee these markets.

Definition of “Security” Amended to Include Digital Asset Security:

First and foremost, Section 3(a)(10) of the Securities Exchange Act will be amended to include a “digital asset security” (and exclude “digital assets”) in the definition of security:

*(10) **The term “security” means** any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, **digital asset security**, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; **but shall not include any fiat currency, commodity, digital asset**, or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.¹⁴*

Digital Asset Security Definition

Next, the Digital Asset Bill (SEC. 101) defines what a digital asset security will be:

“(A) IN GENERAL.—The term ‘digital asset security’ means a digital asset that:

(i) Provides the holder of the digital asset with any of the following rights:

(I) Equity or debt interest in the issuer.

(II) Right to profits, interest, or dividend payments from the issuer.

(III) Voting rights in the major corporate actions (which shall not include new block creations, hardforks, or protocol changes related to the digital asset) of the issuer.

(IV) Liquidation rights in the event of the issuer’s liquidation.

*(ii) In the case of an issuer with a service, goods, or platform that is not wholly operational at the time of issuing such digital asset, with respect to **any fundraising or capital formation activity** (including initial coin offerings) which is accomplished through the issuance of such a digital asset, issues such digital asset to a holder in return for money (including other digital assets) to fund the development of the proposed service, goods, or platform of the issuer.”¹⁵*

What does it mean to be regulated as a security?

Investing in securities in the US is regulated to:

“protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions.”¹⁶

Regulations focus on both the issuing of securities (primary market), and subsequent trade of such securities (secondary market).

The goal of securities laws is firstly to require issuers to fully disclose all material information that an investor would need in order to make up his or her mind about the potential investment. A regulated company must create a registration statement, which includes a prospectus, with copious amounts of information about the security, the company, the business, including audited financial statements.

Next, the subsequent selling and trading in these securities is regulated, by restricting trade to market places over which the regulator has oversight. The Security Exchange Act section §78l(a) states:

“It shall be unlawful for any member, broker, or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security for such exchange in accordance with the provisions of this chapter and the rules and regulations thereunder.”¹⁷

Interpretation Securities Regulations:

- Crypto projects will need to be regulated and provide clear financial information for investors to make an informed decision.
- Trading of securities will generally take place on regulated exchanges.
- Any new fundraising or capital formation activity (including ICOs) are likely to be securities.
- When a crypto is regulated as a security, the entire coin is subject to strict regulations. In the case of commodities, only specific use cases (futures) are regulated. It is a big difference.
- US Congress is taking a leap of faith. It needs identifiable persons to enforce a law upon. Who is going to be held accountable in a decentralized network? Many issuing companies have handed control over to network participants. Perhaps for this reason, Section 12(g) of the Securities

Exchange Act of 1934 will be amended to allow the issuer to apply for “deseuritization.”¹⁸ The question remains: who will apply for deseuritization once a network is decentralized? The investors? Weren’t they the ones supposed to be protected in the first place?

<Changing the Nature of Money_

These regulations are not just about crypto. It is clearly part of a wider discussion on the future of money. As shown below, this bill not only changes the definition of money in the US, but also changes how money is created!

As a first, in Section 5312(a)(3)(B) of title 31, US Code (Money and Finance) digital assets are included as a monetary instrument.¹⁹ However, Section 5103, of title 31, US Code will be amended to specifically exclude digital assets and digital asset securities as legal tender.²⁰ And finally, it is determined that digital assets and digital asset securities will not be covered by Federal Deposit Insurance (FDIC or NCUA).²¹

Introducing the Digital USD

After slamming the door on digital assets to be used as lawful money, the Federal Reserve Act is amended to provide the Federal Reserve Board with far reaching new powers; section 11 will be amended to say:

*“(d) To supervise and regulate through the Secretary of the Treasury the issue and retirement of Federal Reserve notes **(both physical and digital)**, except for the cancellation and destruction, and accounting with respect to such cancellation and destruction, of notes unfit for circulation, and to prescribe rules and regulations **(including appropriate technology)** under which such notes may be delivered by the Secretary of the Treasury to the Federal Reserve agents applying therefor.”²²*

In addition, Federal Reserve notes will in the future also be issued digitally; an amendment to section 16 confirms this:

“Federal reserve notes, to be issued at the discretion of the Board of Governors of the Federal Reserve System for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are authorized. Notwithstanding any other

provision of law, the Board of Governors of the Federal Reserve System is **authorized to issue digital versions of Federal reserve notes in addition** to current physical Federal reserve notes. Further, the Board of Governors of the Federal Reserve System, after consultation with the Secretary of the Treasury, **is authorized to use distributed ledger technology for the creation, distribution and recordation of all transactions involving digital Federal reserve notes**. The said notes shall be obligations of the United States and shall be considered legal tender and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in lawful money on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or at any Federal Reserve bank.”²³

Interpretations, Future of Money:

- The door is shut for the use of cryptos as legal tender.
- The Federal Reserve Board is to be authorized to create and distribute a ledger-based Federal reserve note that could be used for everyday transactions in USD.
- Digital federal reserve notes will make the “recordation” of all transactions possible. Did they use this word because “monitoring all transactions” would be too obvious? Recording all transactions without anyone looking at them makes no sense.
- These amendments significantly increase the power of the Federal Reserve. Contrary to what is widely understood, the Fed does not “print money.” It can only manage the money supply indirectly.²⁴ The private sector “creates” most of what we use as money by issuing credit. It is with the supply of credit by the private banks that the monetary supply is inflated. Conversely, with the reduced demand for credit, the money supply deflates. The FED is not as powerful as it wants the market to believe, and the Federal Reserve Act restricts a lot of its actions. This amendment, however, could drastically expand the authority of the Fed, by allowing them

to create and distribute a Digital Dollar directly. It could change the entire structure of the financial system and potentially have far reaching consequences.

- The original idea behind the Federal Reserve was for private bank deposits to be combined to provide an emergency line of credit in times of economic stress.²⁵ But if the Digital Dollar is based on a blockchain, how can it also be based on reserves? And what mechanism will determine how funds (and how much) are added to the economy? And where and how will they be distributed? What about privacy and security? Will all this authority be handed over to a board of seven unelected bureaucrats? This amendment has the potential to change the way the Federal Reserve operates. This deserves a wider discussion by economists and financial experts outside the crypto-space as well.

<International FATF Crypto Regulation in the US_

Those paying attention to international anti-money laundering legislation know that the following sections from the Digital Asset Bill originate from guidance issued by the FATF (Financial Action Task Force). FATF is an intra-governmental organization creating financial legislation.²⁶

In March, the Paris based FATF issued draft guidance²⁷ (“FATF Guidance”) on a number of topics. And even though this guidance hasn’t been finalized, there are already a number of points directly included in the Digital Asset Bill.

Banning the use of Stablecoins

Subchapter I of chapter 51 of subtitle IV of title 31, United States Code, department of treasury regulation, will be amended, to read as follows:

*“(a) IN GENERAL.—Beginning on the date of the enactment of this section, **no person may issue, use, or permit to be used a digital asset fiat-based stablecoin that is not approved by the Secretary of the Treasury under subsection (b).**”²⁸*

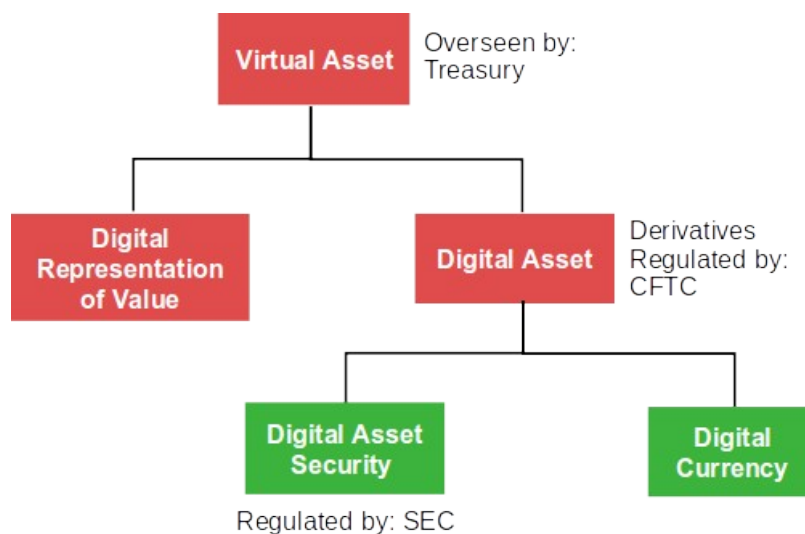
Criminalizing the use of privacy coins and anonymizing services (mixers, coinjoins)

The bank secrecy act is going to be amended to sanction the use of anonymity-enhanced convertible virtual currencies and anonymizing services.²⁹ It is worth noting that willful violations of the bank secrecy act could give rise to a fine of not more than \$250,000, or imprisoned for not more than five years, or both.³⁰

Introduction of the term Virtual Asset Service Provide (VASP) into US Law

As a next step, the term Virtual Asset will be introduced into Section 5312(a) of title 31, United States Code. A Virtual Asset can be a digital asset, or “a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes;”³¹

So far we have seen a number of definitions. To understand their relationship, the following image was made based on the definition of Virtual Asset according to Section 5312(a) of title 31, United States Code:³²



Virtual Asset is a broad definition; it covers most activities involving cryptos. We can see in the Digital Asset Bill that entities that are facilitating transactions in Virtual Assets are to be called “*virtual asset service providers,*” or VASPS. Sec 301 of the Digital Asset Bill defines a VASP:

“ (A) means a person who—

- (i) exchanges between digital asset and fiat currencies
- (ii) exchanges between digital assets;
- (iii) transfers of digital assets;
- (iv) is responsible for the custody, safekeeping of a digital asset or an instrument that enables control over a digital asset;

(v) issues or has the authority to redeem a digital asset; and

(vi) provides financial services related to the offer or sale of a digital asset by a person who issues such digital asset; and

(B) does not include any person who—

(i) obtains a digital asset to purchase goods or services for themselves;

(ii) provides communication service or network access services used by a money transmitter; or

(iii) develops, creates, or disseminates software designed to be used to issue a digital asset or facilitate financial activities associated with a digital asset.”³³

This definition comes directly from the FATF Guidance, with the only difference being that the US excludes the exchange between different forms of virtual assets. On the other hand, section (v) is a new addition.

The Big Picture: Global Regulation

The logic behind this seems to be to first introduce a high-level definition (including coins regulated as commodities, securities, and everything in between). Next, any future global restrictions on the wider crypto-space can be applied at this level.

From the latest FATF Guidance, a number of possible additional restrictions can already be deducted. Things to look out for are the restriction of the use of “*unhosted wallets*,” the introduction of the “*travel rule*,” labeling those who engage in peer-to-peer transactions as a risk, and a whole host of other measures.³⁴

One additional aspect of VASP regulation mentioned in the FATF Guidance is also included in the Digital Asset Bill; VASPs engaged in services which are available in the United States and to United States persons, have to be regulated in the United States, even if the provider is located outside the United States.³⁵

Interpretations International Regulation in the US:

- International AML legislation, created by Paris-based FATF, is being introduced in the US.
- The FATF term “virtual asset service provider” (VASP) is introduced in the US. The definition is so broad that it covers practically all crypto projects.
- After first being in the FATF Guidance, the banning of stablecoins and anonymity-enhanced cryptos and the obligation for VASPs to be licensed in the country of their clients are included in the Digital Asset Bill.
- It is not hard to imagine that other restrictions for cryptos currently discussed by FATF, such as the travel rule and restricting unhosted wallets, will be introduced next. This is not a regulation you introduce to then never use it.
- All VASPs with operating in the US or with US clients need to be regulated in the US.

<Amendments in the Infrastructure Bill_

Last August saw public outcry over the US Infrastructure bill. It included a section on IRS reporting for crypto. Some highlights:

Clarification of Definition of Broker

It makes sense that the tax authorities use a wide definition to cover all possible economic activities in crypto. Section 80603 of the Infrastructure Bill amends the Internal Revenue Code of 1986, provides that brokers need to report the activity of their clients to the IRS and adds the following to the definition of broker:

*“(D) any person who (for consideration) is responsible for regularly providing **any service effectuating transfers of digital assets on behalf of another person.**”³⁶*

Reporting of Digital Assets

In addition, a unique wide definition of digital assets is added:

“any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.”³⁷

Effective Date

Effective after December 31, 2023. So there is time.

Interpretation

There was a lot of commotion about this bill. This was mainly due to the wide definitions used, which could cover all activities in the crypto space, including mining. In response, according to an article on Bloomberg, the U.S. treasury will shortly issue additional guidance, along the lines of the following:

“Other firms key to the nearly \$2 trillion crypto market -- from developers and miners to hardware and software providers

*-- won't have any new requirements, so long as they don't also act as brokers, according to a Treasury official"*³⁸

At a glance, it appears that this bill is not as invasive as originally feared. It would also be impossible to enforce this legislation on miners due to the nature of the technology.

In this case perhaps it would have been better if clear definitions were used of what is, and isn't included. Moreover, comments from "anonymous sources at the treasury" do not provide real regulatory clarity. This industry too easily accepts the opinions of officials as decree. But we are all, including officials, subject to the law. Given that officials change over time, opinions and guidance are not the way forward; clear laws are needed.

The commotion also distracted from the massive changes proposed in the Digital Asset Bill discussed in this paper, which so far have been ignored by the industry.

<About the Author_

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Wesley started his career in finance. He worked as a project controller at Multi Real Estate, a large developer of iconic shopping malls in Europe. He later settled in Dubai where, as a corporate service provider, he assisted entrepreneurs and high net worth individuals with international tax planning and legal structuring.

In 2014, he moved to Asia and started a small consultancy firm. He has since helped hundreds of SMEs, digital nomads, crypto investors and HNWI-individuals with international tax and regulatory challenges.

In 2016, together with a partner he launched a website focusing on explaining specific international tax regulations to a wide audience. Their [blog on transfer pricing](#) is now likely the world's most visited on this topic. He also co-wrote a textbook for students, a training course, and legal templates on the topic. The website and educational materials are published by the boutique tax law firm Thysse de Lange Limited, registered in Hong Kong, of which he is the Managing Partner.

In 2017, he started researching blockchain legal projects, and realized that most of them lacked real-world frameworks. He created the [decentralized legal system](#), a first framework of its kind for Decentralized Law.

Early 2021, he published the [The Crypto Sovereign](#), a unique book on using geo-tax-arbitrage to optimize your taxes, protect your assets, and increase your liberty by moving across borders.

Wesley holds a Master's degree in Management from the University of Greenwich, London.

Contact me:

If you are worried about what FATF regulations mean for you or your project, wish to discuss this topic on your blog or podcast, or need the opinion of someone who is at the forefront of crypto regulations, feel free to contact me:

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