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by Lee A. Sheppard

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by Lee A. Sheppard

Yes, every six months or so we write an article about proposed laws to govern crypto. Congress is finally getting around to doing something, but that something might not be good policy.

Young people want to bring the '90s back. They've all been watching a miniseries streaming on Hulu about the tempestuous relationship of John F. Kennedy Jr. and his wife Carolyn Bessette, the Calvin Klein employee. Yup, cocaine binges and public arguments are the stuff of true love! Bessette wasn't well dressed and Calvin Klein was at that point selling underwear to teenagers. Calvin Klein, which is somehow still in business, was caught flat-footed by the show's popularity and missed a merchandising opportunity.

Gen Z is in love with '90s fashion that prevailed before they were born. Nostalgia for that halcyon era runs so deep that one scented candle company offers a scent called Lola at Coat Check. The trouble is that '90s fashion really wasn't that good. Young people are coveting ill-fitting minimalist clothes that are hard to wear and unflattering, like slip dresses and hip-slung pants.

New designer Matthieu Blazy's Chanel is the world's hottest brand, according to Lyst, which tracks such things. This is not a judgment on the merits. Blazy's subway station show was terrible, but some items sold out. Fashionistas love the Chanel maxi flap bag.

Colors. Color, color, color! The '90s were colorless, but bold color is back: fuchsia, tomato red, lemon yellow, bright violet, royal blue, lime green, emerald green, and blush pink.

'90s hip-slung pants and skirts. These do not even work on the skinny. Size down and wear them higher on the hips.

Bags. Big hardware is sneaking back onto bags, but the last time we had bags with heavy hardware, we didn't have 12 heavy electronic devices to carry in them.

Windbreakers. What? How are windbreakers fashion? You wear a windbreaker when you need a windbreaker, like on a sailboat. We now have fashion versions. Rule No. 1 of sportswear as fashion: Buy the real deal at the sporting goods store. It will last longer and actually achieve its purpose, like keeping the rain and wind out for a windbreaker.

Tropical things. Camp shirts, sarong skirts, harem pants, and barrel-leg trousers are for the thin. Men hate ballooning pants.

Marabou. No, just no, even though big names wore it at the Met Gala. *The Rocky Horror Picture Show* is being revived in an upcoming Broadway musical based on the cult movie. Dr. Frank-N-Furter will be entertaining a new generation of fans at Studio 54.

Single-breasted car coats. They can be dowdy, but they are very handy, not just for getting in and out of cars. Realistically, long, sweeping coats shown on runways are not practical anywhere, nor are the thin trenchcoats of which fashionistas are so fond.

Lingerie as clothing. Maybe for nightclubs, not in office settings.

Makeup. Coral for blush and lips. Also matte rose pink lips, matte foundation, and lip stains. We love Colorescience, which makes heavy-duty sunblock that works like sophisticated makeup.

Flat retro sneakers. Um, why? The point of sneakers/trainers/undifferentiated gym shoes is to pad the wearer's feet on the pavement, gym floor, or other hard surface. Flat sneakers are only a marginal improvement on ballet slippers for purposes of personal mobility.

Jewelry. Big, bold jewelry, including costume jewelry and polished silver jewelry. If you can't see it from 10 feet away, it's not au courant.

Matthieu Blazy reorients Chanel. (Franck Castel/ZUMAPRESS/Newscom)

Sloppy, big men's shirts. These look cute when you're 20. Not when you're 55. Like wearing a single earring, you don't want to look like you're having a senior moment.

The fashion in crypto is for Congress to bless industry practices, which are less than transparent. Cryptoassets are mostly investment assets. Americans validly complain that their elected representatives can't pass necessary legislation, but they even dither with industry-favorable legislation. This article is about crypto enabling bills for taxation and market structure legislation.

When we last visited crypto market structure, two things were holding up legislation. The first and most important was the battle between the banks and the crypto bros about whether stablecoins, which have been enabled by the Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS Act) (P.L. 119-27), can pay yield. The second was the impropriety of the Trump family and associates dabbling in crypto ventures other than silly meme coins.

There's a compromise on stablecoin yield that no one is happy about, enabling the Senate Banking Committee to report out its version of the Digital Asset Market Clarity (CLARITY) Act of 2025 (H.R. 3633), which the House passed last year. The centerpiece of the bill is giving jurisdiction over most cryptoassets to the Commodity Futures Trading Commission. (Prior analysis: *Tax Notes Federal*, Nov. 24, 2025, p. 1207.)

The Senate Banking Committee minority noted that Iran is accepting bitcoin as payment for passage through the Strait of Hormuz, an indicator that crypto is becoming an accepted alternative payments system easily exploited by foreign adversaries, terrorists, and criminals. A bipartisan review of U.S. anti-money-laundering rules concluded that they may be ill-equipped for the challenge. The minority criticized the CLARITY Act for failing to update these rules and exempting decentralized finance (DeFi), which includes mixers like Tornado Cash. Proponents of the CLARITY Act argue that it subjects centralized exchanges that interact with DeFi to anti-money-laundering rules.

On the tax side, the crypto bros' wish list has been introduced as a bill, the Digital Asset Protection, Accountability, Regulation, Innovation, Taxation, and Yields (PARITY) Act. Some of the provisions would have a revenue cost, so the bill's big pay-for is making cryptoassets subject to the wash sale rules. House Ways and Means Committee Chair Jason Smith, R-Mo., is looking for bipartisan support. The bill is loaded with definitions and concepts that not only don't coordinate with the CLARITY Act, they also don't seem to map onto actual usage in crypto world.

As this article was being written, investor Mark Cuban dumped his bitcoin holdings, arguing that the narrative is not holding up. He no longer believes the assertion that bitcoin is a hedge against depreciating fiat currencies, citing

bitcoin price fluctuations during the Iran war. "I always thought bitcoin was a better version of gold than gold. Well, gold just blew up. . . . Bitcoin dropped," he said, retracting his previous argument that bitcoin's limited supply made it a stronger store of value than gold. "Not the hedge I expected it to be, and that was really disappointing, and so I'd say I'm more disappointed in Bitcoin . . . garbage," Cuban said (*CryptoProwl*, May 22, 2026).

The FDIC and Treasury proposed regulations implementing the GENIUS Act, which requires 1-to-1 reserves for stablecoin issuers. FDIC-insured banks are allowed to issue stablecoins through subsidiaries, so FDIC rules will accommodate the new technology with rules similar to those of the Office of the Comptroller of the Currency (OCC) (91 F.R. 18534 (Apr. 10, 2026)). Treasury issued a notice of proposed rulemaking to establish principles to determine whether a state regulatory scheme is substantially similar to the federal regulatory scheme of the GENIUS Act, with the proposed OCC framework being used as the benchmark (91 F.R. 16844 (Apr. 3, 2026); and 91 F.R. 10202 (Mar. 2, 2026)).

President Trump signed an executive order facilitating fintech access to Fed payment systems (EO 14405 (May 19, 2026)). The order directs federal financial regulators to streamline regulatory processes for fintech. It orders the Fed to evaluate the legal, regulatory, and policy framework for access to Fed payment accounts for uninsured depository institutions, nonbanks, and digital payments processors. Readers will recall that payments processors made a big pitch for blockchain handling of payments.

Tax Bill

Only stablecoin would be removed from the barter rules. Cryptoassets would be brought into wash sale, short sale, constructive sale, and mark-to-market rules applicable to securities.

People who buy coffee with bitcoin would still be under the barter rules. The previously proposed "personal use" crypto de minimis exception does not appear in the bill. The PARITY Act's exemption from gain or loss would apply only to payment stablecoin transactions. It would operate by deeming a GENIUS-compliant stablecoin to have a $1 basis, unless the taxpayer's basis is less than 99 cents (proposed section 1046). Dealers and traders would not be eligible for this treatment. The drafters opted for a study of the burden on consumer transactions. But the bill would not turn off broker reporting on stablecoin transactions, which benefit from a $10,000 aggregate reporting exemption under tax regulations (reg. section 1.6045-1(d)(10)). (Prior analysis: *Tax Notes Federal*, Feb. 10, 2025, p. 1001.)

> ***Cryptoassets would be brought into wash sale, short sale, constructive sale, and mark-to-market rules applicable to securities.***

Digital asset would be defined as "a digital representation of value which is recorded on a cryptographically secured distributed ledger" (section 7701(q)(1)). The same definition appears in the CLARITY Act, and it is a bad thing that we can't just get a single definition in one place in the U.S. Code. It feeds the incorrect view that the IRS makes its own determination what is a security or commodity, rather than following securities or commodities rules. The PARITY Act's diverging definitions are intended to slot crypto into tax rules originally meant for publicly traded, transparently priced investment assets.

Digital asset exchange would be defined as "a platform which facilitates the transfer of digital assets by taking custody of, or exercising control over, such assets on behalf of users" (section 7701(q)(2)). That definition doesn't describe an exchange, which matches buyers with sellers and discovers prices. The proposed definition is sufficiently loose that it could encompass DeFi platforms because it does not require any exchange functions, financial regulation, or a human element.

A traded digital asset would be defined as a digital asset that functions as a medium of exchange but does not represent a claim on any money, security, or commodity (section 7701(q)(5)). Contrary to the nomenclature, a traded digital asset would not have to be publicly traded or reliably priced. It need only be traded on a digital asset exchange, which as defined by the bill would just be a platform. This definition is relevant for the bill's proposed trading safe harbor for digital assets, which would shelter crypto

traded on a digital asset exchange (proposed section 864(b)(2)(C)(iii)). In reality, it would make most crypto trading eligible for the safe harbor.

That would be contrary to the intent of the current commodities trading safe harbor, which is restricted to commodities "of a kind customarily dealt in on an organized commodity exchange," meaning a CFTC-designated contract market. There are no transparent, reliable public prices for cryptoassets not currently traded as futures or as exchange-traded funds. There are private prices that punters may choose to accept. Big platforms make markets out of their own inventories — essentially private pools running on blockchain technology. Most crypto is traded this way; there is no one big public blockchain with transparent pricing.

> ***Failing to require functional financial regulation is a public policy decision that Congress is about to make, stepping into the unknown.***

Under the PARITY Act, an eligible digital asset would be defined as a fungible, publicly priced, exchange-traded digital asset that functions as a medium of exchange — basically bitcoin, ethereum, and the few other actively traded cryptoassets (section 7701(q)(4)). The point is to define a fungible cryptoasset. Digital representations of equity, debt, or other financial instruments would be treated as the underlying assets and not as cryptoassets. The CLARITY Act contemplates tokenized securities. SEC Chair Paul Atkins is a big fan of blockchain recordkeeping and settlement for investment assets.

The eligible digital asset concept would be relevant to the extension of the short sale rule to cryptoassets, so crypto loans could be satisfied with identical assets and not the precise cryptoassets that were borrowed (proposed section 1058(c)). Substitute payments for staking rewards, transaction fees, protocol distributions, or other amounts would be included in the gross income of the lender as if directly paid (proposed section 1058(d)). The bill does not address term loans of cryptoassets. (Prior analysis: *Tax Notes Federal*, Apr. 18, 2022, p. 335.)

Cryptoassets would be brought under the wash sale rules by the addition of digital assets to the new list of specified assets, which would also include contracts and options on specified assets (proposed section 1091(g)). Treasury would be empowered to write rules deeming an asset to be substantially identical on the basis of its economic exposure, but not merely because it is based on the same protocol (proposed section 1091(h)). Losses on successive short sales of specified assets would be disallowed (proposed section 1091(e)). Crypto bros have their panties in a twist about becoming subject to the wash sale rules, but no one should have been able to take a return position allowing a loss on crypto traded as futures. (Prior analysis: *Tax Notes Federal*, May 18, 2026, p. 1071.)

Wash sales are estimated to account for at least half of the trading on crypto platforms. A wash sale on a private platform that the bill calls an exchange would have losses disallowed. That is what the PARITY Act says. The wash sale rule doesn't care where the taxpayer made the trade. It merely requires a "sale or other disposition." The philosophy appears to be that if the taxpayer is prepared to live with private pricing, the tax law will accept it as well and disallow the loss. Even if the taxpayer makes the purchase and sale on different platforms, the wash sale rule would apply under regulations to be written (proposed section 1091(h)(1)(C)).

An actively traded digital asset would be defined as a fungible digital asset with minimum trading volume of $50 million for two years and minimum market capitalization of $10 billion for three years (section 7701(q)(3)). The taxpayer interacting with it cannot own more than 5 percent. Treasury is supposed to refine the definition, which would be relevant for the extension of the mark-to-market requirements to digital assets.

Dealers and traders of actively traded digital assets could elect to mark them to market (proposed section 475(g)). Treasury would have authority to make regulations to implement this provision. The law currently forces securities dealers to mark their inventories to market but does not force any nondealer holders to do so. Many cryptoassets, like bitcoin (BTC) and ether (ETH), are the subject of regulated futures

contracts, and those contracts should be marked to market under current law (section 1256).

Nonetheless, policymakers might want to think about forcing all crypto holders, even those that are not dealers or traders, to mark their crypto to market, because it is just too easy to transact in crypto and too easy to hide that fact. Punters can pop their crypto onto a DeFi platform and surreptitiously transact without any recognition or disclosure.

"We're never going to get practical rules on what constitutes a section 1001 event in crypto," said Jason D. Schwartz of CahillNXT. "Wrapping, bridging, liquidity provision, liquid staking tokens, governance tokens, and vaults confound all practitioners. Moreover, many crypto tokens effectively represent business income (e.g., protocol fees) that has been transferred out of corporate solution, meaning the income is not taxed currently and, when taxed, is taxed only at capital gains rates."

> ***Holders put their crypto onto DeFi protocols to accomplish feats that could be tax recognition events if done with a counterparty or intermediary.***

Marking cryptoassets to market annually would obviate the effort of having to identify when they have changed form, such as being put in a wrapper, or looking through to the underlying asset when they have been deposited, such as being put in a vault, or even having to ask questions about what indecipherable programmatic actions have been taken with them. Schwartz gave examples of DeFi transactions. Holders put their crypto onto DeFi protocols to accomplish feats that could be tax recognition events if done with a counterparty or intermediary.

Putting crypto into a vault is a common DeFi transaction. The vault programmatically allocates the deposit among various yield-generating strategies and rebalances them according to parameters set by the vault programmer, who is called a curator. A vault might issue receipt tokens representing the user's deposit plus accrued yield that can be deployed for other transactions. "In theory, vaults should be looked through to all of the stuff going on inside, and users should get Forms 1099 or K-1 if the vault were a person," Schwartz observed, noting that looking through is practically impossible. "So everyone just reports them as open transactions with capital gain or loss at the end, if they report at all."

Ethereum, which is publicly traded as ETFs and as futures, must be transformed to be staked or used with smart contracts. So it is common for holders to exchange ETH for wstETH or solana for jitoSOL. In each case, the new token is a tokenized representation of a staked position, and the associated staking rewards are automatically put up for staking again. "Again, look-through is the right approach in theory but it's impossible for anyone to figure out how to do that, because there's actually a lot going on under the hood," Schwartz observed.

What if the cryptoasset in question is a governance token? HYPE is the governance token for the Hyperliquid protocol, a perpetuals platform. Hyperliquid uses nearly all of its collected fees to repurchase and retire HYPE tokens, which essentially represent accrued fee income. This token burning has the effect of converting current ordinary fee income into deferred capital gains. No one appears to be paying current tax on the fee income because Hyperliquid is a protocol, not an entity.

"If we want to keep the tax base from being eroded by all this stuff, we need to dramatically rethink how we tax crypto," Schwartz said. "Adopting a mark-to-market regime for investors eliminates the need to even deal with the question of *when* you have a realization event. As long as you stay in crypto, it doesn't matter, because you'll have to mark at the end of the year anyway. The technology moves too fast for the IRS to come up with rules on how each new innovation is taxed."

The problem, of course, would be pricing. Would we only mark actively traded digital assets? All these tax rules were meant for assets with reliable, public pricing. Most of the many cryptoassets are privately traded on nontransparent platforms where prices can be manipulated. Is the tax law prepared to live with marking to unreliable pricing? The debate over the broker reporting rules demonstrated that DeFi will not be required to cooperate.

The bill would extend the constructive sale rules to digital assets, without limiting it to actively traded cryptoassets. But those rules haven't proved to be fit for purpose for the assets that are currently covered (section 1259). The drafters didn't bother to reexamine those rules, which were intended for caps and collars, but they might be usefully redirected at DeFi tactics. The extension is a short addition that seems like a throwaway.

The bill would provide for elective deferral of staking rewards. Staking validators could elect not to recognize income on the acquisition of block rewards, but if they dispose of those rewards within four years, they must recognize ordinary income, and costs of validating would be capitalized into basis (proposed section 1400W-2). This election would not apply to the receipt of transaction fees, such as gas fees, so those presumably would still be taxed as ordinary income when received. The assumption appears to be that those fees are received by staking professionals. Only if the validator recognized the rewards currently would basis of staked assets be increased by rewards (proposed section 1400W-1).

Passive staking would not be treated as a trade or business for foreign or tax-exempt stakers (sections 512 and 864; proposed section 7701(p)(1)). A passive validator for this purpose would be one that incurs no deductible business expenses (proposed section 7701(p)(1)(B)(ii)). Thus, staking professionals working as agents for the owners of staked cryptoassets would not be eligible for this treatment.

Grantor trusts would be allowed to stake and compound staking rewards without jeopardizing trust treatment. The bill states that "any power held by the trustee to stake or unstake digital assets, whether directly or through delegation to another party, and to perform any related acts to exercise such power to stake, including the retention of staking rewards, shall not be treated as a power under such trust agreement to vary the investment of the certificate holders" (proposed section 7701(p)(2)(A)). (Prior analysis: *Tax Notes Federal*, June 23, 2025, p. 2217.)

Actively traded digital assets would be treated as readily valued property for charitable donation purposes (proposed section 170(f)(11)(A)(ii)(I)). New rules would be established for charitable contributions of infrequently traded cryptoassets. No deduction would be allowed to the donor unless the donation is substantiated in detail and in writing by the donee. The deduction cannot exceed the proceeds of the donee's subsequent sale (proposed section 170(f)(20)). There would be a hefty new donee penalty for a fraudulent acknowledgment of crypto donations (proposed section 6720D). (Prior analysis: *Tax Notes Federal*, Mar. 23, 2026, p. 1997.)

Market Structure Bill

The CFTC would have the primary role in cryptoasset regulation, with exclusive jurisdiction over futures and spot markets in digital commodities.

Failing to require functional financial regulation is a public policy decision that Congress is about to make, stepping into the unknown. Under the CLARITY Act, private platforms and DeFi would not be regulated as exchanges. The platforms perform broker-dealer, exchange, market-making, clearing, and custody under the same roof, creating a steaming pile of conflicts of interest. The platforms satisfy orders from their own inventory and execute on their own private blockchains. The Gensler SEC went after the platforms for failure to register these functions. The Trump administration settled the cases. The CLARITY Act would legitimize these multi-function structures. (Prior analysis: *Tax Notes Federal*, Apr. 8, 2024, p. 227.)

The CLARITY Act would pick up the GENIUS Act definition of digital asset as "any digital representation of value that is recorded on a cryptographically secured distributed ledger." A digital asset service provider is a person that, for profit, exchanges digital assets for money or other digital assets, acting as custodian, and participating in services related to issuance. It does not include a distributed ledger, self-custodial software, staking validation, or liquidity provision. A distributed ledger is supposed to be public (12 U.S.C. section 5901). Under the CLARITY Act, a digital asset intermediary would be one required to register with the CFTC or the SEC.

Digital commodity would get a statutory definition in the House-passed version of the CLARITY Act as a "digital asset that is intrinsically linked to a blockchain system, and the value of which is derived from or is reasonably expected to be derived from the use of the blockchain system" (proposed 7 U.S.C. section 1a(16)(F)). Intrinsically linked means that blockchain is used for transfer, access to services, governance, repurchase, mining, and validation. Digital commodity does not include securities, other commodities, bank deposits, derivatives, payment stablecoins, pooled investment vehicles, or collectibles.

But how do we know when a digital commodity is not a security? Should issuers be able to argue the point with the SEC? Should issuers be able to argue that they've stopped making entrepreneurial efforts to make the cryptoasset valuable? The Senate version of the CLARITY Act would let cryptoassets issuers have a prove-out.

In the Senate version, CFTC primacy would be achieved in a roundabout way by giving issuers an opportunity to prove to the SEC that their cryptoassets should not be treated as securities. An ancillary asset would be a network token whose value is dependent on the entrepreneurial or managerial efforts of others (the *Howey* test) (proposed section 4B(a) of the Securities Act of 1933, 15 U.S.C. section 77d-1). It would be up to the issuer or the platform to demonstrate otherwise to the SEC. State blue-sky laws would be preempted, but not state fraud laws.

A network token would be a digital commodity linked to a distributed ledger and reasonably expected to derive its value from that linkage. It would not be treated as a security unless it was an investment contract, an interest in an investment company, or a participation in an agreement that is functionally equivalent to debt or equity or has liquidation rights, dividends, interest, or a financial interest in an entity or partnership. Governance tokens wouldn't count in the security analysis.

There would also be a concept of "gratuitous distribution," which would encompass self-staking, self-custodial staking, liquid staking, programmatic distributions, and associated services defined in regulations. If an ancillary asset wasn't gratuitously distributed on a public distributed ledger, it would be a security unless the issuer proves otherwise to the SEC (proposed 15 U.S.C. section 77d-1(b)). So under the Senate bill, security classification would turn on either the *Howey* test or the mode of distribution (*SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)).

> ***Security classification would turn on either the* Howey *test or the mode of distribution.***

Ancillary assets would be rebuttably presumed to be securities, but the presumption could be rebutted by a presentation of reasonable evidence to the SEC by the originator or an intermediary that it is not an ancillary asset (proposed 15 U.S.C. section 77d-1(b)(5)(A)(i)(I)). The originator or an intermediary would be allowed to certify to the SEC that entrepreneurial or managerial efforts to pump the asset have ended, so that the assets are not securities. If a court previously ruled that an asset is not a security, the SEC cannot come back and say that it is. The bill would require the SEC to adopt rules that a network token is not a disqualifying financial interest when the market value of the asset is primarily derived from a distributed ledger system.

The Senate bill acknowledges and supports the SEC's current work on a Regulation Crypto Assets framework that would exempt from registration some ancillary assets sold as part of an investment contract. Industry standard ERC-3643 would be the regulatory model. Reg Crypto would be intended to allow issuers of ancillary assets to reach retail investors quicker. The offering would be limited to $200 million, calculated as the greater of 10 percent of the dollar value of outstanding ancillary assets or $50 million per year over a period of four years. The issuer must comply with annual and semiannual disclosure requirements. Insiders, to whom current insider trading laws would apply, would be limited in the amount of ancillary assets they could sell over a 12-month period. The SEC would be empowered to make exemptions and allow blockchain recordkeeping. Cryptoassets treated as commodities would not be covered by the

Securities Investor Protection Act of 1970 (15 U.S.C. section 78aaa *et seq.*).

The Senate stablecoin yield compromise is that the CLARITY Act would prohibit covered digital asset service providers and their affiliates from paying U.S. customers passive, depositlike interest or yield on payment stablecoin balances. It would allow bona fide activity or transaction-based rewards that are not the functional equivalent of interest, under joint rules to be issued by the SEC, CFTC, and Treasury. So platforms could establish rewards but couldn't create stablecoin money market funds. Issuers were already prohibited from paying yield, so the platforms had what the banks saw as a loophole. The prohibition on interest would be in the bill, not the U.S. Code (section 404 of the CLARITY Act).

Brokers, dealers, and platforms would become subject to the Bank Secrecy Act, and crypto would be added to the definition of monetary instrument (31 U.S.C. section 5312(c)(1)(A)). Treasury and bank regulators would be directed to establish risk-based standards and anti-money-laundering compliance for financial institutions involved with crypto. A pilot program would let them share information with the federal government about finance violations and risks. There would be a study of criminal activity with crypto and a Treasury report on mixers. Stablecoin issuers and service providers would be relieved of liability for putting on a temporary hold at the behest of law enforcement. But what about those crypto ATMs at the grocery store? The bill would establish a regulatory regime with transaction limits and fraud prevention measures.

The CLARITY Act would indulge the fable that DeFi is just software released into the wild. The bill refers to DeFi as "a decentralized governance system," defined as a transparent, rules-based distributed ledger system permitting persons to form consensus on development, administration, and other things, but which is not controlled by any person or group under common control. The system and its controlling persons would be treated as separate unless they are acting in concert or pursuant to an agreement. Importantly, a decentralized governance system could be a legal entity with no centralized management. Delegated administrative authority would not be considered centralized management (proposed 15 U.S.C. section 77b(a)(24)).

> ***The CLARITY Act would indulge the fable that DeFi is just software released into the wild.***

As we have discussed, although it is programmatic, DeFi has human babysitters and human investors in the background. So the bill would establish criteria for when DeFi has been released into the wild, focusing on control, discretion, or the ability to alter or censor protocol operations. Under the bill, a blockchain need not be decentralized in fact — it would be sufficient that its creators intend it to be decentralized while running it for four years. An issuer, blockchain, or decentralized governance system could become mature if the developers let their software operate itself. Once matured, a blockchain could certify to the SEC that it is mature and decentralized, creating a rebuttable presumption of eligibility for decentralized status, which the SEC could challenge and the blockchain could appeal. It would then escape SEC registration and reporting (proposed 15 U.S.C. section 78a(42)(a)).

How's that again? Freedom from SEC regulation would hinge on control. The bill would say that decentralized governance systems alone would not constitute a person or coordinated group for purposes of determining retained human control over the protocol, as long as no single actor has unilateral or practical control. But then the bill would also direct the SEC and Treasury to figure out how to interact with the humans in charge. There would be a voluntary cybersecurity program for DeFi protocols.

Treasury would likewise be directed to issue anti-money laundering guidance for U.S. based front ends. Front-end services are an interface layer through which punters reach DeFi platforms. Digital asset intermediaries would be responsible for risk management and money laundering controls before putting anything on a DeFi protocol. The SEC, CFTC, and Treasury's Financial Crimes Enforcement Network and Office of Foreign Assets Control would make rules and conduct examinations. Federal agencies would not be able to prohibit, restrict, or impair

the ability of someone to use a self-hosted wallet. (Prior coverage: *Tax Notes Federal*, Feb. 10, 2025, p. 1001.)

How viable are some of those crypto platforms, anyway? FTX holders were bailed out and Sam Bankman-Fried jailed on the view — not substantiated by any laws or formal contract terms — that cryptoassets deposited with FTX were customer assets in bankruptcy. The CLARITY Act would formally treat deposited crypto as customer assets in a chapter 7 liquidation (proposed 11 U.S.C. sections 741(1)-(5), 761). Customers would be able to recover crypto as if it were cash (proposed 11 U.S.C. section 746(b)). Worse, there would be an insolvency safe harbor for crypto commodity transactions, which would be deemed derivatives, so that counterparties could close them out without being blocked by the automatic stay (proposed 11 U.S.C. section 561(1)-(2)).

Some of what the CLARITY Act would do is already in place administratively. The CFTC considers any nonsecurity cryptoasset other than a stablecoin to be a digital commodity because it could meet the statutory definition of commodity (7 U.S.C. section 1a(9)). "A digital commodity is a crypto asset that is intrinsically linked to and derives its value from the programmatic operation of a crypto system that is functional, as well as supply and demand dynamics, rather than from the expectation of profits from the essential managerial efforts of others," the CFTC said a March interpretive release. The CFTC says that digital commodity may be native to a DeFi platform (RIN 3038-AF67, 91 F.R. 13714-13733 (Mar. 23, 2026)).

In March the SEC and CFTC issued an interpretive release anticipating market structure legislation about when cryptoassets should be treated as securities. The agencies agree that some actively traded cryptoassets are not securities and are digital commodities because they are not investments in a business: Aptos (APT); Avalanche (AVAX); Bitcoin (BTC); Bitcoin Cash (BCH); Cardano (ADA); Chainlink (LINK); Dogecoin (DOGE); Ether (ETH); Hedera (HBAR); Litecoin (LTC); Polkadot (DOT); Shiba Inu (SHIB); Solana (SOL); Stellar (XLM); Tezos (XTZ); and XRP (XRP). Most of these are traded as futures contracts.

The release establishes a five-part taxonomy for cryptoassets based on their characteristics, uses, and functions. Regulated stablecoins, digital commodities, digital collectibles, and digital tools are not securities. The release discussed how a cryptoasset could become an investment contract or cease to be one. It said that mining, staking, airdrops, and wrapping do not constitute the issuance of securities. (SEC Release Nos. 33-11412 and 34-105020; File No. S7-2026-09 (March 17, 2026).) ■