

TECHTalks | EPISODE 2 | DISSECTING DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOs)

With Robert Massey, Partner, Deloitte Tax LLP and Global Blockchain Tax Leader

Raquel Buscaino: When it comes to Blockchain, it can be easy to get lost in the blizzard of buzzwords. Between crypto, and Non-Fungible Tokens, and decentralized finance, there's a lot to talk about, but today we'll hone in on one specific topic - DAOs, or decentralized autonomous organizations. On today's episode, I've invited Deloitte's Global Tax Blockchain Leader Rob Massey to show us, as we chat about DAOs - what they are, how they work, and - crazy enough - how we might think about taxing them.

Rob, thanks so much for joining us today. We have quite a bit of ground to cover but to start us off, can you please share a little bit of background on who you are, and what inspires you to talk about DAOs, or decentralized autonomous organizations with us today?

Rob Massey: DAOs are the next new thing, and it's been a new thing for a little bit, but they've evolved. What inspires me to talk about it? I have been working in Blockchain and digital assets for a decade now. I was the first person at Deloitte to start serving in the space.

It started with distributed ledger technology, DLT, and then there was the use of digital assets, and then we had DAPS "Decentralized Applications, and now we have DAOs, Decentralized Autonomous Organizations. So it just feels like the next step in the continuum. But what's helpful is to have a decade of industry examples and protocols and watching this continuum grow, that helps me understand what these topics mean, what do they do, and then put the tax lenses on it, put the accounting lenses on it, put the risk lenses on it.

To be clear. I am not a coder but hanging out on edge tech topics for 10 years helps me understand what this stuff really is.

Raquel Buscaino: You mentioned a couple of acronyms and I think that's part of the game here but, Rob, as simply as you can, what is a DAO? What makes DAOs different? Is it just an evolution in the nomenclature, or is it an evolution in how we're using the technology and where the activity is happening?

Rob Massey: It is definitely an evolution, and the evolution that inspires a DAO and what is different in my mind, is that we think about them as a collection of smart contracts enabling actions, and the smart contracts that govern a DAO, sometimes that stack of smart contracts and the dependencies they're in is enough to allow the DAO to operate as almost like a self-executing organization, and sometimes there are other human interactions that it needs to operate.

And that's why you start hearing the phrasing of "decentralized autonomous organization". Well, they're decentralized because they live on a decentralized Blockchain protocol. They're autonomous because many of the actions that they're enabled by are smart contracts, and they don't require much, if any, human interaction.

But that's the fiction right? They feel like an organization but living in the year 2023, it's not a year that you can be a "nothing-nowhere". An organization in our world means that you should probably be attached to or represented by, a legal entity of some kind, and this begins the complexity. When you have an application built on a protocol that's decentralized, that's one thing but when that application has transactions and holds property of some kind, and uses that property in transactions, you can't be a nothing nowhere. You need to be a "something somewhere".

What is meaningful about the DAO - this goes beyond the technology - is the fact that it holds property. That's what's different about a decentralized application. Decentralized software, we have had that for decades. Now that our decentralized software is taking on actions and executing, based on external dependencies, executing transactions and holding property, that's different. And that's why it's difficult to say "It's a nothing-nowhere".

In my opinion, you need to have some representation in the "meat space".

Raquel Buscaino: And what could property be? I mean, I'm thinking, you know Property = "House". I know that's not the extent of it. So what constitutes property?

Rob Massey: It's a great question. Well, today, the property that I'm referring to is digital assets. It's going to be stable coins. It's going to be mainstream crypto. It's going to be programmable crypto. Also now, we have a tokenized property. When real life property is fractalized and tokenized and held in a DOA.

Raquel Buscaino: Are all DAOs created the same? Because you hear about so much activity happening in this space. There's some DAOs that are for social good, there's some that are for investing. What are the different types? What kinds of activity are you seeing in the space?

Rob Massey: There definitely is a lot of variability, and there's a continuum though, some of them are very autonomous. Some have a lot of autonomy, but a little bit of human interaction all the way down to where there's some smart contracts, but with like a lot of human interaction or human dependencies there. So not all DAOs are created equal.

You find some that are purely designed by and enabled by smart contracts and then a voting mechanism by those who hold governance tokens to decide on actions. And once those decisions have been made, then the actions self-execute. Many of them have components which do have a sort of a governing function of humans saying: "If this proposal in this vote goes down a path that seems inappropriate or illegal" then there may be a governing body to override, and not allow that proposal to actually go forward. So there is variability in what DAOs do, but also how they're organized.

You mentioned a few of them. There's investment DOAs that feel a little bit like an investment fund. What's different here is asking "Do these governance token holders really have the right to those funds, much like an owner of an equity fund in the first place? There are art DAOs that own the tokenized rights to real assets in our world. You also see protocol DAOs that have treasuries, and have a governing body with a DAO that's attached, that maybe collects fees from a protocol, and then uses the collection of fees in a treasury to deploy those funds to grant recipients right? Grant recipients receives the funds so that they can build something on top of the protocol, thereby promoting the ecosystem and its growth.

So it becomes a mechanism for the token holders and the governance function to agree on what grants should be awarded, and then deploy those funds.

It is interesting how quickly everything has evolved and the use cases for DAOs are increasing rapidly. Still, there are a lot of unanswered questions from a regulatory standpoint, and to achieve levels of regulatory compliance in this space is challenging. Imperative that when you are iterating on any protocol issuance, but particularly among DAOs, what you're designing, and what you're validating from a legal context must match the technology. You can't just put something in legalese to say that it's right. What's described in legalese must match what's happening in the technology. If there's not a reconciliation between legal and code, you haven't solved it. The technologists have to work with those of us with a regulatory lens.

Raquel Buscaino: I'd like to talk more about those token holders you mentioned earlier. Are they completely anonymous or are there instances in which their identities are known?

Rob Massey: Frequently it's a mix. There are token holders which are anons, take great pains to not disclose their identity. And there's a bunch out there that are doxed [Note: disclosure of identifying information about someone online], not uncommon any more for public entities or for investment funds to make investments in governance token, either because they think they're going to appreciate in value, hold them as investment, or because they want to have some influence on the proposals. They're going to build the DAO to create synergies for their ongoing enterprise and you're going know when a public company invests, because they're not going to take as many actions to hold their own identity.

Raquel Buscaino: It feels like we're talking about almost 2 different worlds here, and you mentioned it earlier: "You have to be a something somewhere." How does the activity investment, specifically as it relates to taxes connects into the real world?

Rob Massey: When I use the phrase: "you're something somewhere", that means a DAO should either be formed and wrapped, some would say "wrapped", in a corporation or an LLC, because if you don't, then a regulator may cast you as one, and then the token holders who have something that feels akin to equity sometimes could be recast as owning equity, and then be on the hook for the income created.

So isn't it better to have an entity that is an appropriate representative of the DAO, either holding the assets, or at least being the representative to recognize the income, or if it's taxable, or do some bookkeeping, or be compliant from an

informational reporting standpoint, or coming outside of the tax lens, what about general “Know Your Customer” rules and anti-money laundering? What about having a legal representative that can put in place a “kill switch” if it looks like the deployment of funds might go to an entity that could be sanctioned? So when I talk about needing to be a “something somewhere”, it's having a governing function in an entity that represents the DAO in some form that helps keep them in line.

Raquel Buscaino: And then from a global landscape, I'll be honest. I don't even know what question to ask but what are the global implications, the questions especially, that clients have about this?

Rob Massey: So there's a lot of questions but start with this concept: If you have a DOA that maybe isn't represented by an entity, then there's questions from different jurisdictions about “okay, where does it attach, naturally?” And you're going to go to either the token holders, or to the grant recipients, or anywhere where those humans or enterprises are identified. Then those jurisdictions may have a right to tax it or to impose other broader regulatory rules. What about money transmission? What about Anti-Money Laundering rules? What about securities laws? Without a legal framework to govern the transactions, then they could be relatively exposed.

The other end is the governance token holder: “If it isn't a DAO that has legal representation and I'm a token holder, then what does that mean to me?” “I know I have a vote, is it an explicit right or is it an implicit right?” “Do I have rights and obligations in the property inside the DAO?” That starts to feel like it could be recast as an entity.

And so, what we see now are people trying to take charge and say, “No, no, here's what the DAO represents, here's the legal entity that represents it, and thereby, the legal framework which it could be governed by. In the US and outside the US, there are different rules that govern what level of attachment, or what level of activity would it take to be drawn into that jurisdiction. Sometimes it's the engagement by the residents, sometimes it could be the owners of those governance tokens, it could be the service providers. You know it could be just anything.

Raquel Buscaino: There's so many different branches of the tree. And it really depends on the type of DAO, where they've chosen to be “a something somewhere”, what their mission objective is, and their governance. There's so many factors at play. Maybe I'll switch to where Deloitte operates in the space. What are some ways Deloitte serves the DOA market? Who are the types of clients that we engage with and what might organizations need to know or care about?

Rob Massey: I'll cover some different angles of the DAO considerations. The first is the founders of a DAO. They start with humans somewhere. And so those humans show up to Deloitte as a client, and they say “we would like your help to launch this and be compliant”. It frequently starts with a labs company.

So, as Deloitte, we're used to helping companies launch products and so collaborating with the founding team and their council in designing what a launch sequence looks like, and structuring that with the tax lens, and the accounting lens, and the regulatory lens. That's something we do, but it's not just the point of launch, you have to say “Hey, what does it look like in a mature state?” “And, what does it look like at the day of launch?” Draw a line between the 2. We need to think about all the considerations now. They're not big yet, and many of them fail but we have to assume that they may be successful and if they are successful, what are the decisions they would have wanted to make now so that they feel secure and safe from a regulatory perspective later, and so, those involve tax considerations, broader regulatory considerations and governance and control frameworks.

The other side is, we serve companies that invest in governance tokens. And we say, “OK, what is this thing that you hold?” “Could it be recast as equity?” “If it is, is it safe to hold it?” So helping companies' diligence or structured investments and make investment decisions again with the regulatory lens. And that happens at the enterprise level, it also happens at a fund level. Many funds today are looking in investing in digital assets' full spectrum. But you need to know what you're investing in, and what that represents again with the tax and importantly with the accounting lens.

Raquel Buscaino: Got it and your traditional large, could-be Fortune 500 companies that aren't crypto native that are saying, hey, “I want to be a governance token a holder for this DAO! How do I participate?” I can understand that's such a real need to have some entity that's providing a service, because you think through a lot of the activity that's happened in the Blockchain digital asset space over the last couple of months, and I think that “who's doing what?” and “what am I doing?” is probably top of mind for a lot of people.

Rob Massey: And the topic is evolving quickly! In a world where the software that you license, there's someone on the other end that controls it, if you would like to have influence on an upgrade, you engage with whoever owns the software.

In the world of decentralized software, if you want influence over a software upgrade, you need to either stake your tokens if it's a stake protocol, or now with the governance tokens, you vote, as to what is the upgrade, as to where the funds are deployed, and which grants are funded for the next state of the ecosystem.

So if you are, in using your example, a fortune 500 companies that you know that protocol that's going to be really important to you. You want to put your own enterprise applications on that protocol. So now you have a vested interest in making sure that it evolves in the right manner. You may need some governance tokens and vote.

That's what's happening next.

Raquel Buscaino: Where do you think DAOs could go in the future? What are potential impacts they could have on the average person?

Rob Massey: It's a really good question. The average person now has the ability to engage with a meaningful ecosystem.

If you have a vision about a topic, a state of the world, as you started to mention, DAOs take different form. Some of them focus on social issues, some of them focus on environmental issues, some of them: it's investing in art, right? And so, you could now have the ability to engage and voice your opinion, and actually have a vote that you can see where it goes.

The cool thing about decentralized protocols and DOAs is transparency. You can see the impact. There's a sense of engagement, a sense of participation and we've seen this play out in some of the more popular DAOs today, the level of community it's building around the world is fascinating.

Raquel Buscaino: Do you think it also kind of turn people in from a consumer into a creator? And what I mean by that is with the products we own, with the services we use, we consume and I would love to hear thoughts: what kind of potential does that unlock for human beings?

Rob Massey: You at least have a seat at the table to voice an opinion. Hey? I like that direction versus the other direction. Maybe it's a sustainability project, a tracking mechanism for carbon credits, even if you don't have the competency to solve that problem but you understand it, and you care about it passionately. Now you have a seat at the table. You can watch it happen, you can voice your opinion. You could help in the funding decision, or you could fund it yourself.

Raquel Buscaino: You know, Rob. I know I've been the one that's been choosing the questions to ask here. But as we kind of think about rounding out this conversation. What question I should have asked that I didn't, or where are you most excited to head? I'll let you pick either or.

Rob Massey: So, as Deloitte, we tend to get questions from founders about how to solve the hard topics and do it the right way. "Can you help us find a path to be compliant?" And that is really inspiring. It takes a lot of discipline, and it takes a lot of patience from founding teams because it's not always going to be perfect with their vision when you start building in compliance into their protocols. But you know I love how the regulators increasingly have an open mind to comment. There are creative ways to find a path forward and be compliant.

What that means, though, is that those of us with a regulatory lens collaborate with the technologists, so when we design paths forward, it's very iterative and the zoom party becomes pretty big because you have regulatory people, and founders, and entrepreneurs, and coders, all trying to speak the same language and make sure that we get it right.

So I love solving these edgy questions, and try and do it in a compliant manner. That is absolutely what I'm inspired about.

Raquel Buscaino: And even, you know. This is just the beginning. And so to see how this is going to evolve. I'm excited about it. Do you have any advice for people who are listening to this podcast? How do I learn more as an individual? How do I participate?

Rob Massey: What I like to do, and what I find a lot of people do is to pick a few trusted individuals and experiment a little bit through different social media channels. Pick your favorite social media and start to follow a few people, and then,

read the comments, read the debates, and then you get a sense of the tone, and then build your network of the people that you follow, and then start to engage with them.

It's a little bit like building your professional network at work but build it through an industry network and what you find is that now you're engaged in a conversation and as the industry evolves, the conversation evolves.

Raquel Buscaino: Absolutely and I think if you go through that route, Rob, as you mentioned, and start finding people who are talking about the conversation as it is happening rather than after the fact. Then it's a great way to find community, too.

Rob Massey: For sure, but the learning should not be discounted. Don't just be passive - that is my point. Start to engage, start to voice your opinion! And what's happening in this space is that we're all learning together, just ask questions and learn!

Raquel Buscaino: Amazing. Well, Rob, it has been such a pleasure. Thank you for giving us a rundown of all things, Blockchain, digital assets, DAOs, tax, how to participate in this evolving community. Truly, thanks for taking the time and sharing your knowledge with us.

Rob Massey: You are most welcome Raquel!

Raquel Buscaino: And for all our listeners out there, I hope that this conversation has helped demystify DAOs and perhaps have energized you to dig deeper into the topic. I'm your host, Raquel Buscaino, and I will catch you on our next episode. Until then, stay savvy.

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