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IRS To Evaluate Taxable Events For Cryptocurrency Compliance

By **Amy Lee Rosen** · October 24, 2018, 6:12 PM EDT

Beverly Hills, Calif. - An Internal Revenue Service official has said its Criminal Investigations Division will look to whether there was a taxable event when evaluating compliance in cryptocurrency reporting, noting it is following leads from a recent case involving Coinbase Inc.

At the Tax Controversy Institute conference in Beverly Hills, California, on Tuesday, Nathan Hochman, a partner at Morgan Lewis & Bockius LLP, spoke with Bryant Jackson, an assistant special agent-in-charge for IRS Criminal Investigation in the Los Angeles office, about how the agency plans to enforce the complicated area of cryptocurrency.

The process has not been as simple as expected, Jackson said, but the IRS and CI have created cyber units, called CCUs, in Washington, D.C., and Los Angeles that support cyber efforts in different fields.

“The hub of the CCU in the west sits in Los Angeles, and we have agents posted in Las Vegas, Denver, Seattle, Phoenix and most recently, Dallas,” he said. “We’ve put these agents there so they can be trained under the guise of the CCUs. Our deputy chief talked earlier about data science and data analytics, and we’re using a lot of that in developing cases and looking into possible potential abusers.”

Jackson explained the only thing CI wants is to bring about compliance by using data science and data analytics to look at whether a crypto transaction was a taxable event and if so, figure out to whom it is attributable.

But Hochman pushed back, saying the IRS has only issued guidance on virtual currencies in 2014, which said any capital gain or loss from the sale or exchange of cryptocurrency must be reported the same way as any other payments made with property. Even after the Treasury Inspector General for Tax Administration released a report heavily criticizing the IRS for not giving more guidance on this issue or publicly addressing difficulties surrounding tax compliance, the IRS still has not acted, he said.

“You folks aren’t talking among yourselves, and you haven’t figured out how to tap the third parties who you can actually try to get information about who owes what in cryptocurrencyland,” Hochman said. “Then a fight emerged over the past couple of months or years that there is actually a playbook out there about what we think the IRS might do because the playbook, … which we will call the 'winning enforcement formula,' is just actually what you did with offshore bank accounts."

Hochman said offshore bank account income was originally estimated being valued at more than $100 billion, but the IRS could not track it down because it lacked sufficient resources. The agency then started an offshore voluntary disclosure program to get more offshore holders to become tax-compliant.

There's a similar trend in cryptocurrencies because virtual currencies had estimated values of about $25 million for 2017, assuming those assets even get reported, and less than 1,000 taxpayers actually filled out the tax forms, he said. There is a parallel because in virtual currencies, the government said it lacks the resources to track it, Hochman said.

One way to track cryptocurrencies could be through obtaining information from virtual currency exchangers via a John Doe summons, through which the IRS can get identification information from taxpayers when it reasonably suspects they are violating tax laws.

By way of example, in December 2016, a California federal court had authorized a John Doe summons by the IRS to get information from Coinbase Inc. to investigate whether its customers were avoiding paying taxes. A California federal judge told Coinbase in November 2017 that it must hand over information on accounts with transactions greater than $20,000 and must provide the taxpayer ID, name, date of birth and address for the accounts.

Hochman asked if it was possible to similarly use third parties, such as a John Doe summons, to get information in the same way the IRS sought offshore assets information or whether the agency was coming up with a similar formula to get cryptocurrency money home.

"What did Coinbase have that the IRS was interested in to devote such serious resources to drop a John Doe summons?" Hochman asked.

Jackson at first deflected by saying the Coinbase summons was issued by the civil section and did not come from criminal investigations.

"We do know that Coinbase is the largest exchanger out there and is the one that is the most compliant with [the Financial Crimes Enforcement Network] and regulations," he said.

But in anticipation of receiving some of these possible leads, CI has started talking about how to put a case together to make it successfully prosecuted from a U.S. Department of Justice and tax perspective, he added.

During another session on Tuesday, Darren John Guillot, the director for the IRS' field collection operations, confirmed that the civil side was already using information from the Coinbase summons. He warned the audience that if they have clients who have virtual currency, they must make sure to report the information on financial statements should the IRS ask for it.

“Two months ago, I got access to all of the Coinbase summons information, and I shared all of the names of the 11,000 people on that list who have cryptocurrency with my revenue officers coast to coast,” he said. “And they have spent the past two months matching the entire assigned work and stuff in the queue that isn’t assigned yet.”

Guillot explained agents are already matching information from the Coinbase summons with case files, so if a taxpayer has not reported a virtual currency transaction properly, the agency may already know about it.

“Make sure your clients know it’s not something that we can’t find out about,” he said.

--Editing by Neil Cohen.