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Tax Treatment of
Transactions in Cryptocurrency
and IRS Tax Enforcement



Cryptocurrency

- What is it? How did it start?
- Isn't it only for tax cheats?
- Is it here to stay?
- How are transactions reported?
- What guidance has been issued?
- What are the IRS' top concerns?



Cryptocurrency – What Is It?

- A medium of exchange using cryptography to secure transactions
- Digital asset using blockchain technology
- Bought and sold on exchanges
- Uses decentralized control instead of centralized electronic money and banking systems



Cryptocurrency – How Did It Start?

- 1970s - Military and spy agency use
- 1990s - Cypherpunks believed that cryptography would promote social change and ensure privacy, anonymity
- 2008 - Bitcoin was released as a peer-to-peer electronic cash system

Cryptocurrency – How Did It Start? (con't.)

- May 22, 2010, Laszlo Hanyecz bought two Papa John's pizzas for 10,000 Bitcoins. Today, those two pizzas would have been sold for over \$60 million!



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Cryptocurrency – Fad or Here to Stay?

- Nearly 2,000 types of cryptocurrencies
- Over 100,000 businesses accept Bitcoin – Expedia, Overstock, Home Depot, Whole Foods, Lowes, Regal Cinemas, etc.
- Ohio Department of Revenue accepts digital currency



Cryptocurrency – Fad or here to stay? (con't.)

- 18 states have blockchain legislation
- Stanford, UC Berkeley and UCLA have blockchain classes
- But, Deloitte analysis found only 8% of 86,000 blockchain projects launched on the GitHub platform had a lifespan over about one year.

IRS Guidance – Civil Compliance

- IRS Notice 2014-21
- Virtual currency is recognized as property
- Gain or loss on sale is treated like a sale or exchange of securities
- Basis is the FMV on date received
- If held as investment property, the gain or loss on sale is capital in nature



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2019

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IRS Guidance – Civil Compliance (con't.)

- Inherited cryptocurrency has the cost basis of the decedent
- Cryptocurrency paid as wages is subject to Federal tax withholding
- Cryptocurrency payments are subject to information reporting (e.g. Forms W-2, 1099, 1042 – Misc., etc.)

IRS Guidance – Unresolved Issues

- IRC Section 1031 – Like-Kind Exchanges
 - Prior to 1-1-2018, may be able to argue like-kind exchange for crypto-to-crypto trades
 - After 1-1-2018, like-kind exchanges must involve real estate



IRS Guidance – Unresolved Issues

- Hard Forks – Is it a taxable event when a coin splits into two or more virtual currencies with a shared history?
- Accounting for gains and losses - FIFO or LIFO? Do taxpayers have the option?



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IRS – Forms Update

- Civil Installment Agreements and Offers in Compromise



<input type="checkbox"/> Virtual currency	Name of virtual currency wallet, exchange or digital currency exchange (DCE)	Email address used to set-up with the virtual currency exchange or DCE	Location(s) of virtual currency	
Type of virtual currency				
Current market value in U.S. dollars as of today				
\$	X .8 = \$		=	(2c) \$
Total investment accounts from attachment. [current market value minus loan balance(s)]				(2d) \$



IRS – Possible Civil Penalties

- IRC 6662 – Accuracy-Related Penalty
- IRC 6663 – Civil Fraud Penalty
- IRC 6721 – Failure to File Correct Information Returns
- IRC 6722 – Failure to Furnish Correct Payee Statements
- Reasonable Cause Defense



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Financial Crimes Enforcement Network (FinCEN) Guidance

- 2013 - Money transmitters must register as Money Service Businesses (MSBs)
- MSBs must register, report, and follow BSA and other rules including Suspicious Transaction Reports (STRs) and Currency Transaction Reports (CTRs)



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Financial Crimes Enforcement Network (FinCEN) Guidance (con't.)

- A “User” obtains virtual currency to purchase goods or services. Not an MSB.
- An “Exchanger” trades virtual currency for other currencies. May be an MSB.
- An “Administrator” issues virtual currency and authorized to redeem virtual currency. May be an MSB.

Financial Crimes Enforcement Network (FinCEN) Guidance (con't.)

- March 2018 – Regulations apply to the sale of Initial Coin Offerings (ICO)-derived cryptocurrencies
- April 2019 – First enforcement action against Eric Powers as peer-to-peer exchanger for willful failure to honor FinCEN obligations



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IRS v. Coinbase

- In 2017, Coinbase (America's largest platform for exchanging Bitcoin to U.S. dollars) had 5.9 million customers and served \$6 billion exchanges in Bitcoin
- Only 800-900 taxpayers filed IRS Form 8949



IRS v. Coinbase (con't.)

- In November 2017, the U.S. District Court for the Northern District of California ordered Coinbase to produce documents on 14,000 customers who had at least \$20,000 in any one transaction in one year between 2013 and 2015



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IRS Issues Letters

Letter 6174 – May have duty to report; no response required

Letter 6174-A – May have reporting error; no response required

Letter 6173 – Response under penalties of perjury



IRS – Criminal Investigation Division

- CI employees now complete cyber training
- Belief the future of white collar crimes will have a cyber component in them
- Joint Chiefs of Global Tax Enforcement (J5)
- Challenges with prosecution



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What to do?

- *Show me the (digital) money!*
- Correctly report transactions
- IRS Domestic Voluntary Disclosure
- Qualified amended returns

Questions?



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