

## IRS Warns Cryptocurrency Holders to Report Transactions and Pay Taxes

It is no secret that cryptocurrency holders are facing increased scrutiny by the IRS. In 2018, the agency announced a virtual currency compliance campaign that included outreach and examinations.<sup>1</sup> As part of its latest sequence this summer, the IRS recently publicized that it has begun sending letters to cryptocurrency holders advising them of their reporting and payment obligations and warning that failure to properly report transactions or pay taxes owed might result in penalties or criminal enforcement. Following on the heels of this announcement, the IRS also began sending notices to taxpayers that claim a discrepancy in the income reported on tax returns. The IRS expects to send up to 10,000 letters to cryptocurrency holders by the end of August 2019,<sup>2</sup> but there is no information on the number of notices that will be issued.

The IRS letters explain that the agency has information indicating that the recipient may hold virtual currency assets. They describe cryptocurrency transactions that may trigger tax reporting obligations and outline reporting requirements, as well as advise recipients how to amend previously filed returns containing errors. The letters also warn that failure to report virtual currency transactions may expose recipients to future civil and criminal enforcement by the IRS. Though unstated in the communications, receipt of one of these letters may assist the IRS in proving willfulness intent in any future enforcement proceedings (in the event a recipient fails to take appropriate action).

There are three different versions of the letter. Two—Letters 6174-A and 6174—detail cryptocurrency holders' reporting obligations and provide resources for further information. While neither requires a response, Letter 6174-A warns that the IRS may send further correspondence about potential enforcement activity in the future. The third variety—Letter 6173—requires recipients to respond by a specified date and to either correct previous tax compliance errors or provide a statement signed under penalties of perjury supporting their position that they had previously complied with all tax reporting requirements. The letter promises to cross-check taxpayers' submissions with information received from banks, financial advisors, and other sources. Finally, Letter 6173 warns that a failure to respond may cause the IRS to refer the taxpayer's case for examination.

In a statement announcing the letters' issuance, IRS Commissioner Charles Rettig cautioned that taxpayers should take the letters "very seriously."<sup>3</sup> Both Letters 6174-A and 6173 advise that the IRS has information that recipients may not have reported previous transactions correctly. This information may have been obtained from the IRS' highly publicized John Doe Coinbase summons that resulted in the virtual currency exchange producing identifying information for over 10,000 users that engaged in cryptocurrency transactions over a two-year period. Commissioner Rettig has further warned that the IRS was "expanding [its] efforts involving

---

<sup>1</sup> "IRS Announces the Identification and Selection of Five Large Business and International Campaigns," July 2, 2018, available at <https://www.irs.gov/businesses/irs-announces-the-identification-and-selection-of-five-large-business-and-international-compliance-campaigns> (last visited on Aug. 8, 2019).

<sup>2</sup> IRS News Release, "IRS has begun sending letters to virtual currency owners advising them to pay back taxes, file amended returns; part of agency's larger efforts," July 26, 2019 (IR-2019-132).

<sup>3</sup> *Id.*

virtual currency, including increased use of data analytics,”<sup>4</sup> suggesting that sources for the letters may be broader than the Coinbase summons alone.

In addition to these three letters, the IRS most recently began sending taxpayers Notice CP2000.<sup>5</sup> This notice informs the taxpayer that the income or payment information provided on the tax return differs from the information the IRS has received by a third party, such as an employer or financial institution. The Notice is not an assessment. Rather, recipients are told to complete a specific response form, which allows the taxpayer to agree or dispute the information contained in the Notice. The Notice directs the recipient how to respond and what steps to take depending on whether the information is correct or disputed. If the taxpayer disputes the information, then the Notice suggests contacting the third party to send corrected information to the IRS.

The IRS letters and notice precede long-promised further agency guidance on the taxation of virtual currency. In recent months, IRS officials have indicated that further guidance was imminent. Until it is released, the agency’s only guidance dates back to March 2014, when the IRS issued Notice 2014-21.<sup>6</sup> The existing guidance provides that virtual currencies are treated as property, not currency, for U.S. federal tax purposes. Thus, general tax principles applicable to property transactions likewise apply to transactions involving virtual currency, such as calculating basis, recognizing loss or gain, and determining the character of that loss or gain as capital or ordinary. The guidance also covers reporting virtual currency in gross income—including whether it is received as payment for services or through mining—and provides some information on reporting. The upcoming guidance is expected to include both a revenue ruling and revenue procedure and to address calculating cost basis, cost basis assignment, and the treatment of forks.<sup>7</sup>

The IRS is not the only taxing authority showing increased interest in cryptocurrency compliance. Abroad, the British tax authorities have requested that a number of cryptocurrency exchanges turn over users’ names and transaction histories in order to assist in collecting unpaid taxes.<sup>8</sup> In the United States, more than 15 states, including Massachusetts, have passed legislation in the last year requiring marketplace facilitators to collect and remit sales tax on transactions entered into using virtual currencies.

In light of taxing authorities’ ramped-up enforcement efforts with respect to cryptocurrency, virtual currency holders should carefully review tax compliance obligations both in the United States and abroad. This is especially important for recipients of one of the IRS’ recent letters or Notice CP2000; it is unlikely that such persons can disclaim knowledge of reporting requirements going forward. As always, taxpayers should exercise caution in responding to any requests from taxing authorities.

---

<sup>4</sup> *Id.*

<sup>5</sup> “Understanding Your CP2000 Notice,” available at <https://www.irs.gov/individuals/understanding-your-cp2000-notice> (last visited Aug. 16, 2019).

<sup>6</sup> 2014-16 IRB 938.

<sup>7</sup> Letter to Hon. Tom Emmer from Charles P. Rettig (May 16, 2019), available at <https://www.taxnotes.com/tax-notes-today-federal/cryptocurrency/irs-publish-additional-virtual-currency-guidance-rettig-says/2019/05/21/29j9j> (last accessed Aug. 8, 2019).

<sup>8</sup> “British Authorities Seek Data from Crypto Exchanges in Search of Tax Evaders,” available at <https://www.coindesk.com/british-tax-authority-seeks-customer-data-from-crypto-exchanges-in-search-of-tax-evaders> (last accessed Aug. 8, 2019).