Cryptocurrency - IRS Enforcement Efforts To Ensure Compliance

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ABA Section of Taxation of Section of Real Property, Trust & Estate Law
2019 Fall Tax Meeting
October 5, 2019
Hyatt Regency, San Francisco, CA
Virtual Currency

- Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like “real” currency -- i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance -- but it does not have legal tender status in any jurisdiction.
General Background

• In general, the sale or exchange of convertible virtual currency, or the use of convertible virtual currency to pay for goods or services in a real-world economy transaction, has tax consequences that may result in a tax liability.

• Virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.

• The character of the gain or loss generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer. A taxpayer generally realizes capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. For example, stocks, bonds, and other investment property are generally capital assets. A taxpayer generally realizes ordinary gain or loss on the sale or exchange of virtual currency that is not a capital asset in the hands of the taxpayer.
• IRS reminds taxpayers to report virtual currency transactions

• Taxpayers who do not properly report the income tax consequences of virtual currency transactions can be audited for those transactions and can be liable for penalties and interest.

• In more extreme situations, taxpayers could be subject to criminal prosecution for failing to properly report the income tax consequences of virtual currency transactions.
Application of FinCEN Regulations to Virtual Currency

- A user of virtual currency is **not** an MSB under FinCEN's regulations and therefore is not subject to MSB registration, reporting, and recordkeeping regulations.

- However, an administrator or exchanger is an MSB under FinCEN's regulations, specifically, a money transmitter, unless a limitation to or exemption from the definition applies to the person.

  - FIN-2-13-G001
Title 31 Regulation


Businesses must be registered as a money transmitting business with the Secretary of the Treasury Department’s Financial Crimes Enforcement Unit (FinCEN) as required by Title 31 U.S.C. Section 5330.

This applies to domestic and foreign based MSBs conducting substantial business in the United States.

Failure of administrators/exchangers to register as an MSB is usually a good indicator that the entity lacks knowledge of anti-money laundering requirements including the Funds Transfer and Funds Travel Rules.
Virtual Currency Enforcement Specialist

• What is a FinCEN Virtual Currency Enforcement Specialist?
  – Analyze, research, describe, and assess financial institutions, or their partners, directors, officer, or employees, operating in convertible virtual currency for their compliance with the U.S. anti-money laundering/combating the financing of terrorism (AML/CFT) regulatory framework;
  – Conduct research and build compliance and enforcement cases and organize their supporting evidence, as well as analyze and prioritize targets based on FinCEN priorities;
Virtual Currency Enforcement Specialist (2)

- Participate in the formulation, planning, development, and implementation of compliance and enforcement strategies related to virtual currency businesses that have industry-wide, national, or international impact, including those related to national security.

- Serve as a technical expert regarding cryptocurrency, blockchain analytics, and cyber intelligence gathering tools in order to produce sophisticated analyses, assess the darknet, and conduct blockchain analytics.
IRS-CI Evolution on Virtual Currency

- IRS-CI formed a team in 2013 to study the use of virtual currencies to avoid taxes by moving money in and out of offshore accounts.
- IRS-CI is forming specialized teams with expertise to develop high-impact cases.
Evolution of Virtual Currency(1)

- IRS-CI began looking into Virtual Currency in 2013
- At the time IRS-CI involved with a lot of Identity Theft Crimes (IDT) involving tax returns
- Those crimes evolved to Cyber IDT often times involving the dark web and virtual currency
Evolution of Virtual Currency (2)

- **Cyber Crimes HQ Office**: Oversees the nationwide implementation of IRS-CI cybercrime programs. Develop policy, strategy and investigative support issues.

- **Cyber Crimes Units**: IRS-CI has two fully operational CCUs (Washington DC and Los Angeles) staffed with technology savvy special agents, investigative analysts, data/software engineers, computer investigative specialist, and other support personnel.

- **Field Office Cyber Coordinators**: CI has 21 Lead Cyber Coordinators in each of our 21 field offices.

- **Cyber Support Unit**: CI recently stood up a Cyber Support Unit with eight investigative analyst and one supervisory investigative analyst solely focused on supporting cyber investigations.

- **National Cyber Forensic and Training Alliance**: IRS-CI assigned a CCU SA to act as a liaison officer at NCFTA Headquarters. This is a partnership between private industry, government, and academia for the sole purpose of identifying, mitigating, and disrupting cyber crime.
• **European Cybercrime Centre**: A CCU special agent is assigned to the EC3 as a liaison officer in Netherlands.

• **Nationally Coordinated Investigations Unit**: An embedded unit within CI that is using Data Analytics to build typologies in various financial driven crimes to include cybercrime

• **Cyber Undercover Program**: IRS-CI launched a cyber undercover program to train cyber agents to conduct undercover operations online.

• **Cyber Fusion Team**: CI led coordination within IRS to share real-time intelligence from the Dark Web and other online sources.

• **Joint Chiefs of Global Tax Enforcement (J5)**: In 2018, IRS-CI teamed up with tax authorities from the United Kingdom, Canada, Australia, and the Netherlands. The J5 are committed to combatting transnational tax crime through increased enforcement collaboration. The J5 will work together to gather information, share intelligence, conduct operations and build the capacity of tax crimes, money laundering and cyber crime enforcement.
IRS-CI Priorities (Virtual Currency)

- Intersection of Cyber and Financial Crimes = Virtual Currency
- IRS-CI follows the digital money
- Pursuing tax (Title 26) and money laundering (Title 18) violations
- Crypto Kiosks
- Dark web marketplaces
Notable Investigative Highlights

- Liberty Reserve
- BTCe
- Silk Road I and II
- Alphabay

In all investigations, CI was the lead agency in the cryptocurrency tracing and ultimately the attribution of main targets or the associated network servers.
Virtual currency tax compliance is an IRS priority.

- The IRS is focused on enforcing tax compliance for holders of virtual currency.
- Virtual currency is ongoing focus area for the IRS and IRS Criminal Investigation using all available compliance avenues:
  - examination
  - criminal prosecution
  - data analytics
- Compliance efforts are focused on enforcing the law and helping taxpayers fully understand and meet their obligations.
- Virtual currency is an asset and is treated as such in IRS examination and collection activities.
- Interviews with taxpayers now routinely include questions about virtual currency assets and transactions.
Reporting Virtual Currency Transactions

– IRS Notice 2014-21
  • states that virtual currency is property for federal tax purposes
  • provides guidance on how general federal tax principles apply to virtual currency transactions.

– Transactions in virtual currency should follow analogous property taxation rules.

– When applying these rules taxpayers should take positions that are reasonable and consistent.

– The IRS anticipates issuing additional legal guidance in this area.
IRS Compliance Activities

• Current activities include
  ▪ Guidance
  ▪ Training
  ▪ Communications and education
  ▪ Coordination efforts
Guidance

• Guidance for employees working cases involving virtual currency
  – Sept 2018 – Formed Collection Virtual Currency Team, tasked with developing policy and guidance on collection strategies
  – Ongoing – Guidance to Field Collection, summons guidance, IRM guidance
  – Communication efforts include a new section on internal website and articles in newsletters reaching CEASO, ATAT and International employees.
  – Coming soon: Additional guidance pending on levy, seizure and sale procedures, and glossary of terms.
Training

• Training for employees working cases that involve virtual currency
  – New and revised training materials
  – CPEs
  – Each Field Collection Area selected a subject matter expert who received face-to-face training to be shared with ROs, advisers, PALS
  – Virtual Currency Toolkit
IRS Educational Letters

• July 26, 2019 – IRS announced it began sending educational letters to taxpayers with virtual currency transactions (IR-2019-132)

• More than 10,000 taxpayers received letters.

• Three variations of the educational letter: Letter 6173, 6174 and 6174-A.

• All versions strive to help taxpayers understand their tax and filing obligations and how to correct past errors.
IRS Educational Letters

- Letters advised taxpayers to review tax filings and when appropriate, amend past returns and pay back taxes, interest and penalties.
- Names of taxpayers were obtained through various ongoing IRS compliance efforts.
- Taxpayers are pointed to information on IRS.gov, including which forms and schedules to use and where to send them.
Updated Forms and Publications

- Collection Information Statement (Form 433-A) updated to request information on virtual currency
- Instructions (Pub. 1854 and 5059) also updated
Coordination Efforts

• Within IRS
  – National Cryptocurrency Issue Team – works on virtual currency issues with cross-functional impact; coordinate strategies and share initiatives
  – Collection Virtual Currency (CVC) team working with IRS-CI, Collection, Counsel

• Other federal law enforcement
Key Points

• Compliance efforts are focused on enforcing the law, educating taxpayers so they can meet their obligations.

• Taxpayers who do not properly report the income tax consequences of virtual currency transactions:
  – are, when appropriate, liable for tax, penalties and interest.
  – In some cases, could be subject to criminal prosecution.

• IRS anticipates issuing more legal guidance in this area in the near future.

• More information: IRS.gov, search “virtual currencies”
The information included in these slides is for discussion purposes only and should not be relied on without seeking individual legal advice.