A CLIENT WITH CRYPTOCURRENCY JUST CALLED – WHAT NOW?

ABA 2020 Midyear Tax Meeting
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Boca Raton, FL

Handouts

CCTP
Saturday, February 1, 2020
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A CLIENT WITH CRYPTOCURRENCY JUST CALLED – WHAT NOW?
Handouts - TOC

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March 18, 2013
FinCEN’s Regulations to Persons Administering, Exchanging or Using Virtual Currencies FIN-2013-G001
Guidance

FIN-2013-G001

Issued: March 18, 2013

Subject: Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies

The Financial Crimes Enforcement Network ("FinCEN") is issuing this interpretive guidance to clarify the applicability of the regulations implementing the Bank Secrecy Act ("BSA") to persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies.¹ Such persons are referred to in this guidance as "users," "administrators," and "exchangers," all as defined below.² 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. An administrator or exchanger is not a provider or seller of prepaid access, or a dealer in foreign exchange, under FinCEN’s regulations.

Currency vs. Virtual Currency

FinCEN’s regulations define currency (also referred to as "real" currency) as "the coin and paper money of the United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance."³ In contrast to real currency, "virtual" currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction. This guidance addresses "convertible" virtual currency. This type of virtual currency either has an equivalent value in real currency, or acts as a substitute for real currency.

¹ FinCEN is issuing this guidance under its authority to administer the Bank Secrecy Act. See Treasury Order 180-01 (March 24, 2003). This guidance explains only how FinCEN characterizes certain activities involving virtual currencies under the Bank Secrecy Act and FinCEN regulations. It should not be interpreted as a statement by FinCEN about the extent to which those activities comport with other federal or state statutes, rules, regulations, or orders.
² FinCEN’s regulations define “person” as “an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities.” 31 CFR § 1010.100(mm).
³ 31 CFR § 1010.100(m).
Background

On July 21, 2011, FinCEN published a Final Rule amending definitions and other regulations relating to money services businesses ("MSBs"). Among other things, the MSB Rule amends the definitions of dealers in foreign exchange (formerly referred to as "currency dealers and exchangers") and money transmitters. On July 29, 2011, FinCEN published a Final Rule on Definitions and Other Regulations Relating to Prepaid Access (the "Prepaid Access Rule"). This guidance explains the regulatory treatment under these definitions of persons engaged in virtual currency transactions.

Definitions of User, Exchanger, and Administrator

This guidance refers to the participants in generic virtual currency arrangements, using the terms "user," "exchanger," and "administrator." A user is a person that obtains virtual currency to purchase goods or services. An exchanger is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency. An administrator is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.

Users of Virtual Currency

A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not an MSB under FinCEN's regulations. Such activity, in and of itself, does not fit within the definition of "money transmission services" and therefore is not subject to FinCEN's registration, reporting, and recordkeeping regulations for MSBs.

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4 Bank Secrecy Act Regulations – Definitions and Other Regulations Relating to Money Services Businesses, 76 FR 43585 (July 21, 2011) (the “MSB Rule”). This defines an MSB as "a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (ff)(1) through (ff)(7) of this section. This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States." 31 CFR § 1010.100(ff).
5 Final Rule – Definitions and Other Regulations Relating to Prepaid Access, 76 FR 45403 (July 29, 2011).
6 These terms are used for the exclusive purpose of this regulatory guidance. Depending on the type and combination of a person's activities, one person may be acting in more than one of these capacities.
7 How a person engages in "obtaining" a virtual currency may be described using any number of other terms, such as "earning," "harvesting," "mining," "creating," "auto-generating," "manufacturing," or "purchasing," depending on the details of the specific virtual currency model involved. For purposes of this guidance, the label applied to a particular process of obtaining a virtual currency is not material to the legal characterization under the BSA of the process or of the person engaging in the process.
8 As noted above, this should not be interpreted as a statement about the extent to which the user's activities comport with other federal or state statutes, rules, regulations, or orders. For example, the activity may still be subject to abuse in the form of trade-based money laundering or terrorist financing. The activity may follow the same patterns of behavior observed in the "real" economy with respect to the purchase of "real" goods and services, such as systematic over- or under-invoicing or inflated transaction fees or commissions.
9 31 CFR § 1010.100(ff)(1-7).
Administrators and Exchangers of Virtual Currency

An administrator or exchanger that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter under FinCEN’s regulations, unless a limitation to or exemption from the definition applies to the person.\textsuperscript{10} FinCEN’s regulations define the term “money transmitter” as a person that provides money transmission services, or any other person engaged in the transfer of funds. The term “money transmission services” means “the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.”\textsuperscript{11}

The definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies. Accepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the BSA.\textsuperscript{12} FinCEN has reviewed different activities involving virtual currency and has made determinations regarding the appropriate regulatory treatment of administrators and exchangers under three scenarios: brokers and dealers of e-currencies and e-precious metals; centralized convertible virtual currencies; and de-centralized convertible virtual currencies.

\textbf{a. E-Currencies and E-Precious Metals}

The first type of activity involves electronic trading in e-currencies or e-precious metals.\textsuperscript{13} In 2008, FinCEN issued guidance stating that as long as a broker or dealer in real currency or other commodities accepts and transmits funds solely for the purpose of effecting a \textit{bona fide} purchase or sale of the real currency or other commodities for or with a customer, such person is not acting as a money transmitter under the regulations.\textsuperscript{14}

However, if the broker or dealer transfers funds between a customer and a third party that is not part of the currency or commodity transaction, such transmission of funds is no longer a fundamental element of the actual transaction necessary to execute the contract for the purchase or sale of the currency or the other commodity. This scenario is, therefore, money

\textsuperscript{10} FinCEN’s regulations provide that whether a person is a money transmitter is a matter of facts and circumstances. The regulations identify six circumstances under which a person is not a money transmitter, despite accepting and transmitting currency, funds, or value that substitutes for currency. 31 CFR § 1010.100(ff)(5)(ii)(A)–(F).
\textsuperscript{11} 31 CFR § 1010.100(ff)(5)(ii)(A).
\textsuperscript{12} Ibid.
\textsuperscript{13} Typically, this involves the broker or dealer electronically distributing digital certificates of ownership of real currencies or precious metals, with the digital certificate being the virtual currency. However, the same conclusions would apply in the case of the broker or dealer issuing paper ownership certificates or manifesting customer ownership or control of real currencies or commodities in an account statement or any other form. These conclusions would also apply in the case of a broker or dealer in commodities other than real currencies or precious metals. A broker or dealer of e-currencies or e-precious metals that engages in money transmission could be either an administrator or exchanger depending on its business model.
\textsuperscript{14} Application of the Definition of Money Transmitter to Brokers and Dealers in Currency and other Commodities, FIN-2008-G008, Sept. 10, 2008. The guidance also notes that the definition of money transmitter excludes any person, such as a futures commission merchant, that is “registered with, and regulated or examined by...the Commodity Futures Trading Commission.”
transmission. Examples include, in part, (1) the transfer of funds between a customer and a third party by permitting a third party to fund a customer's account; (2) the transfer of value from a customer's currency or commodity position to the account of another customer; or (3) the closing out of a customer's currency or commodity position, with a transfer of proceeds to a third party. Since the definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies, the same rules apply to brokers and dealers of e-currency and e-precious metals.

b. Centralized Virtual Currencies

The second type of activity involves a convertible virtual currency that has a centralized repository. The administrator of that repository will be a money transmitter to the extent that it allows transfers of value between persons or from one location to another. This conclusion applies, whether the value is denominated in a real currency or a convertible virtual currency. In addition, any exchanger that uses its access to the convertible virtual currency services provided by the administrator to accept and transmit the convertible virtual currency on behalf of others, including transfers intended to pay a third party for virtual goods and services, is also a money transmitter.

FinCEN understands that the exchanger's activities may take one of two forms. The first form involves an exchanger (acting as a "seller" of the convertible virtual currency) that accepts real currency or its equivalent from a user (the "purchaser") and transmits the value of that real currency to fund the user's convertible virtual currency account with the administrator. Under FinCEN's regulations, sending "value that substitutes for currency" to another person or to another location constitutes money transmission, unless a limitation to or exemption from the definition applies. This circumstance constitutes transmission to another location, namely from the user's account at one location (e.g., a user's real currency account at a bank) to the user's convertible virtual currency account with the administrator. It might be argued that the exchanger is entitled to the exemption from the definition of "money transmitter" for persons involved in the sale of goods or the provision of services. Under such an argument, one might assert that the exchanger is merely providing the service of connecting the user to the administrator and that the transmission of value is integral to this service. However, this exemption does not apply when the only services being provided are money transmission services.

The second form involves a de facto sale of convertible virtual currency that is not completely transparent. The exchanger accepts currency or its equivalent from a user and privately credits the user with an appropriate portion of the exchanger's own convertible virtual currency held with the administrator of the repository. The exchanger then transmits that

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15 In 2011, FinCEN amended the definition of money transmitter. The 2008 guidance, however, was primarily concerned with the core elements of the definition — accepting and transmitting currency or value — and the exemption for acceptance and transmission integral to another transaction not involving money transmission. The 2011 amendments have not materially changed these aspects of the definition.

16 See footnote 11 and adjacent text.

17 31 CFR § 1010.100(ff)(5)(ii)(F).
internally credited value to third parties at the user’s direction. This constitutes transmission to another person, namely each third party to which transmissions are made at the user’s direction. To the extent that the convertible virtual currency is generally understood as a substitute for real currencies, transmitting the convertible virtual currency at the direction and for the benefit of the user constitutes money transmission on the part of the exchanger.

**c. De-Centralized Virtual Currencies**

A final type of convertible virtual currency activity involves a de-centralized convertible virtual currency (1) that has no central repository and no single administrator, and (2) that persons may obtain by their own computing or manufacturing effort.

A person that creates units of this convertible virtual currency and uses it to purchase real or virtual goods and services is a user of the convertible virtual currency and not subject to regulation as a money transmitter. By contrast, a person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is a money transmitter. In addition, a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.

**Providers and Sellers of Prepaid Access**

A person’s acceptance and/or transmission of convertible virtual currency cannot be characterized as providing or selling prepaid access because prepaid access is limited to real currencies.¹⁸

**Dealers in Foreign Exchange**

A person must exchange the currency of two or more countries to be considered a dealer in foreign exchange.¹⁹ Virtual currency does not meet the criteria to be considered “currency” under the BSA, because it is not legal tender. Therefore, a person who accepts real currency in

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¹⁸ This is true even if the person holds the value accepted for a period of time before transmitting some or all of that value at the direction of the person from whom the value was originally accepted. FinCEN’s regulations define “prepaid access” as “access to funds or the value of funds that have been paid in advance and can be retrieved or transferred at some point in the future through an electronic device or vehicle, such as a card, code, electronic serial number, mobile identification number, or personal identification number.” 31 CFR § 1010.100(bb). Thus, “prepaid access” under FinCEN’s regulations is limited to “access to funds or the value of funds.” If FinCEN had intended prepaid access to cover funds denominated in a virtual currency or something else that substitutes for real currency, it would have used language in the definition of prepaid access like that in the definition of money transmission, which expressly includes the acceptance and transmission of “other value that substitutes for currency.” 31 CFR § 1010.100(ff)(5)(I).

¹⁹ FinCEN defines a “dealer in foreign exchange” as a “person that accepts the currency, or other monetary instruments, funds, or other instruments denominated in the currency, of one or more countries in exchange for the currency, or other monetary instruments, funds, or other instruments denominated in the currency, of one or more other countries in an amount greater than $1,000 for any other person on any day in one or more transactions, whether or not for same-day delivery.” 31 CFR § 1010.100(ff)(I).
exchange for virtual currency, or *vice versa*, is not a dealer in foreign exchange under FinCEN’s regulations.

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Financial institutions with questions about this guidance or other matters related to compliance with the implementing regulations of the BSA may contact FinCEN’s Regulatory Helpline at (800) 949-2732.
Virtual Economies and Currencies, GAO 13-516 (May 2013)
VIRTUAL ECONOMIES AND CURRENCIES

Additional IRS Guidance Could Reduce Tax Compliance Risks
VIRTUAL ECONOMIES AND CURRENCIES

Additional IRS Guidance Could Reduce Tax Compliance Risks

What GAO Found

Transactions within virtual economies or using virtual currencies could produce taxable income in various ways, depending on the facts and circumstances of each transaction. For example, transactions within a "closed-flow" virtual currency system do not produce taxable income because a virtual currency can be used only to purchase virtual goods or services. An example of a closed-flow transaction is the purchase of items to use within an online game. In an "open-flow" system, a taxpayer who receives virtual currency as payment for real goods or services may have earned taxable income since the virtual currency can be exchanged for real goods or services or readily exchanged for government-issued currency, such as U.S. dollars.

Virtual economies and currencies pose various tax compliance risks, but the extent of actual tax noncompliance is unknown. Some identified risks include taxpayers not being aware that income earned through virtual economies or currencies is taxable or not knowing how to calculate such income. Because of the limited reliable data available on their size, it is difficult to determine how significant virtual economy and currency markets may be or how much tax revenue is at risk through their usage. Some experts with whom we spoke indicated a potential for growth in the use of virtual currencies.

Beginning in 2007, IRS assessed the tax compliance risks from virtual economies, and in 2009 posted information on its website on the tax consequences of virtual economy transactions. However, IRS has not provided taxpayers with information specific to virtual currencies because of other priorities, resource constraints, and the need to consider the use of these recently-developed currencies, according to IRS officials. By not issuing guidance, IRS may be missing an opportunity to address virtual currency tax compliance risks. Given the uncertain extent of noncompliance with virtual currency transactions, formal guidance, such as regulations, may not be warranted. According to IRS officials, formal guidance requires extensive review, which adds to development time and cost. However, IRS may be able to develop more timely and less costly informal guidance, which, according to IRS officials, requires less extensive review and can be based on other existing guidance. An example is the information IRS provides to taxpayers on its website on the tax consequences of virtual economy transactions. Posting such information would be consistent with IRS’s strategy for preventing and minimizing taxpayers’ noncompliance by helping them understand and meet their tax responsibilities.
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Abbreviations

EBEI  Electronic Business and Emerging Issues
IRS  Internal Revenue Service
MMORPG  massively multiplayer online role-playing game

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May 15, 2013

The Honorable Max Baucus
Chairman
The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate

Recent years have seen the development of virtual economies, such as those within online role-playing games, through which individual participants can earn and exchange virtual goods and services. Within some virtual economies, virtual currencies have been created as a medium of exchange for goods and services. Virtual property and currency can have economic value outside of virtual economies, such as when individuals trade these virtual goods for dollars or other government-issued currencies. More recently, virtual currencies have been developed outside of virtual economies as alternatives to government-issued currencies to exchange for real-world goods and services. These innovations raise questions about their related tax requirements and whether their increased adoption could pose challenges for the Internal Revenue Service (IRS) in its efforts to ensure tax compliance.

You asked us to review virtual economies and currencies and IRS's approach to addressing their tax implications. This report's objectives are to (1) describe the tax reporting requirements for virtual economies and currencies, (2) identify the potential tax compliance risks of virtual economies and currencies, and (3) assess how IRS has addressed the tax compliance risks of virtual economies and currencies.

To describe reporting requirements for virtual economies and currencies, we reviewed the Internal Revenue Code and applicable IRS regulations, including relevant sections of the Internal Revenue Manual, and interviewed IRS officials. We also reviewed academic articles and interviewed academics whose research focuses on virtual currencies and taxation of virtual transactions, as well as tax practitioners and representatives from the American Institute of Certified Public Accountants. We selected academics to interview based on criteria including the recognition and citations of their research in the relevant literature. We selected tax practitioners and representatives based on
their association with an organization with widely-recognized expertise in federal tax matters.

To identify potential compliance risks associated with virtual currencies and virtual economies, we reviewed and analyzed legal and academic literature and government reports, including the National Taxpayer Advocate’s 2008 Annual Report to Congress and the European Central Bank’s October 2012 report on virtual currencies. We then discussed these compliance risks with knowledgeable experts, including the Bitcoin Foundation, a virtual currency user group; tax professionals, including members of the American Institute of Certified Public Accountants; representatives from a company that publishes a virtual economy platform; and academics who have written about virtual currencies and taxation of virtual economy transactions. We selected experts based on criteria including their recognition and citations in the literature, and their expertise and recognition in representing taxpayers in federal tax matters or in representing virtual economy or currency concerns. We interviewed IRS officials knowledgeable on virtual economies and currencies and overall IRS tax compliance enforcement efforts. We also performed Internet searches to see what information was circulating for determining the proper tax treatment of virtual economy and currency transactions.

To assess how IRS has addressed compliance risks, we reviewed IRS documentation, including training manuals, examination guides, and internal reports detailing compliance challenges posed by virtual economies. We also interviewed knowledgeable IRS staff on the agency’s efforts to learn about virtual economies and currencies and address them through compliance efforts. We compared IRS’s efforts to federal program management guidance on gathering and monitoring information to identify and assess program risks, including the internal control standards for federal government and our Internal Control Management and Evaluation Tool.¹ Such guidance stipulates that agencies should have adequate mechanisms to identify risks to agency programs arising from external factors and that agencies should consider and, if appropriate, address the risks associated with technological advancements and developments and risks resulting from business and economic changes, among other types of changes. We also reviewed

general IRS procedures and plans for providing information to taxpayers to help them comply with tax requirements included in IRS’s Taxpayer Assistance Blueprint and related progress reports to Congress.²

We conducted this performance audit from September 2012 to May 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

There are no legal definitions for a virtual economy or currency, but generally, a virtual economy is comprised by the economic activities among a community of entities that interact within a virtual setting, such as an online, multi-user game. Virtual economies can be closed, meaning the economic activities and units of exchange used within the community do not interact with the real economy outside of the virtual environment setting, or they can be open, with some economic activity occurring in both the virtual setting and the real economy. A virtual currency is, generally, a digital unit of exchange that is not backed by a government-issued legal tender. Virtual currencies can be used entirely within a virtual economy, or can be used in lieu of a government-issued currency to purchase goods and services in the real economy. Some virtual economies may function similarly to barter exchanges,³ where bartering is the exchange of goods or services in lieu of monetary payments. For example, a carpenter may build a desk for a dentist in exchange for dental work. Barter transactions are taxable transactions, and taxpayers must report the fair market value of the good or service received on their tax returns. Some of the variations in virtual currencies and their interaction with the real economy are shown in figure 1.

²The 2007 Taxpayer Assistance Blueprint—a 5-year strategic plan for improving service to taxpayers—is a collaborative effort of IRS, the National Taxpayer Advocate, and the IRS Oversight Board. Congress has received annual update reports on the implementation of the blueprint.

³The term "barter exchange" means any organization of members providing property or services who jointly contract to trade or barter such property or services. 26 U.S.C. § 6045.
In a "closed-flow" virtual currency system, a virtual currency can be used only within a game or virtual environment to purchase virtual goods or services, such as additional tools to use within a game. Virtual tools amassed by players can be traded in a game for other in-game assets or to advance to higher play levels, but they hold no value outside of the game and cannot be cashed out for dollars or other government-issued currencies.

In a hybrid system, one or more of the flows between the virtual currency and real dollars or goods and services is closed. For example, participants can purchase virtual currency with real dollars or earn virtual currency by completing tasks, such as taking surveys, and then use the currency to purchase real or virtual goods and services. However, the virtual currency might not be exchangeable back into real dollars. An example of a hybrid system is some massively multiplayer online role-playing games (MMORPG). MMORPGs allow users to create avatars, or graphical representations of themselves, that exist within a digital world and interact with other avatars around the globe to carry out tasks. Some MMORPGs operate as a closed-flow system, but some of these closed-
flow systems can leak into the real economy via third-party transactions. Some MMORPGs, like World of Warcraft®, a large MMORPG, have third-party exchanges that allow users to exchange virtual goods for real dollars. This interaction between the virtual and real economies can be limited by the game’s distributor through terms of use agreements.

In an "open-flow" system, virtual currencies can be used to purchase both real and virtual goods and services, as well as be readily exchanged for government-issued currency, such as U.S. dollars. One example of an open-flow currency designed primarily for use in a virtual economy is Second Life® Linden™ dollars. Second Life, a product of Linden Lab®, is a virtual economy created in 2003 that has its own virtual currency. "Residents" of Second Life create avatars and interact with other avatars in a user-defined and user-created environment. Within Second Life, residents can create virtual assets, such as buildings that they rent or sell to other residents, or operate virtual businesses, such as virtual clothing stores that sell virtual goods to other residents. Transactions taking place within Second Life use Linden Lab’s virtual currency, Linden dollars. Second Life residents can sell their Linden dollars to other residents for U.S. dollars through the LindeX™ exchange, which uses third-party payment networks to process the payments and allows residents to cash out of the Second Life world.

An open-flow currency can also be developed and designed primarily to be used to purchase real goods and services outside an online game virtual economy. An example is bitcoin, a decentralized digital currency that uses a peer-to-peer computer network to move bitcoins around the world. Developed in 2009 by an anonymous programmer or programmers, bitcoin is a privately-issued digital currency that exists only as a long string of numbers and letters in a user’s computer file. Bitcoins use cryptography to secure and safeguard against counterfeiting. Unlike U.S. dollars and other currencies, bitcoin is not government issued and does not have a physical coin or bill associated with its circulation, such as a Federal Reserve note. Bitcoin has grown in popularity since its introduction and, according to academics and user groups with whom we spoke, is the most widely circulated virtual currency available. Bitcoins act as a real world currency in that users pay for real goods and services, such as coffee or web development services, with bitcoins as opposed to U.S. dollars or other government-issued currencies. Third-party exchanges allow bitcoin users to exchange their bitcoins back to government-issued currencies, such as U.S. dollars, euro, or yen.
Bitcoins are created and entered into circulation through a process, called mining, that members of the bitcoin network perform. To perform the work of mining, bitcoin miners download free bitcoin software that they use to solve complex equations. These equations serve to verify the validity of bitcoin transactions by grouping several transactions into a block and mathematically proving that the transactions occurred and do not represent double spending of a bitcoin. When a miner's computer solves an equation, the bitcoin network accepts the block of transactions as valid and creates 25 new bitcoins and awards them to the successful miner.\(^4\)

By the bitcoin program's design, there will be a maximum of 21 million bitcoins in circulation once all bitcoins have been mined, which the program's design projects to be in the year 2140. In addition to mining new bitcoins, users can also acquire bitcoins already in circulation by purchasing them on third-party exchanges or accepting bitcoins as gifts or payments for goods or services. Figure 2 shows an example of how bitcoins enter circulation and how an individual can use bitcoins to pay for real goods or services.

\(^4\)According to bitcoin's design, the number of bitcoins issued to successful miners will halve every time the network reaches 210,000 blocks, or approximately every four years. From inception through November 2012, rewards were 50 bitcoins. In 2016, rewards are expected to halve again to 12.5 bitcoins.
Figure 2: How Bitcoins Enter Circulation and Are Used in Transactions

1. **Mining**
   - Bitcoins enter into circulation through a process known as mining. Bill installs bitcoin mining software on his computer, which he uses to solve complex equations for the bitcoin network. If Bill successfully solves an equation, he receives a block of 25 bitcoins. Bitcoins come in the form of a long string of numbers and letters, known as a bitcoin address. Each bitcoin address is unique.

2. **Wallets and Addresses**
   - Bill stores his bitcoins in a bitcoin wallet, which is a program that saves bitcoin addresses, on a hard drive, on the internet, or another data storage device. Bitcoin users can have multiple wallets, each wallet can hold multiple addresses, and such an address holds a balance of bitcoins.

3. **Making a Purchase with Bitcoins**
   - Bill wants to buy a t-shirt from Carol, who accepts bitcoins. To conduct the transaction, Carol sends her bitcoin address to Bill. Bill instructs his wallet to send a payment to Carol's address.

4. **Verifying the Transaction**
   - The transaction is bundled with other transactions and verified by the bitcoin mining community in blocks. Solving complex equations, miners verify the transactions to ensure the transactions are valid and the transactions are then locked and added to the permanent bitcoin history, or block chain, eventually making the transactions irreversible.

5. **Transaction Complete**
   - Bill's bitcoins are credited to Carol's address within minutes, and the bitcoin transaction is complete. The miner that successfully solved the equations to verify the block containing Bill and Carol's transaction is rewarded with 25 bitcoins.

Source: GAO.
Bitcoin transactions can be anonymous, since all that is needed to complete a transaction is a bitcoin address, which does not contain any personal identifying information. Only the private key holder knows the identity of the bitcoin address owner.

The size of the virtual economy and currency markets is unclear due to limitations in available data. For example, some companies that offer virtual economy platforms are private firms and do not report statistics about their virtual worlds' activities. Further, due to the global nature of the Internet, borderless transactions, and an individual’s ability to have multiple virtual economy or currency accounts, we did not find reliable data available indicating the use of virtual economies or currencies by individuals or exclusively by U.S. taxpayers. Even with these limitations, some data exist that may provide some context for the size of virtual economy and currency markets.

- According to bitcoin’s peer-to-peer-network-generated statistics, as of May 1, 2013, approximately 11 million bitcoins were in circulation. From May 2012 through February 2013, prices ranged between $5 and $20 for 1 bitcoin. Prices increased through March 2013, and then from April 1, 2013, to May 1, 2013, ranged between $79 and over $237 for 1 bitcoin. In the same time period, the number of bitcoin transactions per day ranged from approximately 8,000 to 70,000 transactions per day.

- As of December 31, 2012, there were over 9.6 million active users of World of Warcraft, a large MMORPG, according to Blizzard Entertainment, the company that develops and publishes the World of Warcraft games.

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5Given these limitations, we did not test the reliability of data, such as the data generated from the bitcoin network, but are providing some figures to provide context for the possible size of these markets.

6http://blockchain.info. (Date accessed May 1, 2013.)

7Due to data limitations, it is difficult to calculate the velocity, or the rate at which bitcoins are spent, and the number of transactions between unique users in a given time period.

8https://mtgox.com. (Date accessed May 1, 2013.) https://mtgox.com operates the largest bitcoin exchange. The site has daily and monthly limits on how many bitcoins may be exchanged back to U.S. dollars or other virtual or government-issued currencies. These limits may be raised if users provide additional documentation confirming their identity.
According to Linden Lab, creators of Second Life, residents exchanged more than US$150 million worth of Linden dollars within Second Life's economy in the third quarter of 2010.

IRS is responsible for ensuring taxpayer compliance for all economic areas, including virtual economies and currencies. One mechanism that assists IRS in enforcing tax laws is information reporting, through which third parties report to IRS and taxpayers on certain taxpayer transactions. For example, subject to certain thresholds, third-party settlement organizations are required to report on Form 1099-K payments in settlement of third-party network transactions. A common example of a third-party settlement organization is an online auction-payment facilitator, which operates as an intermediary between buyers and sellers by transferring funds between their accounts in settlement of purchases. Another type of third-party information reporting is performed by barter exchanges, which, generally, are organizations that facilitate barter transactions among exchange members. Such barter exchanges are required to report on Form 1099-B each member's barter transactions proceeds. Third-party information reporting is widely acknowledged to increase voluntary tax compliance, in part because taxpayers know that IRS is aware of their income.

Likewise, in its role in administering the tax code, IRS must implement the laws Congress enacts through detailed guidance. To accomplish this responsibility, IRS publishes several forms of guidance, such as regulations, revenue rulings and procedures, and notices. IRS also provides more informal guidance on its website based on factors such as perceived need, media coverage, or IRS staff identifying an emerging tax compliance issue. As outlined in IRS’s Taxpayer Assistance Blueprint and related reports, a key part of IRS’s strategy for preventing and minimizing noncompliance is to outreach to taxpayers to help them understand and meet their tax responsibilities. One of the guiding principles of this approach is to enhance IRS’s website so that it becomes the first choice of taxpayers for obtaining the information they need to comply.

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9Third-party settlement organizations must file Form 1099-K if gross payments to a payee exceed $20,000 and there are more than 200 transactions with the payee in a given tax year.
Virtual Economy and Currency Transactions May Be Taxable If They Produce Income

Transactions within virtual economies or using virtual currencies could produce taxable income in a number of ways depending on their specific facts and circumstances. U.S. tax laws and regulations generally require taxpayers to report and pay taxes on all income, regardless of the source from which the income was derived;\textsuperscript{10} there are no additional rules specific to virtual currencies or economies. For example, similar to cash transactions, there are no third-party reporting requirements specific to virtual economy or currency transactions, as there are with some other types of electronic funds transactions, such as with transactions conducted through third-party payment networks. Taxpayers are required to account for any taxable income, including income that is not subject to third-party information reporting. The following examples show how some taxpayers may incur a tax liability when using a virtual currency for the three types of virtual currency systems described in the background of this report. We discussed these examples with IRS officials, who agreed with how we characterized the potential tax implications.

\textsuperscript{10}For federal tax purposes, all income is taxable, although the tax code excludes some items from income, such as gifts or inheritances, subject to exceptions, while it allows other items to be deducted to reduce taxable income, subject to limitations and restrictions, such as trade or business expenses.

- David plays an online game through which he is issued money that he can use to purchase properties within the game. These properties
have no value outside the game and David cannot exchange his online money for U.S. dollars. David has not engaged in a taxable transaction.

- Ann plays an online game and amasses virtual tools that are valuable to her avatar. The online game does not allow users to directly exchange their virtual tools for U.S. dollars, but rather they can do so using a third-party, making this a hybrid system. Ann uses a third-party exchange not affiliated with the online game to coordinate the transfer of her virtual tools to another player in exchange for U.S. dollars. The transfer is conducted by the third-party exchange and payment is mediated by a third-party payment network. Ann may have earned taxable income from the sale of these virtual tools.
- John is a resident of Second Life. He rents virtual property to other residents who pay him in Linden dollars. At the end of the year, John exchanges his Linden dollars for U.S. dollars and realizes a profit. John may have earned taxable income from his activities in Second Life.

- Bill is a bitcoin miner. He successfully mines 25 bitcoins. Bill may have earned taxable income from his mining activities.

- Carol makes t-shirts and sells them over the Internet. She sells a t-shirt to Bill, who pays her with bitcoins. Carol may have earned taxable income from the sale of the t-shirt.

Virtual Economies and Currencies Pose Various Tax Compliance Risks, but the Extent of Noncompliance Is Unknown

IRS, tax experts, academics, and others have identified various tax compliance risks associated with virtual economies and currencies, including underreporting, mischaracterization, and evasion. These risks are not unique to virtual economies and currencies, as they also exist for other types of transactions, such as cash transactions, where there are not always clear records or third-party tracking and reporting of transactions. The tax compliance risks we identified for virtual economies and currencies are described below.

- **Taxpayer lack of knowledge of tax requirements.** Income is generally defined as any undeniable accessions to wealth, clearly
realized, and over which the taxpayers have complete dominion.\textsuperscript{11} The unsophisticated taxpayer may not properly identify income earned through virtual economies or currencies, such as virtual online game assets exchanged for real word currency, as taxable income. If taxpayers using virtual currencies turn to the Internet for tax help, they may find misinformation in the absence of clear guidance from IRS. For example, when we performed a simple Internet search for information on taxation of bitcoin transactions, we found a number of websites, wikis, and blogs that provided differing opinions on the tax treatment of bitcoins, including some that could lead taxpayers to believe that transacting in virtual currencies relieves them of their responsibilities to report and pay taxes.

- **Uncertainty over how to characterize income.** Even if taxpayers are aware that they may have a tax liability, they may be uncertain about the proper tax treatment of virtual transactions, according to tax experts, including academics and tax practitioners with whom we spoke. For example, characterization depends on whether the virtual economy activity or virtual currency unit is to be treated as property, barter, foreign currency, or a financial instrument. According to some experts with whom we spoke, some virtual currency transactions could be considered barter transactions, which may not be an obvious characterization to unsophisticated taxpayers.\textsuperscript{12} This characterization could result in noncompliance with requirements for reporting and paying tax on barter income.

- **Uncertainty over how to calculate basis for gains.** Income earned from virtual economy or currency transactions may not be taxable if it is equivalent to that from an occasional online garage sale, meaning occasional income from selling goods for less than their original purchase price. It may be difficult for individuals receiving income from virtual economies to determine their basis for calculating gains. For example, some online games require players to pay a monthly fee in exchange for use of the game and a monthly allowance of virtual currency. If a player then sells a virtual tool gained in the game for real money, calculating the basis for any taxable gain may be difficult for the unsophisticated taxpayer.


\textsuperscript{12}26 U.S.C. § 6045 addresses barter exchanges and barter transactions.
- **Challenges with third-party reporting.** Third-party information reporting requirements do not apply specifically to transactions using virtual economies or currencies. Virtual economy or currency transactions may be subject to third-party information reporting to the extent that these transactions involve the use of a third-party payment network to mediate the transaction and the taxpayer meets reporting threshold requirements. Because virtual economy and currency transactions are inherently difficult to track, including identifying the true identities of the parties to the transaction, third-party information reporting may be difficult or prohibitively burdensome for some virtual economy and currency issuers to administer.

- **Evasion.** Some taxpayers may use virtual economies and currencies as a way to evade taxes. Because transactions can be difficult to trace and many virtual economies and currencies offer some level of anonymity, taxpayers may use them to hide taxable income.

Because of the limited reliable data available on their size, it is difficult to determine how significant virtual economy and currency markets may be or how much tax revenue is at risk through their usage. Some experts with whom we spoke indicated that there is potential for growth in the use of virtual currencies. Additionally, the European Central Bank recently issued a report on virtual currencies, acknowledging their potential for future growth and interaction with the real economy. If the use of virtual economies and currencies expands, it can be expected that associated revenue at risk of tax noncompliance will grow.

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14European Central Bank, *Virtual Currency Schemes* (Frankfurt am Main, Germany: October 2012).
IRS Has Provided Some Guidance on Tax Reporting Requirements for Virtual Economies but Not for Virtual Currencies Used Outside of Virtual Economies

IRS has assessed the tax compliance risks from virtual economies and virtual currencies used within those economies, and developed a plan to address them in a manner consistent with internal control standards. Beginning in 2007, IRS's Electronic Business and Emerging Issues (EBEI) policy group identified and surveyed internal and external information sources, gathered data on the industry, and collect trend information, among other efforts. EBEI determined that virtual economies presented opportunities for income underreporting and developed (1) a potential compliance strategy, including initiating a compliance improvement project to gather research data and analyze compliance trends, and (2) a potential action plan for specific compliance activities. According to IRS compliance officials, IRS ultimately decided not to pursue these actions in light of available IRS resources and other higher priority needs. Also, IRS did not find strong evidence of the potential for tax noncompliance related to virtual economies, such as the number of U.S. taxpayers involved in such activity or the amount of federal tax revenue at risk.

However, in November 2009, based on EBEI having determined the need, IRS posted information on its website on the tax consequences of virtual economy transactions. The web page points out that, in general, taxpayers can receive income in the form of money, property, or services from a virtual economy, and that if taxpayers receive more income than they spend, they may be required to report their gains as taxable income. The page further states that IRS has provided guidance on the tax treatment of issues similar to online gaming activities, including bartering, gambling, business, and hobby income, and provides links to IRS publications on those topics. IRS officials who were involved in issuing this guidance reported it cost less to make an online statement pointing taxpayers to existing guidance than it would have cost to develop and publish new guidance specific to virtual economies.

IRS has not assessed the tax compliance risks of open-flow virtual currencies developed and used outside of virtual economies. These types of currencies, generally, were introduced after IRS's last review of compliance related to virtual economy transactions. According to IRS compliance officials, IRS would learn about tax compliance issues related to virtual currencies as it would any other tax compliance issue, such as IRS examiners identifying compliance problems during examinations or taxpayers requesting guidance on how to comply with certain tax requirements. To date, these processes have not resulted in IRS identifying virtual currencies used outside of virtual economies as a compliance risk that warrants specific attention.
 Likewise, IRS has not issued guidance specific to virtual currencies used outside of virtual economies due to competing priorities and resource constraints, and because the use of virtual currencies is a relatively recent development that requires further consideration before guidance can be issued, according to IRS’s Office of Chief Counsel and compliance officials. As previously discussed, taxpayers may be unaware that income from transactions using this type of virtual currency may be taxable, or if they are aware, uncertain on how to characterize it. By not issuing guidance, IRS may be missing an opportunity to address these compliance risks and minimize their impact and the potential for noncompliance. Given the uncertain extent of noncompliance related to virtual currency transactions, formal guidance, such as regulations, revenue rulings, or revenue notices, may not be warranted at this time. According to officials from IRS’s Office of Chief Counsel, these types of guidance require extensive review within IRS and the Department of the Treasury and, in some cases, public comment, which add to the time and cost of development. However, IRS may be able to develop informal guidance, which, according to Chief Counsel officials, requires less extensive agency review and can be based on other existing guidance. As such, IRS can develop informal guidance in a more timely and less costly manner than formal guidance, according to the officials. An example of such informal guidance is the information IRS provides to taxpayers on its website on the tax consequences of virtual economy transactions. Posting such information to its website would be consistent with IRS’s strategy for preventing and minimizing taxpayers’ noncompliance by helping them understand and meet their tax responsibilities, as outlined in IRS’s Taxpayer Assistance Blueprint.

Conclusions

Virtual economies and the use of virtual currencies intended as alternatives to government-issued currencies are a recent phenomenon, and the extent to which their use results in tax noncompliance is unknown. Given this uncertainty, available funding, and other priorities, IRS made a reasoned decision not to implement a compliance approach specific to virtual economies and currencies. However, IRS did see value

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15 Although IRS has not issued guidance, another Department of the Treasury agency, the Financial Crimes Enforcement Network, recently issued interpretive guidance clarifying the treatment of persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies. However, such guidance does not discuss the tax treatment of virtual currency transactions. FIN-2013-G001
in providing taxpayers with information on the tax consequences of virtual economy transactions, a low-cost step to potentially mitigate some of the noncompliance risk associated with such transactions. The uncertainty about the extent virtual currencies are used in taxable transactions and any associated tax noncompliance means that costly compliance activities are not merited at this time. However, the fact that misinformation is circulating and the possibility of growth in the use of virtual currencies outside virtual economies suggest that it would be prudent to take low-cost steps, if available, to mitigate potential compliance risks. The type of information IRS provided about virtual economy transactions is one model.

Recommendation for Executive Action

To mitigate the risk of noncompliance from virtual currencies, the Commissioner of Internal Revenue should find relatively low-cost ways to provide information to taxpayers, such as the web statement IRS developed on virtual economies, on the basic tax reporting requirements for transactions using virtual currencies developed and used outside virtual economies.

Agency Comments and Our Evaluation

We sent a draft of this report to the Acting Commissioner of Internal Revenue for comment. In written comments, reproduced in appendix I, IRS agreed with our recommendation and stated it would provide information to taxpayers on the basic tax reporting requirements for transactions involving virtual currencies by linking to existing relevant guidance. IRS noted that it was aware of the tax compliance risks associated with virtual currencies and was taking other steps, such as developing training resources for agents, to address them. IRS also provided technical comments on our draft report, which we incorporated, as appropriate.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to interested congressional committees, the Secretary of the Treasury, the Acting Commissioner of Internal Revenue, and other interested parties. In addition, the report also will be available at no charge on the GAO website at http://www.gao.gov.
If you or your staff have any questions about this report, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix II.

James R. White
Director, Tax Issues
Strategic Issues
May 3, 2013

Mr. James R. White
Director, Tax Issues
Strategic Issues Team
U.S. Government Accountability Office
441 G. Street NW
Washington, DC 20548

Dear Mr. White:

Thank you for the opportunity to review your draft report entitled, "VIRTUAL ECONOMIES AND CURRENCIES: Additional IRS Guidance Could Reduce Tax Compliance Risks" (GAO 13-516). We are pleased your report acknowledges the Service’s efforts to provide taxpayers with information on the tax consequences of virtual economy transactions by posting information on our website and providing links to existing IRS guidance on bartering, gambling, business, and hobby income.

As your report notes, we began evaluating the tax compliance risks associated with virtual economies and virtual currencies in 2007. Although the Service did not specifically use the term "virtual currency," which was not well-defined at the time, this evaluation included all types of electronic payment systems. The systems evaluated included what is now covered by the term "virtual currency" whether used inside or outside the virtual world.

The Service is aware of the potential tax compliance risks posed by off-shore and anonymous electronic payment systems, and we are working to address these risks. Our efforts have included discussions with other federal agencies, evaluating our agents’ expertise, developing continuing professional education curricula, providing online and classroom training, and creating lead sheets and questionnaires for agent use during examinations.
We agree that providing taxpayers with information on the basic tax reporting requirements for transactions involving virtual currencies could further aid our efforts. The enclosed response addresses your recommendation.

If you have questions, please call me, or members of your staff may contact Faris Fink, Commissioner, Small Business/Self Employed Division at (202)622-0600.

Sincerely,

[Signature]

Steven T. Miller
Deputy Commissioner for Services and Enforcement

Enclosure
Enclosure

GAO Recommendation and IRS Response to GAO Draft Report
VIRTUAL ECONOMIES AND CURRENCIES: Additional IRS Guidance Could Reduce
Tax Compliance Risks (GAO-13-516)

Recommendation
To mitigate the risk of noncompliance from virtual currencies, the Commissioner of
Internal Revenue should find relatively low-cost ways to provide information to
taxpayers - such the Web statement IRS developed on virtual economies - on the basic
tax reporting requirements for transactions using virtual currencies developed and used
outside virtual economies.

Comment
We will provide information to taxpayers on the basic tax reporting requirements for
transactions involving virtual currencies by linking to existing relevant guidance.
Appendix II: GAO Contact and Staff Acknowledgments

<table>
<thead>
<tr>
<th>GAO Contact</th>
<th>James R. White, (202) 512-9110 or <a href="mailto:whitej@gao.gov">whitej@gao.gov</a></th>
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<tr>
<td>Staff Acknowledgments</td>
<td>In addition to the contact named above, Jeff Arkin (Assistant Director), David Dornisch, Lois Hanshaw, Richard Hung, Ronald W. Jones, Donna Miller, Ed Nannenhorn, Danielle N. Novak, and Sabrina Streagle made key contributions to this report.</td>
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IRS Notice 2014-21 (2014)
Notice 2014-21

SECTION 1. PURPOSE

This notice describes how existing general tax principles apply to transactions using virtual currency. The notice provides this guidance in the form of answers to frequently asked questions.

SECTION 2. BACKGROUND

The Internal Revenue Service (IRS) is aware that “virtual currency” may be used to pay for goods or services, or held for investment. 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.

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as “convertible” virtual currency. Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies. For a more comprehensive description of convertible virtual currencies to date, see Financial Crimes Enforcement Network (FinCEN) Guidance on the Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (FIN-2013-G001, March 18, 2013).

SECTION 3. SCOPE

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. This notice addresses only the U.S. federal tax consequences of transactions in, or transactions that use, convertible virtual currency, and the term “virtual currency” as used in Section 4 refers only to convertible virtual currency. No inference should be drawn with respect to virtual currencies not described in this notice.

The Treasury Department and the IRS recognize that there may be other questions regarding the tax consequences of virtual currency not addressed in this notice that warrant consideration. Therefore, the Treasury Department and the IRS request comments from the public regarding other types or aspects of virtual currency transactions that should be addressed in future guidance.

Comments should be addressed to:
Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand delivered Monday through Friday between the hours of 8 A.M. and 4 P.M. to:

Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, taxpayers may submit comments electronically via e-mail to the following address: Notice.Comments@irs.counsel.treas.gov. Taxpayers should include "Notice 2014-21" in the subject line. All comments submitted by the public will be available for public inspection and copying in their entirety.

For purposes of the FAQs in this notice, the taxpayer’s functional currency is assumed to be the U.S. dollar, the taxpayer is assumed to use the cash receipts and disbursements method of accounting and the taxpayer is assumed not to be under common control with any other party to a transaction.

SECTION 4. FREQUENTLY ASKED QUESTIONS

Q-1: How is virtual currency treated for federal tax purposes?

A-1: For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.

Q-2: Is virtual currency treated as currency for purposes of determining whether a transaction results in foreign currency gain or loss under U.S. federal tax laws?

A-2: No. Under currently applicable law, virtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes.

Q-3: Must a taxpayer who receives virtual currency as payment for goods or services include in computing gross income the fair market value of the virtual currency?

A-3: Yes. A taxpayer who receives virtual currency as payment for goods or services must, in computing gross income, include the fair market value of the virtual currency,
measured in U.S. dollars, as of the date that the virtual currency was received. See Publication 525, Taxable and Nontaxable Income, for more information on miscellaneous income from exchanges involving property or services.

**Q-4: What is the basis of virtual currency received as payment for goods or services in Q&A-3?**

**A-4:** The basis of virtual currency that a taxpayer receives as payment for goods or services in Q&A-3 is the fair market value of the virtual currency in U.S. dollars as of the date of receipt. See Publication 551, Basis of Assets, for more information on the computation of basis when property is received for goods or services.

**Q-5: How is the fair market value of virtual currency determined?**

**A-5:** For U.S. tax purposes, transactions using virtual currency must be reported in U.S. dollars. Therefore, taxpayers will be required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt. If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into U.S. dollars (or into another real currency which in turn can be converted into U.S. dollars) at the exchange rate, in a reasonable manner that is consistently applied.

**Q-6: Does a taxpayer have gain or loss upon an exchange of virtual currency for other property?**

**A-6:** Yes. If the fair market value of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency, the taxpayer has taxable gain. The taxpayer has a loss if the fair market value of the property received is less than the adjusted basis of the virtual currency. See Publication 544, Sales and Other Dispositions of Assets, for information about the tax treatment of sales and exchanges, such as whether a loss is deductible.

**Q-7: What type of gain or loss does a taxpayer realize on the sale or exchange of virtual currency?**

**A-7:** 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. Inventory and other property held mainly for sale to customers in a trade or
business are examples of property that is not a capital asset. See Publication 544 for more information about capital assets and the character of gain or loss.

Q-8: Does a taxpayer who “mines” virtual currency (for example, uses computer resources to validate Bitcoin transactions and maintain the public Bitcoin transaction ledger) realize gross income upon receipt of the virtual currency resulting from those activities?

A-8: Yes, when a taxpayer successfully “mines” virtual currency, the fair market value of the virtual currency as of the date of receipt is includible in gross income. See Publication 525, *Taxable and Nontaxable Income*, for more information on taxable income.

Q-9: Is an individual who “mines” virtual currency as a trade or business subject to self-employment tax on the income derived from those activities?

A-9: If a taxpayer’s “mining” of virtual currency constitutes a trade or business, and the “mining” activity is not undertaken by the taxpayer as an employee, the net earnings from self-employment (generally, gross income derived from carrying on a trade or business less allowable deductions) resulting from those activities constitute self-employment income and are subject to the self-employment tax. See Chapter 10 of Publication 334, *Tax Guide for Small Business*, for more information on self-employment tax and Publication 535, *Business Expenses*, for more information on determining whether expenses are from a business activity carried on to make a profit.

Q-10: Does virtual currency received by an independent contractor for performing services constitute self-employment income?

A-10: Yes. Generally, self-employment income includes all gross income derived by an individual from any trade or business carried on by the individual as other than an employee. Consequently, the fair market value of virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income and is subject to the self-employment tax. See FS-2007-18, April 2007, *Business or Hobby? Answer Has Implications for Deductions*, for information on determining whether an activity is a business or a hobby.

Q-11: Does virtual currency paid by an employer as remuneration for services constitute wages for employment tax purposes?

A-11: Yes. Generally, the medium in which remuneration for services is paid is immaterial to the determination of whether the remuneration constitutes wages for employment tax purposes. Consequently, the fair market value of virtual currency paid as wages is subject to federal income tax withholding, Federal Insurance Contributions
Act (FICA) tax, and Federal Unemployment Tax Act (FUTA) tax and must be reported on Form W-2, Wage and Tax Statement. See Publication 15 (Circular E), Employer’s Tax Guide, for information on the withholding, depositing, reporting, and paying of employment taxes.

Q-12: Is a payment made using virtual currency subject to information reporting?

A-12: A payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property. For example, a person who in the course of a trade or business makes a payment of fixed and determinable income using virtual currency with a value of $600 or more to a U.S. non-exempt recipient in a taxable year is required to report the payment to the IRS and to the payee. Examples of payments of fixed and determinable income include rent, salaries, wages, premiums, annuities, and compensation.

Q-13: Is a person who in the course of a trade or business makes a payment using virtual currency worth $600 or more to an independent contractor for performing services required to file an information return with the IRS?

A-13: Generally, a person who in the course of a trade or business makes a payment of $600 or more in a taxable year to an independent contractor for the performance of services is required to report that payment to the IRS and to the payee on Form 1099-MISC, Miscellaneous Income. Payments of virtual currency required to be reported on Form 1099-MISC should be reported using the fair market value of the virtual currency in U.S. dollars as of the date of payment. The payment recipient may have income even if the recipient does not receive a Form 1099-MISC. See the Instructions to Form 1099-MISC and the General Instructions for Certain Information Returns for more information. For payments to non-U.S. persons, see Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.

Q-14: Are payments made using virtual currency subject to backup withholding?

A-14: Payments made using virtual currency are subject to backup withholding to the same extent as other payments made in property. Therefore, payors making reportable payments using virtual currency must solicit a taxpayer identification number (TIN) from the payee. The payor must backup withhold from the payment if a TIN is not obtained prior to payment or if the payor receives notification from the IRS that backup withholding is required. See Publication 1281, Backup Withholding for Missing and Incorrect Name/TINs, for more information.

Q-15: Are there IRS information reporting requirements for a person who settles payments made in virtual currency on behalf of merchants that accept virtual currency from their customers?
A-15: Yes, if certain requirements are met. In general, a third party that contracts with a substantial number of unrelated merchants to settle payments between the merchants and their customers is a third party settlement organization (TPSO). A TPSO is required to report payments made to a merchant on a Form 1099-K, Payment Card and Third Party Network Transactions, if, for the calendar year, both (1) the number of transactions settled for the merchant exceeds 200, and (2) the gross amount of payments made to the merchant exceeds $20,000. When completing Boxes 1, 3, and 5a-1 on the Form 1099-K, transactions where the TPSO settles payments made with virtual currency are aggregated with transactions where the TPSO settles payments made with real currency to determine the total amounts to be reported in those boxes. When determining whether the transactions are reportable, the value of the virtual currency is the fair market value of the virtual currency in U.S. dollars on the date of payment.

See The Third Party Information Reporting Center, http://www.irs.gov/Tax-Professionals/Third-Party-Reporting-Information-Center, for more information on reporting transactions on Form 1099-K.

Q-16: Will taxpayers be subject to penalties for having treated a virtual currency transaction in a manner that is inconsistent with this notice prior to March 25, 2014?

A-16: Taxpayers may be subject to penalties for failure to comply with tax laws. For example, underpayments attributable to virtual currency transactions may be subject to penalties, such as accuracy-related penalties under section 6662. In addition, failure to timely or correctly report virtual currency transactions when required to do so may be subject to information reporting penalties under section 6721 and 6722. However, penalty relief may be available to taxpayers and persons required to file an information return who are able to establish that the underpayment or failure to properly file information returns is due to reasonable cause.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Keith A. Aqui of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information about income tax issues addressed in this notice, please contact Mr. Aqui at (202) 317-4718; for further information about employment tax issues addressed in this notice, please contact Mr. Neil D. Shepherd at (202) 317-4774; for further information about information reporting issues addressed in this notice, please contact Ms. Adrienne E. Griffin at (202) 317-6845; and for further information regarding foreign currency issues addressed in this notice, please contact Mr. Raymond J. Stahl at (202) 317-6938. These are not toll-free calls.
Sept 7, 2015 IRS contract with Chainalysis Inc.
**ORDER FOR SUPPLIES OR SERVICES**

**IMPORTANT:** Mark all packages and papers with contract and/or order numbers.

1. **DATE OF ORDER:** 09/07/2015
2. **CONTRACT NO.:** TINNO-15-P-00340
3. **ORDER NO.:** V-S-V0-02-MD-802 000
4. **REQUISITION/REFERENCE NO.:**
   - **NAME OF CONTRACTOR:** Genevieve Colvin
   - **COMPANY NAME:** CHAINALYSIS INC.
   - **STREET ADDRESS:** 1510 Page Mill Rd STE 110
   - **CITY:** Palo Alto
   - **STATE:** CA
   - **ZIP CODE:** 94304
   - **ACCOUNTING AND APPROPRIATION DATA:** 15150939 V00052 01 3152 00 MCB4
   - **BUSINESS CLASSIFICATION (Other than Small):** Eligible Under the WOSB Program
   - **PLACE OF DELIVERY:** 1914 Government Blk No.
   - **DELIVER TO F.O.B. POINT ON OR BEFORE:** 09/09/2015
   - **DISADVANTAGED:** Small, Other Than Small, Women-Owned Small Business (WOB), HUBZone, Small Business (WOSB)
   - **ENTITY UNDER THE NO F.O.B. POINT:** Destination
   - **GOVERNMENT BILL NO.:** 15 DELIVER TO F.O.B. POINT ON OR BEFORE (Date): 09/09/2015
   - **DISCOUNT TERMS:** Terms: 0% Days: 0
   - **REQUISITIONING OFFICE:** GSA/P

### SCHEDULE (See reverse for Rejections)

<table>
<thead>
<tr>
<th>ITEM NO.</th>
<th>SUPPLIES OR SERVICES</th>
<th>QUANTITY ORDERED</th>
<th>UNIT</th>
<th>UNIT PRICE</th>
<th>AMOUNT</th>
</tr>
</thead>
<tbody>
<tr>
<td>001</td>
<td>The contractor shall provide one Chainalysis Reactor Investigate License for 12 months in accordance with the attached statement of work. Period of performance: September 7, 2016 through September 6, 2018. Cost breakdown is as follows: $1,059 x 12 months = $13,188. Invoicing advance payment authorized in accordance with 31 U.S.C. 3324(d)(2). Purchase order number should be shown on all invoices and packing.</td>
<td>12.00</td>
<td>YR</td>
<td>1,099.00</td>
<td>13,188.00</td>
</tr>
</tbody>
</table>

**22. UNITED STATES OF AMERICA BY (Signature):** Genevieve Colvin

**AUTHORIZED FOR LOCAL REPRODUCTION:** Computer Generated

**PREVIOUS EDITION NOT VULNEABLE**
(Continued)

Delivery: Electronic delivery to: __________________________

Refer contractual questions or concerns to
Faith Ashton at (240) 613-7386.
C.1 INTRODUCTION
In support of its mission, Internal Revenue Service (IRS) Criminal Investigation (CI) needs to obtain access to the commercial database World Check, which will give us immediate access to overseas data from 256 different countries where World Check analysts are gathering facts on companies, business individuals, local attorneys and more. This is the viable source for this information.

C.2 OBJECTIVE
The purpose of this acquisition is to get access to the contractor reactor to help us trace the movement of money through the bitcoin economy. This is necessary to identify and obtain evidence on individuals using bitcoin to either launder money or conceal income as part of tax fraud or other Federal crimes.

C.3 SCOPE
The scope includes procuring the following products:

<table>
<thead>
<tr>
<th>Product</th>
<th>Description of Goods or Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reactor</td>
<td>Investigative license</td>
</tr>
</tbody>
</table>

C.4 TASKS
TECHNICAL SUPPORT
Vendor shall provide access to the contractor through a web application that communicates to servers where data analysis, research and annotations are stored. User is able to start investigations using a breadth of data sources from known Bitcoin services to transactions hashes, Bitcoin addresses and arbitrary amounts of text.

C.5 DELIVERY
The IRS CI Point of Contact is IRS CI, Attn: 

CONTRACT ADMINISTRATION DATA
(a) The Contracting Officer for this requirement is:

Page C - 1
Genevieve Colvin  
Internal Revenue Service  
Office of Procurement  

**Contracting Officer's Representative (COR) Point of Contact**  
The COR Point of Contact for this order is listed below:  

- **Name:**  
- **Address:**  
- **Voice:**  
- **Email:**  

(b) Performance of work under this contract must be subject to the technical direction of the COR identified above, or a representative designated in writing. The term "technical direction" includes, without limitation, direction to the contractor that directs or redirects the labor effort, shifts the work between work areas or locations, fills in details and otherwise serves to ensure that tasks outlined in the work statement are accomplished satisfactorily.  

(c) Technical direction must be within the scope of the specification(s)/work statement. The COR does not have authority to issue technical direction that:  

1. constitutes a change of assignment or additional work outside the specification(s)/work statement;  
2. constitutes a change as defined in the clause entitled "Changes";  
3. in any manner causes an increase or decrease in the contract price, or the time required for contract performance;  
4. changes any of the terms, conditions, or specification(s)/work statement of the contract;  
5. interferes with the contractor's right to perform under the terms and conditions of the contract; or  
6. directs, supervises or otherwise controls the actions of the contractor's employees.  

(d) Technical direction may be oral or in writing. The COR shall confirm oral direction in writing within five work days, with a copy to the contracting officer.  

(e) The contractor shall proceed promptly with performance resulting from the technical direction issued by the COTR. If, in the opinion of the contractor, any direction of the COTR, or his/her designee, falls within the limitations in (c), above, the contractor shall immediately notify the contracting officer no later than the beginning of the next Government work day.  

(f) Failure of the contractor and the contracting officer to agree that technical direction is within the scope of the contract shall be subject to the terms of the clause entitled "Disputes."  

**C.6 PLACE OF PERFORMANCE**  
300 North Los Angeles Street  
Room 5016  
Los Angeles, CA 90012  

**C.7 PERIOD OF PERFORMANCE**  
Period of performance: Date of award through September 6, 2016
C.8 GOVERNMENT-FURNISHED PROPERTY
Access to Government property does not apply.

9. **Section 508 Compliance**

**B. 508 Compliance:**

Section 508 of the Rehabilitation Act Amendments of 1998 (29 U.S.C. 794d) was adopted to ensure that the Government’s electronic and information technology allows Federal employees with disabilities access to, and use of, information and data that is comparable to that which is available to, and for use by, Federal employees without disabilities. Section 508 contains exceptions (e.g., national security, individual purchase would result in undue burden on the agency, back office systems, etc.) -- a list of such exceptions is available at the U.S. Government's Section 508 web site:

Section 508 requires that Federal procurement officials assess electronic and information technologies in relation to the Access Board's published Electronic and Information Technology Standards [hereafter Section 508 Standards] -- procuring, developing, using, and maintaining only those end-user products most closely conforming to Section 508 Standards. While Section 508 does not regulate private sector or state and local government agencies, it encourages the adoption of Section 508 principles when making purchasing decisions.

Electronic and information technology (EIT) has the same meaning as "information technology" except EIT also includes any equipment or interconnected system or subsystem of equipment that is used in the creation, conversion, or duplication of data or information. The term EIT includes, but is not limited to, telecommunication products (such as telephones), information kiosks and transaction machines, worldwide websites, multimedia, and office equipment (such as copiers and fax machines).

According to Section 508 Standards, an information technology system is accessible to people with disabilities if it can be used in a variety of ways that do not depend on a single sense or ability. For example, a system that provides output only in audio format would not be accessible to people with hearing impairments, and a system that requires mouse actions to navigate would not be accessible to people who cannot use a mouse because of a dexterity or visual impairment.

Even with an accessible system, individuals with disabilities may still need specific accessibility-related software or peripheral devices as an accommodation to be able to use it. For example, in order to use a telephone, a person who is hard of hearing may need add-on equipment such as TDD adapters. This is a perfectly acceptable and permissible way to conform to Section 508 Standards.
<table>
<thead>
<tr>
<th>1. Requester:</th>
<th>2. Estimated Cost:</th>
<th>3. Requisition No.:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$13,188</td>
<td>VSV02MCO2000</td>
</tr>
</tbody>
</table>

4. Company Name (include address):
Chainalysis Inc
175 Varick Street
New York, NY 10014

5. Performance Period:
Date of Award through September 6, 2016

6. Description of Supplies/Services:
Chainalysis Reactor Investigate License

7. Authority Permitting a Sole Source Acquisition: FAR 13.106-1(b)(1)—Contracting Officers (COs) may solicit from one source if the CO determines that the circumstances of the contract action deem only one source reasonably available.

Check the appropriate authority from the list below:
[X] Only one responsible source; or brand-name specification.
[ ] Unusual and compelling urgency.
[ ] Industrial mobilization, engineering, developmental or research capability, exclusive licensing agreement, or expert services.

8. Describe why only one source can perform the required work:
Chainalysis is the only company in the United States that mines and links the necessary bitcoin transaction data and provides access to their proprietary database of bitcoin transactions. Chainalysis is the originator of this data and there are no resellers or distributors — it is a web-based product. They have collected data that no one else has.

9. Describe the informal market survey and the results, or state why a market survey was not conducted:
Since bitcoin is a new and emerging technology, there is not yet an established market in bitcoin transaction analytics services in the United States (although there are a few vendors of bitcoin news/price analytics, which is not directly related). However, common technology emerging news sources (including Reddit and CoinDesk) have been consulted and no other current product offerings for bitcoin transaction analytics services with similar data were identified in the United States.

10. Requester Signature & Title:
Requester Signature
Phone No.: 07/16/2015

11. CO Certification: I determine the circumstances of this acquisition deem only one source reasonably available.

Genevieve
Colvin
CO Signature

12. Small Business Specialist (SBS) Certification (if over $25,000):
SBS Signature
Rev. 2/2015
To whom it may concern,

Chainalysis Inc. is the sole manufacturer of the product Reactor and there are no resellers. It is the first and only real-time investigation tool for tracing Bitcoin transactions. Leveraging the largest proprietary database of meta-data associated with Bitcoin transactions, investigators are able to gain greater insights over the source of funds of particular Bitcoin transactions and follow the money from hacks, ransomware and other malicious activity.

Reactor is provided through a web application that communicates to our servers where the data analysis, research and annotations are stored. The user is able to start their investigation using a breadth of data sources from known Bitcoin services to transactions hashes, Bitcoin addresses and arbitrary amounts of text. Once the investigator has started the investigation all the calculations about how different entities in the Bitcoin network are all calculated in real-time and the data is kept live, displaying the latest information about recent transactions. There is no other tool that is capable of doing these calculations in real-time.

Our real-time infrastructure allows the user to create custom clusters of Bitcoin addresses to assist in spotting transaction patterns, interactions with other entities and simplify an investigation so that it can be presented as court evidence. The flexibility of calculating everything in real-time means that alerts and risk scores can be calculated adding additional monitoring and investigative capabilities. Even entities that have not been labelled in our vast database can inherit some information from whom that entity has transacted with.

Reactor is the only interactive investigation tool. It allows an investigator to label entities and export graphs so that investigations can be performed across multiple investigators and performed over separate sessions. Through our APIs, an organisation can also upload arbitrary amounts of data attached to any Bitcoin address allowing multiple databases to be overlaid and new correlations and leads generated.

Transactions in Bitcoin are made with pseudonyms, which need to be tied to real-world identities in order to gain insights about the parties involved in a transaction and their purpose. Our tool has information on 25 per cent of all Bitcoin addresses, which account for approximately 50 per cent of all the Bitcoin activity. We additionally have over 4 million tags on Bitcoin addresses that we have scraped from web forums and leaked data sources including dark market forums and Mt. Gox deposit and withdrawal information.

Finally, the Chainalysis team is regarded as the pioneers of this type of analysis and can be called upon to serve as expert witnesses in trials and provide training sessions as required.

Yours Sincerely,

Jonathan Levin
Co-Founder and VP Business Development
Sept 21, 2016
Treasury Inspector General for Tax Administration Report finds “As the Use of Virtual Currencies in Taxation Become More Common, Additional Actions are Needed.”
As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

September 21, 2016
Reference Number: 2016-30-083

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.
To report fraud, waste, or abuse, call our toll-free hotline at:
1-800-366-4484

By Web:
www.treasury.gov/tigta/

Or Write:
Treasury Inspector General for Tax Administration
P.O. Box 589
Ben Franklin Station
Washington, D.C. 20044-0589

Information you provide is confidential and you may remain anonymous.
AS THE USE OF VIRTUAL CURRENCIES IN TAXABLE TRANSACTIONS BECOMES MORE COMMON, ADDITIONAL ACTIONS ARE NEEDED TO ENSURE TAXPAYER COMPLIANCE

Highlights

Final Report issued on September 21, 2016

Highlights of Reference Number: 2016-30-083 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Alternative payment methods, such as convertible virtual currencies, have grown in popularity in recent years and have emerged for some people as a potential alternative to using traditional currencies like U.S. dollars. Virtual currencies offer potential benefits over traditional currencies, including lower transaction fees and faster transfer of funds for services provided. However, some virtual currencies are also popular because the identity of the parties involved is generally anonymous, leading to a greater possibility of their use in illegal transactions.

WHY TIGTA DID THE AUDIT

Recently, many types of virtual currencies have been created for use in lieu of currency issued by a government to purchase goods and services in the real economy. The overall objective of this review was to evaluate the IRS's strategy for addressing income produced through virtual currencies.

WHAT TIGTA FOUND

Although the IRS issued Notice 2014-21, Virtual Currency Guidance, and established the Virtual Currency Issue Team, there has been little evidence of coordination between the responsible functions to identify and address, on a program level, potential taxpayer noncompliance issues for transactions involving virtual currencies. None of the IRS operating divisions have developed any type of compliance initiatives or guidelines for conducting examinations or investigations specific to tax noncompliance related to virtual currencies. In addition, it does not appear that any of the actions taken by the IRS to address virtual currency tax noncompliance were coordinated to ensure that the IRS maintains a strategic approach to the tax implications of virtual currencies.

Although the IRS requested comments to Notice 2014-21 from the public, no actions were taken to address the comments received. TIGTA reviewed all the comments and found several examples of information requested by the public that would be helpful in understanding how to comply with the tax reporting requirements when using or receiving virtual currencies.

In addition, third-party methods of reporting taxable transactions to the IRS do not separately identify transactions related to virtual currencies. While employers and businesses are required to report taxable virtual currency transactions, current third-party information reporting documents do not provide the IRS with any means to identify that the taxable transaction amounts being reported were specifically related to virtual currencies.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) develop a coordinated virtual currency strategy that includes outcome goals, a description of how the agency intends to achieve those goals, and an action plan with a timeline for implementation; 2) provide updated guidance to reflect the necessary documentation requirements and tax treatments needed for the various uses of virtual currencies; and 3) revise third-party information reporting documents to identify the amounts of virtual currencies used in taxable transactions.

The IRS agreed with TIGTA’s recommendations and plans to develop a virtual currency strategy including an assessment of whether changes to information reporting documents are warranted. The IRS also agreed that additional guidance would be helpful and plans to share the recommendation with the IRS’s Office of Chief Counsel for coordination with the Department of the Treasury’s Office of Tax Policy.
September 21, 2016

MEMORANDUM FOR Deputy Commissioner for Services and Enforcement

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance (Audit # 201530022)

This report presents the results of our review to evaluate the Internal Revenue Service’s (IRS) strategy for addressing income produced through virtual currencies. This review is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management’s complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).
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As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUR</td>
<td>Automated Underreporter</td>
</tr>
<tr>
<td>BSA</td>
<td>Bank Secrecy Act</td>
</tr>
<tr>
<td>CFR</td>
<td>Code of Federal Regulations</td>
</tr>
<tr>
<td>FAQ</td>
<td>Frequently Asked Question</td>
</tr>
<tr>
<td>FinCEN</td>
<td>Financial Crimes Enforcement Network</td>
</tr>
<tr>
<td>GAO</td>
<td>Government Accountability Office</td>
</tr>
<tr>
<td>IRS</td>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>MSB</td>
<td>Money Services Business</td>
</tr>
<tr>
<td>VCIT</td>
<td>Virtual Currency Issue Team</td>
</tr>
</tbody>
</table>
As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

Background

Alternative payment methods, such as convertible virtual currencies (hereafter referred to as virtual currencies), have grown in popularity in recent years and have emerged for some people as a potential alternative to using traditional currencies like U.S. dollars. For example, bitcoin automated teller machines in shops, malls, and service stations and on college campuses are providing consumers with easy access to bitcoins. These virtual currencies essentially allow taxpayers to pay for the goods and services they need in the same way as traditional currencies.

Virtual currencies offer potential benefits over traditional currencies, including lower transaction fees and faster transfer of funds for services provided. However, some virtual currencies are also popular because the identity of the parties involved is generally anonymous, leading to a greater possibility of their use in illegal transactions.

According to the Government Accountability Office (GAO), a virtual currency is generally considered a digital unit of exchange that is not backed by a government-issued legal tender. Virtual currencies originally were used in the online gaming industry. Recently, many types of virtual currencies have been created for use in lieu of a government-issued currency to purchase goods and services in the real economy. Although there are approximately 250 active virtual currencies listed, bitcoin is by far the most popular, comprising nearly 82 percent of the entire virtual currency market. Between May 2013 and April 2016, the number of bitcoins in circulation increased from approximately 11.2 million to more than 15.4 million, while the number of daily transactions related to bitcoins has grown from 58,795 to about 220,804. As of April 21, 2016, one bitcoin had the price equivalent of approximately $443, and bitcoins had a total market value of more than $6.8 billion.

Bitcoin was introduced in Calendar Year 2009 by an unidentified programmer or programmers using the name Satoshi Nakamoto. The bitcoin computer protocol permits the storage of unique digital representations of value (bitcoins) and facilitates the assignment of bitcoins from one user

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1 See Appendix IV for a glossary of terms.
3 Map of Coins (Mapofcoins.com).
4 CoinDesk (Coindesk.com).
5 CoinMarketCap (Coinmarketcap.com). This is the price that an asset would fetch in the marketplace. Market value is also commonly used to refer to the market capitalization of a publicly traded company and is obtained by multiplying the number of its outstanding shares by the current share price.
to another through an Internet-based peer-to-peer network. Bitcoins are divisible to eight decimal places, thereby enabling their use in any kind of transaction regardless of their value.

Bitcoins are created and entered into circulation through a process called mining. Bitcoin miners download free software that they use to solve complex mathematical equations. This process verifies the validity of the bitcoin transactions by grouping several transactions into a block and mathematically proving that the transactions occurred and did not involve double spending of a bitcoin. When a miner or group of miners (mining pools) solves an equation, the bitcoin network accepts the block of transactions as valid and creates new bitcoins and awards them to the successful miner or mining pool. In addition to mining, bitcoins already in circulation can be acquired by accepting them as gifts or payments for goods or services, purchasing them at bitcoin kiosks (sometimes referred to as bitcoin automated teller machines), or purchasing them on third-party exchanges.⁶

To describe how existing general tax principles apply to transactions using virtual currency, the Internal Revenue Service (IRS) issued Notice 2014-21, Virtual Currency Guidance, in March 2014. The notice provides that virtual currencies should be treated as property for tax purposes. Notice 2014-21 also provides answers to 16 frequently asked questions (FAQ) on virtual currencies. The FAQs provide basic information on the U.S. Federal tax implications of transactions in, or transactions that use, virtual currencies. The same general tax principles that apply to property transactions apply to transactions using virtual currencies. Among other things, this means that:

- The fair market value of virtual currency paid as wages is subject to Federal income tax withholding, Federal Insurance Contributions Act tax, and Federal Unemployment Tax Act tax and must be reported on Form W-2, Wage and Tax Statement.

- Payments using a virtual currency made to independent contractors are taxable, and self-employment tax rules apply. Generally, payers must issue a Form 1099-MISC, Miscellaneous Income, to the IRS and to the payee.

- The character of gain or loss from the sale or exchange of a virtual currency depends on whether the virtual currency is a capital asset in the hands of the taxpayer.

- A payment made using a virtual currency is subject to information reporting to the same extent as any other payment made in property.

Notice 2014-21 also directs taxpayers to Publication 15, (Circular E), Employer’s Tax Guide; Publication 334, Tax Guide for Small Businesses; Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities; Publication 525, Taxable and Nontaxable Income; Publication 535, Business Expenses; Publication 544, Sales and Other Dispositions of Assets; Publication 551, Basis of Assets; and Publication 1281, Backup Withholding for Missing and

⁶ These third-party exchanges allow users to exchange traditional currencies, such as U.S. dollars, for bitcoins and exchange bitcoins back to traditional currencies.
Incorrect Name/TINs, for additional guidance on virtual currencies. The notice and these publications are available to taxpayers on IRS.gov.

According to IRS management, the Large Business and International Division’s Offshore Arrangements Practice Network Steering Committee established the Virtual Currency Issue Team (VCIT) in December 2013 to get a better understanding of how virtual currencies may affect international taxable transactions. Specifically, the original focus of the VCIT was the identification of international underreporting strategies using virtual currency to facilitate tax avoidance/evasion schemes. In April 2015, the VCIT’s focus was expanded to act as a forum for interested individuals from various IRS offices and functions to meet and share knowledge on virtual currency. The VCIT includes members from the IRS’s Office of Chief Counsel and Criminal Investigation as well as the Large Business and International Division and the Small Business/Self-Employed Division. The VCIT’s current efforts are to: 1) determine if virtual currencies are being used as a method to hide income and avoid U.S. taxation; 2) be a vehicle to share virtual currency knowledge across the IRS; and 3) identify audit techniques that can be used to determine if taxpayers using virtual currencies in transactions, especially in offshore arrangements, are attempting to conceal income and avoid U.S. taxation.

The VCIT has met periodically to learn about virtual currencies and share knowledge. According to IRS management, in Fiscal Year 2015, the VCIT developed virtual currency training that was presented to more than 200 Large Business and International Division employees in two online sessions and is available online for tax compliance employees in other divisions to review. The training mostly focused on understanding the basics of virtual currency, including the mining of virtual currency, as well as the uses of virtual currency and associated terminology. The training also identified some of the audit techniques and tools examiners could use to identify virtual currency transactions.

Additionally, members of Criminal Investigation’s Financial Crimes function provided virtual currency awareness presentations in Fiscal Years 2015 and 2016 to more than 300 special agents. According to Criminal Investigation management, the purpose of these presentations was to provide “a general overview of what virtual currency is and in particular what bitcoin is and how it works.”

This review was performed at the Large Business and International Division Headquarters in Washington, D.C., with information obtained from Criminal Investigation, the Large Business and International and Small Business/Self-Employed Divisions, and the Office of Chief Counsel during the period of October 2015 through June 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.
As the Use of Virtual Currencies in
Taxable Transactions Becomes More Common, Additional
Actions Are Needed to Ensure Taxpayer Compliance

Results of Review

Management Needs to Develop a Virtual Currency Strategy

IRS management needs to develop an overall strategy to address taxpayer use of virtual currencies as property and as currency. In Calendar Year 2013, the GAO reported:

IRS has not assessed the tax compliance risks of open-flow virtual currencies developed and used outside of virtual economies. These types of currencies, generally, were introduced after IRS’s last review of compliance related to virtual economy transactions. According to IRS compliance officials, IRS would learn about tax compliance issues related to virtual currencies as it would any other tax compliance issue, such as IRS examiners identifying compliance problems during examinations or taxpayers requesting guidance on how to comply with certain tax requirements. To date, these processes have not resulted in IRS identifying virtual currencies used outside of virtual economies as a compliance risk that warrants specific attention.⁷

Since the GAO issued its report on virtual currencies three years ago, the IRS’s position on virtual currency as a tax compliance risk requiring additional oversight has remained relatively unchanged.

Virtual Currency and the Bank Secrecy Act

The Bank Secrecy Act (BSA), which was enacted to help prevent money laundering, creates a number of reporting obligations upon financial institutions and money services businesses (MSB).⁸ MSBs include check cashers, issuers and redeemers of travelers’ checks and money orders, and money transmitters.⁹ MSBs are subject to the BSA reporting requirements, including Currency Transaction Reports and Suspicious Activity Reports.¹⁰

Under delegated authority from the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN), the IRS has BSA enforcement responsibilities for financial institutions not

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⁹ 31 CFR § 1010.100(ff) (2011).
regulated by a Federal bank agency or another Federal regulator. The IRS pursues BSA enforcement responsibilities through its Specialty Examination function in the Small Business/Self-Employed Division and pursues criminal violations of the BSA through its Criminal Investigation.

In March 2013, the FinCEN issued interpretive guidance that addresses the applicability of the BSA to persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currency. The guidance provides information to help taxpayers determine whether their activities with virtual currencies classify them as an MSB, which are types of nonbank financial institutions that are regulated by the BSA. Specifically, these guidelines distinguish the differences between users, administrators, and exchanges of virtual currency. For example:

- A user is a person who obtains virtual currency to purchase goods or services.
- An administrator is a person who is engaged as a business in using (putting into circulation) a virtual currency and who has the authority to redeem (to withdraw from circulation) such virtual currency.
- An exchanger is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency.

The FinCEN guidance states that a user who obtains virtual currency and uses it to purchase real or virtual goods or services is not an MSB. Importantly, the FinCEN guidance states that an administrator or exchange that 1) accepts and transmits a virtual currency or 2) buys or sells virtual currency for any reason is a money transmitter (an MSB) under FinCEN’s regulations and would be subject to the BSA monitoring and reporting requirements unless a limitation to or exemption from the definition applies to the person.

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11 The IRS's website (IRS.gov) identifies the following types of businesses as examples of MSBs: money transmitters; currency dealers or exchanges; and check cashers or issuers of traveler’s checks, money orders, or stored value cards. There are other requirements to being considered an MSB, including engaging in one or more transactions on or after September 20, 1999, in an amount greater than $1,000, in currency or monetary instruments, for any person and during any one day.

12 FinCEN regulations provide that whether a person is a money transmitter is a matter of facts and circumstances. The regulations identify the circumstances under which a person is not a money transmitter despite accepting and transmitting currency, funds, or value that substitutes for currency. See 31 CFR § 1010.100(ff)(5)(ii)(A)–(F).
As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

As an MSB, virtual currency administrators and exchanges are required to comply with the Department of the Treasury’s reporting requirements, including Suspicious Activity Reports. The failure to follow these rules would subject virtual currency administrators and exchanges to significant civil and criminal liability.

In January 2014, the FinCEN issued clarifying rulings on virtual currency miners and investors. The first ruling states that to the extent a user creates or “mines” a virtual currency solely for a user’s own purposes, the user is not a money transmitter under the BSA. The second ruling states that a company purchasing and selling virtual currency as an investment exclusively for the company’s benefit is not a money transmitter.

By virtue of the FinCEN rulings, the IRS has significant tools available to help ensure that virtual currency exchanges are following the law and that unscrupulous individuals are not engaged in criminal activities through the use of virtual currencies. However, the IRS has primarily focused its limited virtual currency efforts on tax compliance issues and not enforcement of the potential criminal activities that are subject to the BSA. Although FinCEN guidance deems that virtual exchanges are MSBs subject to BSA regulation, the IRS did not include representatives from the Small Business/Self-Employed Division’s BSA Program on the VCIT. Additionally, Small Business/Self-Employed Division Examination Policy function management was unaware of any strategies under development for BSA compliance enforcement related to virtual currency administrators or exchanges.

**Enforcement efforts to date**

In an October 2014 news article related to virtual currency, Bloomberg Bureau of National Affairs quoted Criminal Investigation management as saying that “agents will be targeting the use of the [virtual] currency to dodge taxes.” When we followed up with Criminal

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13 31 CFR § 1022.320 describes the suspicious reporting obligation as follows:
(2) A transaction requires reporting under the terms of this section if it is conducted or attempted by, at, or through a money services business, involves or aggregates funds or other assets of at least $2,000 (except as provided in paragraph (a)(3) of this section), and the money services business knows, suspects, or has reason to suspect that the transaction (or a pattern of transactions of which the transaction is a part):
(i) Involves funds derived from illegal activity or is intended or conducted in order to hide or disguise funds or assets derived from illegal activity (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any Federal law or regulation or to avoid any transaction reporting requirement under Federal law or regulation;
(ii) Is designed, whether through structuring or other means, to evade any requirements of this chapter or of any other regulations promulgated under the Bank Secrecy Act; or
(iii) Serves no business or apparent lawful purpose, and the reporting money services business knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.
(iv) Involves use of the money services business to facilitate criminal activity.
14 31 U.S.C. § 5322 provides for criminal punishments for violations, which can include fines and imprisonment.
Investigation management to determine what steps have since been taken to identify taxpayers that are using virtual currency to "dodge taxes," we were told that nothing specific has been done.

Criminal Investigation management stated that most of the criminal cases involving virtual currency are related to narcotics and money laundering and provided us general information on five closed criminal investigation cases that involved virtual currency. In most of these case examples, the criminal allegation was for operating a bitcoin exchange without an MSB license or FinCEN registration in violation of 18 United States Code (U.S.C.) Section 1960.16 While the number of cases to date is small, it is significant that Criminal Investigation was able to disrupt potential criminal enterprises using laws, such as the BSA, governing MSBs.

There was one significant case example cited to us that involved Ross Ulbricht, the creator and operator of the “Silk Road” website. Criminal Investigation participated in an investigation along with several other Federal Government agencies. According to court documents, Ulbricht created the Silk Road in January 2011 and owned and operated the underground website until it was shut down by law enforcement authorities in October 2013. The Silk Road served as a sophisticated and extensive criminal marketplace on the Internet where unlawful goods and services, including illegal drugs of virtually all varieties, were bought and sold regularly by the site’s users. While in operation, the Silk Road was used by thousands of drug dealers and other unlawful vendors to distribute hundreds of kilograms of illegal drugs and other unlawful goods and services to more than 100,000 buyers, and to launder hundreds of millions of dollars deriving from these unlawful transactions. Ulbricht sought to anonymize transactions on the Silk Road by operating it on a special network of computers on the Internet designed to conceal the identities of the networks’ users. Ulbricht also designed the Silk Road to include a bitcoin-based payment system that concealed the identities and locations of the users transmitting and receiving funds through the site.

The Silk Road case is an example of a successful collaborative Federal investigation, but it is also a reminder that the anonymity feature of some virtual currencies is what attracts unscrupulous individuals to their use. The IRS should prepare a comprehensive virtual currency strategy that will assist taxpayers lawfully engaged with virtual currencies to voluntarily comply with the tax laws while seeking to identify individuals unlawfully engaged in their use.

Although the IRS established the VCIT and issued Notice 2014-21, there has been little evidence of coordination between the responsible functions to identify and address, on a program level, potential taxpayer noncompliance issues for transactions involving virtual currencies. None of the IRS operating divisions have developed any type of compliance initiatives or guidelines for conducting examinations or investigations specific to tax noncompliance related to virtual currency. In addition, it does not appear that any of the actions already taken by the IRS to address virtual currency tax noncompliance were coordinated to ensure that the IRS develops the

16 Pursuant to 31 U.S.C. § 5330, all MSBs must register with the FinCEN.
overall “big picture” associated with taxpayer use of virtual currencies. However, according to Large Business and International Division management, in January 2016, a subgroup of the VCIT was established to look at the feasibility of creating a campaign around how the IRS should address tax noncompliance related to virtual currency. This work is still in the discussion stages.

To encourage and support results-oriented management, the Government Performance and Results Act was enacted by Congress to require Federal agencies to develop strategic plans, set performance goals, and report annually on their performance results as compared to their established goals.17 With the implementation of this legislation, the IRS is required to integrate these plans and goals into its operational management regime.

The IRS needs to ensure that it develops a strategic plan that includes management oversight as well as adequate internal controls for its virtual currency programs. Until a comprehensive virtual currency strategy is developed, the IRS is open to the risk that undetected noncompliance of virtual currency taxable transactions will result in an increase to the Tax Gap.

**Recommendation**

**Recommendation 1:** The Deputy Commissioner for Services and Enforcement should request the Large Business and International Division, the Small Business/Self-Employed Division, and Criminal Investigation to develop a coordinated virtual currency strategy that includes outcome goals, a description of how the agency intends to achieve those goals, and an action plan with a timeline for implementation. In addition, the strategy should use the tools available to the IRS and identify how the IRS is going to meet its BSA, criminal investigation, and tax enforcement obligations as related to virtual currencies as well as identify how actions will be monitored and the methodologies used to measure the actions taken.

**Management’s Response:** The IRS agreed with this recommendation. The IRS agreed that a comprehensive virtual currency strategy is important. The Large Business and International Division will collaborate with other business operating divisions to identify potential noncompliance in the virtual currency area and develop the appropriate strategy for addressing such noncompliance. Criminal Investigation will coordinate with the divisions to promote fraud awareness relative to virtual currency compliance issues and assist with any training and coordination relative to the virtual currency program.

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More Action Is Needed to Educate Taxpayers About Virtual Currency Tax Compliance

Notice 2014-21 states, “the IRS is aware that ‘virtual currency’ may be used to pay for goods and services or held for investment.” Although the IRS officially stipulates that virtual currency should be treated as property, taxpayers can still use it as currency in small transactions, such as purchasing a cup of coffee or a digital song download, or in large transactions, such as renting an apartment or purchasing a vehicle or a home. Additionally, Notice 2014-21 describes:

...virtual currency as 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 any another 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.

For example, bitcoins can be digitally traded between users and can be purchased for or exchanged into U.S. dollars, Euros, and other real or virtual currencies.

Notice 2014-21 requires a taxpayer who receives virtual currency as payment for goods or services to compute gross income using the fair market value of the virtual currency, measured in U.S. dollars, as of the date that the virtual currency is received. However, because bitcoins are divisible to eight decimal places, this means that each bitcoin can be divided up into 100 million pieces. Based on this general guidance, when a portion of a bitcoin is used to make a purchase, taxpayers will have to treat the transaction as property and determine their tax basis for the bitcoin on the day of the purchase. For example, if a taxpayer uses a portion of a bitcoin to buy a cup of coffee each day for one week, he or she will have to determine what portion of the bitcoin was used to make the purchase based on the daily exchange rate, convert it into U.S. dollars, and keep a record of each transaction so that the gain or loss from his or her virtual currency property can be properly reported. Notice 2014-21 does not provide taxpayers with guidance on what records should be kept and how the records should be maintained. Due to the potential complexity of reporting otherwise simple retail purchase transactions related to virtual currencies, further guidance is needed to help taxpayers voluntarily comply with their tax obligations.

In addition, U.S. employees who are paid bitcoins as wages for services provided to their employers face similar challenges.18 Although employers need to accurately calculate the Social Security taxes and other withholdings for their employees in U.S. dollars, employees who receive bitcoins as wages need to maintain accurate records, especially if they do not...

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18 According to various organizational websites and news articles, employees who work for organizations and businesses like The Bitcoin Foundation, Coinbase, and The Internet Archive have the option of their salaries being paid in bitcoins.
As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

immediately use or convert their bitcoins received as wages into currency. Once bitcoins are used or converted, there may be a gain or loss that needs to be recorded so that the gain or loss can be accurately reported on the employee’s tax return. Further guidance regarding recordkeeping may provide valuable assistance to employees who may not be accustomed to getting paid in property. This is especially true for those employees who consider the bitcoin amounts received as “wages” because their employer reports to the IRS the wages the employee received in bitcoins as U.S. dollars on the employee’s Form W-2.

In addition to receiving virtual currency as a payment for goods and services, some members of the public receive virtual currency as payment for services associated with mining virtual currencies. Notice 2014-21 requires that when a taxpayer successfully “mines” virtual currency, the fair market value of the currency as of the date of receipt is includible in gross income. However, properly reporting the correct amount could become complex because of fluctuations in bitcoin valuation and because some miners may only be receiving portions of a bitcoin instead of a whole bitcoin.

In March 2014, the IRS requested comments to Notice 2014-21 from the public about the virtual currency information explained in the notice. To date, the IRS has received and reviewed 36 comments submitted by the public; however, no actions were taken to address the comments received. We reviewed all the comments and found several examples of information requested by the public that would be helpful in understanding how to comply with the tax reporting requirements when using or receiving virtual currencies.

The public identified three primary issues, which included comments on the burden of:

- Keeping track of transactions associated with virtual currencies when they are used as property. The public requested information about the valuation method to be use for virtual currencies and the lack of an official valuation source. The public also expressed concerns about the impact on businesses that would have to keep track of gains or losses on all transactions because virtual currencies are to be treated as property instead of currency. Some of the comments point out that the recordkeeping of each transaction will become onerous for people who use virtual currencies in everyday purchases.

- Keeping track of the cost and payments related to mining bitcoins. The public requested information about how to account for bitcoins earned in the mining process because some people only own the equipment used for mining. Some comments explained that some taxpayers pool their computer resources together to help solve the bitcoin equations so only partial pieces are earned at different times, and the coins earned can be received multiple times in the same day.

- Determining how to ensure tax compliance of transactions involving virtual currencies. The public requested information about whether virtual currencies could be used in individual retirement or investment accounts or given as charitable contributions. The
public wanted to know what accounting method to use to report sales transactions involving virtual currencies.

As the GAO points out in its report on financial derivatives, “When application of tax law is complex or uncertain ... guidance to taxpayers is an important tool for IRS to address tax effects and potential abuse.”19 Because the IRS has determined that virtual currency is treated as property, the public may not understand that each purchase of consumer goods with a virtual currency could result in a reportable tax transaction. The public feedback shows that a number of potential issues were created with the IRS’s decision to treat virtual currencies as property. To assist taxpayers in determining their tax obligations when using a virtual currency, the IRS needs to provide more detailed guidance about the recordkeeping requirements to track a realized gain or loss when virtual currencies are used as property or as currency.

Unlike the IRS, the Australian Taxation Office addressed the need for tax guidance in differentiating between the various uses of virtual currencies. For example, both the Australian Taxation Office and the IRS determined that virtual currencies, like bitcoin, are assets for capital gains tax purposes. However, when using them to pay for personal transactions, the Australian Taxation Office decided that there will be no income tax implications if the person is not in business or carrying on an enterprise and is simply paying for goods or services. Any capital gain or loss realized from the disposal of the virtual currency is to be disregarded provided its cost is $10,000 (Australian dollars) or less.

During discussions with IRS management, our auditors were told that no changes to the IRS guidance would be made based on the comments received from the public. With questions that the public has about recordkeeping, mining, and tax compliance reporting for virtual currencies, some potential for noncompliance exists because the detailed guidance needed by taxpayers to properly comply with their virtual currency tax obligations was not provided by the IRS.

**Recommendation**

**Recommendation 2:** The Deputy Commissioner for Services and Enforcement should take action to provide updated guidance to reflect the documentation requirements and tax treatments needed for the various uses of virtual currencies.

**Management’s Response:** The IRS agreed with this recommendation. The IRS agreed that additional guidance would be helpful; however, the IRS conveyed that guidance allocation decisions are based on available resources and other competing organizational and legislative priorities. The IRS will share this recommendation for guidance with the IRS’s Office of Chief Counsel for coordination with the Department of the Treasury’s Office of Tax Policy.

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Office of Audit Comment: While we understand that resources are limited and subject to competing priorities, the IRS’s current guidance related to virtual currencies is insufficient. To help taxpayers voluntarily comply with their tax obligations, the IRS should devote some of its efforts to provide adequate direction in this new and complex area.

Third-Party Information Reporting Documents Should Be Revised to Encourage Taxpayer Compliance and to Facilitate Identification of Virtual Currency Reporting Noncompliance

Current third-party methods of reporting taxable transactions to the IRS, such as Form W-2, Form 1099-MISC, and Form 1099-K, Payment Card and Third Party Network Transactions, do not separately identify transactions related to virtual currency. For example, in the FAQs for Notice 2014-21, it states, “the fair market value of virtual currency paid as wages is subject to Federal income tax withholding, Federal Insurance Contributions Act tax, and Federal Unemployment Tax Act tax and must be reported on Form W-2…” Notice 2014-21 also refers employers to Publication 15, which addresses the filing of Form 1099-MISC to report payments of $600 or more to persons not treated as employees (independent contractors) for services performed for a trade or business. In the FAQs, it states that:

...self-employment income includes all gross income derived by an individual from any trade or business carried on by the individual as other than an employee. Consequently, the fair market value of virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income and is subject to the self-employment tax.

While employers and businesses are required to report taxable virtual currency transactions on Form W-2, Form 1099-MISC, etc., these forms currently do not provide the IRS with any means to identify that the taxable transaction amounts being reported were specifically related to virtual currencies. Similarly, the instructions provided in Notice 2014-21 for Form 1099-K state that:

When completing Boxes 1, 3, and 5a-1 on the Form 1099-K, transactions where the Third Party Settlement Organization settles payments made with virtual currency are aggregated with transactions made with real currency to determine the total amounts to be reported in those boxes. When determining whether the transactions are reportable, the value of the virtual currency is the fair market value of the virtual currency in U.S. dollars on the date of payment.

20 In general, a third party that contracts with a substantial number of unrelated merchants to settle payments between the merchants and their customers is a third-party settlement organization as defined in Notice 2014-21.
As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

Again, there is no method provided for differentiating the virtual currency transaction amount from a transaction amount made with real currency as they are currently aggregated together and reported as one amount on Form 1099-K.

The GAO’s Standards for Internal Control in the Federal Government provides five components for internal control.21 These include:

- Control Environment.
- Risk Assessment.
- Control Activities.
- Information and Communication.
- Monitoring.

Risk Assessment provides that management should identify and analyze the risks related to achieving defined objectives. Management identifies risks and analyzes them to estimate their significance; this analysis provides a basis for responding to the risks. The IRS has determined that there is a risk of reporting noncompliance through the use of virtual currencies in taxable transactions. However, the IRS has not developed a methodology for gathering data on virtual currency use in taxable transactions—data that are necessary to analyze the risk of noncompliance and to estimate its significance.

In April 2016, the IRS estimated that the average gross Tax Gap for Tax Years 2008 through 2010 was $458 billion per year. The largest portion of the Tax Gap, $387 billion annually, is due to underreporting. According to the IRS, taxpayer compliance is higher when income is subject to third-party information reporting and even higher when also subject to withholding. IRS Tax Gap analyses found that, “Misreporting of income amounts subject to substantial information reporting and withholding is 1 percent; of income amounts subject to substantial information reporting but not withholding, it is 7 percent; and of income amounts subject to little or no information reporting, such as nonfarm proprietor income, it is 63 percent.” In addition, the latest Taxpayer Attitude Survey from the IRS Oversight Board, issued in December 2014, found that personal integrity and third-party reporting are the top two factors having a “great deal of influence” on whether taxes are reported and paid honestly.

The IRS already uses third-party reporting documents to verify information claimed by taxpayers on their tax returns. The IRS’s Automated Underreporter (AUR) program systemically compares amounts shown on a taxpayer’s tax return with information reported on third-party documents such as Form 1099-B, Proceeds From Broker and Barter Exchange Transactions. For example, the AUR program matches the proceeds reported by a barter exchange with the

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income claimed by a taxpayer on his or her tax return. IRS guidelines identify bartering as an exchange of one taxpayer’s property or services for another taxpayer’s property or services without the use of currency. The fair market value of property or services received through barter is taxable income. The barter exchanges are required to report their members’ transactions to the IRS on Form 1099-B.

Form 1099-B contains a box showing the proceeds from bartering, which allows the IRS to specifically identify bartering transactions. The AUR program uses this information to identify when bartering proceeds reported by a third party do not agree with what was reported by a taxpayer. The IRS may correspond with the taxpayer for additional information if it appears that bartering income was underreported. These contacts with the taxpayer can result in adjustments to the tax return.

Form 1099-B has been revised since its introduction in Tax Year 1983 to provide the IRS with information regarding additional taxable transactions. Figure 1 is an example of the Tax Year 1983 Form 1099-B before any revisions.

Figure 1: Copy of Tax Year 1983 Form 1099-B

Source: IRS.gov.

Figure 2 shows the Tax Year 2016 Form 1099-B after various revisions were made by the IRS through the years to capture additional information for compliance purposes.

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22 Internal Revenue Code § 6045(c)(3) defines a barter exchange as any organization of members providing property or services who contract to trade or barter the property or services.
Information reporting documents such as Forms 1099-MISC, 1099-B, 1099-K, W-2, etc. provide third-party information to the IRS regarding potentially taxable transactions and encourage voluntary compliance. Revising existing information reporting documents to require employers, businesses, and third-party settlement organizations to identify virtual currency transaction amounts would provide the IRS with some of the data necessary to analyze the risk of taxpayer reporting noncompliance regarding virtual currencies. Once the IRS develops a methodology to capture the information needed to identify potentially taxable virtual currency transactions, it should consider using the existing AUR program and more formalized examinations as a template when developing any virtual currency compliance program.
Recommendation

Recommendation 3: The Deputy Commissioner for Services and Enforcement should revise third-party information reporting documents to identify the amounts of virtual currency used in taxable transactions.

Management's Response: The IRS agreed with this recommendation. As part of the IRS's overall strategy development in response to Recommendation 1, the IRS will consider whether changes to information reporting documents would assist in identifying noncompliance related to virtual currency transactions. In its consideration, the IRS will assess the cost and impact to filers of these information returns, as well as taxpayer burden. However, based on the IRS's current fiscal climate, the IRS is faced with competing funding priorities requiring a need-based prioritization of information technology expenditures. Consequently, the IRS does not consider modifying information reporting documents to capture virtual currency amounts as a priority at this time.

Office of Audit Comment: As the IRS develops its strategy to ensure taxpayer compliance related to virtual currencies, the IRS also needs a methodology for gathering data on virtual currency transactions in order to identify and measure the risk of noncompliance. The IRS has already established that taxpayer compliance is higher when income is subjected to third-party information reporting. We believe that by identifying virtual currency transactions through third-party information reporting documents, the risk of taxpayer noncompliance can be reduced.
Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the IRS’s strategy for addressing income produced through virtual currencies. To accomplish this objective, we:

I. Evaluated the IRS’s compliance strategy for addressing the use of virtual currencies for taxable transactions.
   A. Identified and reviewed current delegation authority from the Department of the Treasury’s FinCEN and the IRS’s enforcement responsibilities as they relate to virtual currencies.
   B. Interviewed members of the VCIT to determine the purpose and goals of the team and identify actions completed to meet the goals of the team. We reviewed the minutes of the VCIT meetings to identify emerging issues and team decisions on virtual currencies.
   C. Reviewed the final FAQs and public comments received in response to the questions in IRS Notice 2014-21, Virtual Currency Guidance.
   D. Reviewed IRS guidance to taxpayers on IRS.gov and publications to determine if the guidance was adequate to educate and inform taxpayers on how to account for the use of virtual currencies on their tax returns.
   E. Evaluated what the IRS had done to inform, educate, and assist taxpayers who are using virtual currencies for taxable transactions.
   F. Determined what procedures are in place to address virtual currency issues during investigations and audits.
   G. Evaluated the IRS’s current third-party methods of reporting taxable virtual currency transactions, including those used to identify taxable income attributable to bartering transactions.

Internal controls methodology

Internal controls relate to management’s plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the

1 See Appendix IV for a glossary of terms.
As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

following internal controls were relevant to our audit objective: IRS policies, procedures, guidance, and training pertaining to virtual currency. To evaluate these controls, we interviewed management in the Large Business and International Division, the Small Business/Self-Employed Division, Criminal Investigation, and the Office of Chief Counsel. We obtained and analyzed relevant policies, procedures, and guidance, and reports provided in regard to training, guidance to the public, and VCIT meeting minutes.
Appendix II

Major Contributors to This Report

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Bryce Kisler, Director
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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Chief Counsel
Chief, Criminal Investigation
Commissioner, Large Business and International Division
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Director, Office of Audit Coordination
# Glossary of Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bitcoin</td>
<td>The open source software used to create the bitcoin virtual currency and the peer-to-peer network formed as a result (when capitalized). The individual units of the bitcoin virtual currency (when lowercase).</td>
</tr>
<tr>
<td>Convertible Virtual Currency</td>
<td>Virtual currency that has an equivalent value in real currency or that acts as a substitute for real currency.</td>
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<td>Fair Market Value</td>
<td>A selling price for an item or property at which a buyer and seller will agree to do business.</td>
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<tr>
<td>Fiscal Year</td>
<td>Any yearly accounting period, regardless of its relationship to a calendar year.  The Federal Government’s fiscal year begins on October 1 and ends on September 30.</td>
</tr>
<tr>
<td>Information Reporting Document</td>
<td>A return that includes any form, statement, or schedule required to be filed with the IRS with respect to any amount from which tax is required to be deducted and withheld.</td>
</tr>
<tr>
<td>Internal Revenue Code</td>
<td>Federal tax law begins with the Internal Revenue Code, enacted by Congress in Title 26 of the U.S.C. It is the main body of domestic statutory tax law of the United States organized topically, including laws covering the income tax, payroll taxes, gift taxes, estate taxes, and statutory excise taxes. Its implementing agency is the IRS.</td>
</tr>
<tr>
<td>Money Services Business</td>
<td>A type of nonbank financial institution. They include the following types of businesses: money transmitters, currency dealers or exchanges, and check cashers or issuers of traveler’s checks, money orders, or stored value cards.</td>
</tr>
<tr>
<td>Tax Gap</td>
<td>The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.</td>
</tr>
<tr>
<td>Tax Year</td>
<td>A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.</td>
</tr>
<tr>
<td>Virtual Currency</td>
<td>A digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value.</td>
</tr>
</tbody>
</table>
Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

September 8, 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Douglas W. O'Donnell
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report TIGTA 2015-30-022: As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

Thank you for the opportunity to review and comment on the subject draft report. Alternative payment methods, such as convertible virtual currencies, have grown in popularity in recent years and have emerged as a potential alternative to using traditional currencies such as the U.S. dollar.

As outlined in the report, we have completed some preliminary compliance work related to virtual currencies, including several criminal investigations that have successfully disrupted criminal enterprises that were using virtual currencies in their illegal transactions. We have also issued guidance to taxpayers on virtual currencies, in addition to developing and delivering training to our employees on this emerging issue. But we agree that more can be done to develop a coordinated virtual currency strategy, and we will work on further developing the IRS' overall strategic approach to virtual currencies, taking into account the findings in your report. Indeed, a cornerstone of the LB&I Future State is to improve our flexibility to respond to emerging issues such as these, for example, via the development of strategic and coordinated campaigns that would deploy tailored treatments streams for addressing tax compliance — using both enforcement tools (such as examinations and criminal investigations for addressing noncompliance or illegal transactions), as well as outreach, education and training on compliance with the tax obligations surrounding virtual currencies.

The corrective actions that the IRS will take to address the recommendations are more fully described in the attachment. If you have any questions, please contact me, or a member of your staff may contact Pamela Drenthe, Director, Withholding & International Individual Compliance, at (202) 515-4417.

Attachment
Attachment

TIGTA Audit 2015-30-022: As the Use of Virtual Currencies in Taxable Transactions Become More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance

RECOMMENDATION 1:

The Deputy Commissioner for Services and Enforcement should request the Large Business and International Division, the Small Business/Self-Employed Division, and Criminal Investigation to develop a coordinated virtual currency strategy that includes outcome goals, a description of how the agency intends to achieve those goals, and an action plan with a timeline for implementation. In addition, the strategy should use the tools available to the IRS and identify how the IRS is going to meet its Bank Secrecy Act (BSA), criminal investigation, and tax enforcement obligations as related to virtual currencies as well as identify how actions will be monitored and the methodologies used to measure the actions taken.

CORRECTIVE ACTIONS:

IRS agrees that a comprehensive virtual currency strategy is important. LB&I will collaborate with other business operating divisions to identify potential noncompliance in this area, and develop the appropriate strategy for addressing such noncompliance. Criminal Investigation will coordinate with the divisions to promote fraud awareness relative to virtual currency compliance issues and assist with any training and coordination relative to this program area.

IMPLEMENTATION DATE: 9/30/2017

RESPONSIBLE OFFICIAL(S):

Director, Withholdings & International Individual Compliance Practice Area, LB&I
Director, Criminal Investigation, Financial Crimes

CORRECTIVE ACTION(S) MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.
RECOMMENDATION 2:

The Deputy Commissioner for Services and Enforcement should take action to provide updated guidance to reflect the documentation requirements and tax treatments needed for the various uses of virtual currencies.

CORRECTIVE ACTIONS:

IRS agrees that additional guidance would be helpful. Guidance allocation decisions are based on available resources and other competing organizational and legislative priorities (such as guidance to implement enacted legislation). We will share this recommendation for guidance with the IRS Office of Chief Counsel for coordination with the Department of Treasury Office of Tax Policy.

IMPLEMENTATION DATE: 12/30/2016

RESPONSIBLE OFFICIAL(S):

Director, Withholding & International Individual Compliance Practice Area, LB&I

CORRECTIVE ACTION(S) MONITORING PLAN:

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3:

The Deputy Commissioner for Services and Enforcement should revise third-party information reporting documents to identify the amounts of virtual currency used in taxable transactions.

CORRECTIVE ACTIONS:

As part of our overall strategy development in response to Recommendation 1, IRS will consider whether changes to information reporting documents would assist in identifying non-compliance related to virtual currency transactions. Any changes will need to be assessed for cost to IRS and the payors who file these information returns, as well as taxpayer burden. However, in our current fiscal climate, the IRS is faced with competing funding priorities; and this reduced funding has required a need-based prioritization of Information Technology expenditures. Modifying information reporting documents to capture virtual currency amounts is not a priority at this time.

IMPLEMENTATION DATE: N/A
RESPONSIBLE OFFICIAL(S):
Director, Withholding & International Individual Compliance Practice Area, LB&I

CORRECTIVE ACTION(S) MONITORING PLAN:
We will monitor this corrective action as part of our internal management control system.
Guidance

FIN-2013-G001

Issued: March 18, 2013
Subject: Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies

The Financial Crimes Enforcement Network ("FinCEN") is issuing this interpretive guidance to clarify the applicability of the regulations implementing the Bank Secrecy Act ("BSA") to persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies.¹ Such persons are referred to in this guidance as "users," "administrators," and "exchangers," all as defined below.² 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. An administrator or exchanger is not a provider or seller of prepaid access, or a dealer in foreign exchange, under FinCEN’s regulations.

Currency vs. Virtual Currency

FinCEN’s regulations define currency (also referred to as "real" currency) as "the coin and paper money of the United States or of any other country that [i] is designated as legal tender and that [ii] circulates and [iii] is customarily used and accepted as a medium of exchange in the country of issuance."³ In contrast to real currency, "virtual" currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction. This guidance addresses "convertible" virtual currency. This type of virtual currency either has an equivalent value in real currency, or acts as a substitute for real currency.

¹ FinCEN is issuing this guidance under its authority to administer the Bank Secrecy Act. See Treasury Order 180-01 (March 24, 2003). This guidance explains only how FinCEN characterizes certain activities involving virtual currencies under the Bank Secrecy Act and FinCEN regulations. It should not be interpreted as a statement by FinCEN about the extent to which those activities comport with other federal or state statutes, rules, regulations, or orders.
² FinCEN’s regulations define "person" as "an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities." 31 CFR § 1010.100(mm).
³ 31 CFR § 1010.100(mm).
Background

On July 21, 2011, FinCEN published a Final Rule amending definitions and other regulations relating to money services businesses ("MSBs"). Among other things, the MSB Rule amends the definitions of dealers in foreign exchange (formerly referred to as "currency dealers and exchangers") and money transmitters. On July 29, 2011, FinCEN published a Final Rule on Definitions and Other Regulations Relating to Prepaid Access (the "Prepaid Access Rule"). This guidance explains the regulatory treatment under these definitions of persons engaged in virtual currency transactions.

Definitions of User, Exchanger, and Administrator

This guidance refers to the participants in generic virtual currency arrangements, using the terms "user," "exchanger," and "administrator." A user is a person that obtains virtual currency to purchase goods or services. An exchanger is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency. An administrator is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.

Users of Virtual Currency

A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not an MSB under FinCEN’s regulations. Such activity, in and of itself, does not fit within the definition of "money transmission services" and therefore is not subject to FinCEN’s registration, reporting, and recordkeeping regulations for MSBs.

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4 Bank Secrecy Act Regulations – Definitions and Other Regulations Relating to Money Services Businesses, 76 FR 43585 (July 21, 2011) (the “MSB Rule”). This defines an MSB as “a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (f)(1) through (f)(7) of this section. This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States.” 31 CFR § 1010.100(ff).

5 Final Rule – Definitions and Other Regulations Relating to Prepaid Access, 76 FR 45403 (July 29, 2011).

6 These terms are used for the exclusive purpose of this regulatory guidance. Depending on the type and combination of a person’s activities, one person may be acting in more than one of these capacities.

7 How a person engages in “obtaining” a virtual currency may be described using any number of other terms, such as “earning,” “harvesting,” “mining,” “creating,” “auto-generating,” “manufacturing,” or “purchasing,” depending on the details of the specific virtual currency model involved. For purposes of this guidance, the label applied to a particular process of obtaining a virtual currency is not material to the legal characterization under the BSA of the process or of the person engaging in the process.

8 As noted above, this should not be interpreted as a statement about the extent to which the user’s activities comport with other federal or state statutes, rules, regulations, or orders. For example, the activity may still be subject to abuse in the form of trade-based money laundering or terrorist financing. The activity may follow the same patterns of behavior observed in the “real” economy with respect to the purchase of “real” goods and services, such as systematic over- or under-invoicing or inflated transaction fees or commissions.

9 31 CFR § 1010.100(ff)(1-7).
Administrators and Exchangers of Virtual Currency

An administrator or exchanger that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter under FinCEN’s regulations, unless a limitation to or exemption from the definition applies to the person. FinCEN’s regulations define the term “money transmitter” as a person that provides money transmission services, or any other person engaged in the transfer of funds. The term “money transmission services” means “the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.”

The definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies. Accepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the BSA. FinCEN has reviewed different activities involving virtual currency and has made determinations regarding the appropriate regulatory treatment of administrators and exchangers under three scenarios: brokers and dealers of e-currencies and e-precious metals; centralized convertible virtual currencies; and de-centralized convertible virtual currencies.

a. E-Currencies and E-Precious Metals

The first type of activity involves electronic trading in e-currencies or e-precious metals. In 2008, FinCEN issued guidance stating that as long as a broker or dealer in real currency or other commodities accepts and transmits funds solely for the purpose of effecting a bona fide purchase or sale of the real currency or other commodities for or with a customer, such person is not acting as a money transmitter under the regulations.

However, if the broker or dealer transfers funds between a customer and a third party that is not part of the currency or commodity transaction, such transmission of funds is no longer a fundamental element of the actual transaction necessary to execute the contract for the purchase or sale of the currency or the other commodity. This scenario is, therefore, money

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10 FinCEN’s regulations provide that whether a person is a money transmitter is a matter of facts and circumstances. The regulations identify six circumstances under which a person is not a money transmitter, despite accepting and transmitting currency, funds, or value that substitutes for currency. 31 CFR § 1010.100(ff)(5)(i)(A)–(F).
31 CFR § 1010.100(ff)(5)(i)(A).
12 Ibid.
13 Typically, this involves the broker or dealer electronically distributing digital certificates of ownership of real currencies or precious metals, with the digital certificate being the virtual currency. However, the same conclusions would apply in the case of the broker or dealer issuing paper ownership certificates or manifesting customer ownership or control of real currencies or commodities in an account statement or any other form. These conclusions would also apply in the case of a broker or dealer in commodities other than real currencies or precious metals. A broker or dealer of e-currencies or e-precious metals that engages in money transmission could be either an administrator or exchanger depending on its business model.
14 Application of the Definition of Money Transmitter to Brokers and Dealers in Currency and other Commodities, FIN-2008-0008, Sept. 10, 2008. The guidance also notes that the definition of money transmitter excludes any person, such as a futures commission merchant, that is “registered with, and regulated or examined by... the Commodity Futures Trading Commission.”
transmission. Examples include, in part, (1) the transfer of funds between a customer and a third party by permitting a third party to fund a customer’s account; (2) the transfer of value from a customer’s currency or commodity position to the account of another customer; or (3) the closing out of a customer’s currency or commodity position, with a transfer of proceeds to a third party. Since the definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies, the same rules apply to brokers and dealers of e-currency and e-precious metals.

**b. Centralized Virtual Currencies**

The second type of activity involves a convertible virtual currency that has a centralized repository. The administrator of that repository will be a money transmitter to the extent that it allows transfers of value between persons or from one location to another. This conclusion applies, whether the value is denominated in a real currency or a convertible virtual currency. In addition, any exchanger that uses its access to the convertible virtual currency services provided by the administrator to accept and transmit the convertible virtual currency on behalf of others, including transfers intended to pay a third party for virtual goods and services, is also a money transmitter.

FinCEN understands that the exchanger’s activities may take one of two forms. The first form involves an exchanger (acting as a “seller” of the convertible virtual currency) that accepts real currency or its equivalent from a user (the “purchaser”) and transmits the value of that real currency to fund the user’s convertible virtual currency account with the administrator. Under FinCEN’s regulations, sending “value that substitutes for currency” to another person or to another location constitutes money transmission, unless a limitation to or exemption from the definition applies. This circumstance constitutes transmission to another location, namely from the user’s account at one location (e.g., a user’s real currency account at a bank) to the user’s convertible virtual currency account with the administrator. It might be argued that the exchanger is entitled to the exemption from the definition of “money transmitter” for persons involved in the sale of goods or the provision of services. Under such an argument, one might assert that the exchanger is merely providing the service of connecting the user to the administrator and that the transmission of value is integral to this service. However, this exemption does not apply when the only services being provided are money transmission services.

The second form involves a de facto sale of convertible virtual currency that is not completely transparent. The exchanger accepts currency or its equivalent from a user and privately credits the user with an appropriate portion of the exchanger’s own convertible virtual currency held with the administrator of the repository. The exchanger then transmits that

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15 In 2011, FinCEN amended the definition of money transmitter. The 2008 guidance, however, was primarily concerned with the core elements of the definition — accepting and transmitting currency or value — and the exemption for acceptance and transmission integral to another transaction not involving money transmission. The 2011 amendments have not materially changed these aspects of the definition.

16 See footnote 11 and adjacent text.

17 31 CFR § 1010.100(ff)(5)(ii)(F).
internally credited value to third parties at the user’s direction. This constitutes transmission to another person, namely each third party to which transmissions are made at the user’s direction. To the extent that the convertible virtual currency is generally understood as a substitute for real currencies, transmitting the convertible virtual currency at the direction and for the benefit of the user constitutes money transmission on the part of the exchanger.

**c. De-Centralized Virtual Currencies**

A final type of convertible virtual currency activity involves a de-centralized convertible virtual currency (1) that has no central repository and no single administrator, and (2) that persons may obtain by their own computing or manufacturing effort.

A person that creates units of this convertible virtual currency and uses it to purchase real or virtual goods and services is a user of the convertible virtual currency and not subject to regulation as a money transmitter. By contrast, a person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is a money transmitter. In addition, a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.

**Providers and Sellers of Prepaid Access**

A person’s acceptance and/or transmission of convertible virtual currency cannot be characterized as providing or selling prepaid access because prepaid access is limited to real currencies.\(^{18}\)

**Dealers in Foreign Exchange**

A person must exchange the currency of two or more countries to be considered a dealer in foreign exchange.\(^{19}\) Virtual currency does not meet the criteria to be considered “currency” under the BSA, because it is not legal tender. Therefore, a person who accepts real currency in

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\(^{18}\) This is true even if the person holds the value accepted for a period of time before transmitting some or all of that value at the direction of the person from whom the value was originally accepted. FinCEN’s regulations define “prepaid access” as “access to funds or the value of funds that have been paid in advance and can be retrieved or transferred at some point in the future through an electronic device or vehicle, such as a card, code, electronic serial number, mobile identification number, or personal identification number.” 31 CFR § 1010.100(ff). Thus, “prepaid access” under FinCEN’s regulations is limited to “access to funds or the value of funds.” If FinCEN had intended prepaid access to cover funds denominated in a virtual currency or something else that substitutes for real currency, it would have used language in the definition of prepaid access like that in the definition of money transmission, which expressly includes the acceptance and transmission of “other value that substitutes for currency.” 31 CFR § 1010.100(ff)(5)(i).

\(^{19}\) FinCEN defines a “dealer in foreign exchange” as a “person that accepts the currency, or other monetary instruments, funds, or other instruments denominated in the currency, of one or more countries in exchange for the currency, or other monetary instruments, funds, or other instruments denominated in the currency, of one or more other countries in an amount greater than $1,000 for any other person on any day in one or more transactions, whether or not for same-day delivery.” 31 CFR § 1010.100(ff)(1).
exchange for virtual currency, or vice versa, is not a dealer in foreign exchange under FinCEN’s regulations.

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Financial institutions with questions about this guidance or other matters related to compliance with the implementing regulations of the BSA may contact FinCEN’s Regulatory Helpline at (800) 949-2732.
US v. Coinbase, Inc.  
Case No 17-cv-01431  
Order to Enforce IRS Summons  
(Nov 28, 2017)
The Internal Revenue Service ("IRS") served a summons on Coinbase, Inc., a virtual currency exchange, seeking records regarding nearly all of Coinbase's customers for a several-year period. After Coinbase failed to comply with the summons, the United States of America ("the Government") filed a petition to enforce the summons pursuant to 26 U.S.C. §§ 7402(b) and 7604(a). After the Court heard oral argument on a motion to quash the summons and a motion to intervene, the IRS narrowed the scope of its summons such that it applies to far fewer, but still more than 10,000, Coinbase account holders. The Court subsequently allowed Doe 4 to intervene, and the parties stipulated to a briefing schedule on the Government's Petition. Having now reviewed the parties' briefing and having had the benefit of oral argument on November 9, 2017, the Court GRANTS in part and DENIES in part the Petition to Enforce. The summons as narrowed by the Court serves the IRS's legitimate purpose of investigating Coinbase account holders who may not have paid federal taxes on their virtual currency profits.

BACKGROUND

A. The Initial IRS Summons

IRS Notice 2014-21 describes how the IRS applies U.S. tax principles to transactions involving virtual currency such as bitcoin. (Dkt. No. 3 ¶ 8.) Pursuant to the Notice, virtual
currencies that can be converted into traditional currency are property for tax purposes. (Id.)

Thus, a taxpayer can have a gain or a loss on a sale or exchange of virtual currency. (Id.)

Last year the Government filed an ex parte petition pursuant to 26 U.S.C. § 7609(h)(2) for an order permitting the IRS to serve a “John Doe” administrative summons on Coinbase (“the Initial Summons”). The Initial Summons sought “information regarding United States persons who at any time during the period January 1, 2013 through December 31, 2015 conducted transactions in a convertible virtual currency as defined in IRS Notice 2014-21.” (Case No. 16-cv-06658-JSC, Dkt. No. 2-4 at 13 ¶ 48.) It requested nine categories of documents including: complete user profiles, know-your-customer due diligence, documents regarding third-party access, transaction logs, records of payments processed, correspondence between Coinbase and Coinbase users, account or invoice statements, records of payments, and exception records produced by Coinbase’s AML system. (Case No. 16-cv-06658-JSC, Dkt. No. 2 at 13-14.) Based upon a review of the Petition to Serve and supporting documents, the Court granted permission to serve the Initial Summons upon Coinbase. (Case No. 16-cv-06658-JSC, Dkt. No. 7.)

B. The Petition to Enforce

The Government served the Initial Summons on Coinbase whose service was accepted by counsel for the company. (Dkt. No. 3 ¶ 6.) Coinbase refused to comply. (Id. at ¶¶ 36, 37.) The Government thereafter brought a petition to enforce the Initial Summons. (Dkt. No. 1.) In support of its Petition the Government submitted a declaration from IRS agent David Utzke. (Dkt. No. 3.)

Mr. Utzke is a senior revenue agent in the IRS’s offshore compliance initiatives program and is assigned to virtual currency matters. (Id. ¶ 1.) Mr. Utzke states that the IRS “is conducting an investigation to determine the identity and correct federal income tax liability of United States persons who conducted transactions in a convertible virtual currency ... for the years ended December 31, 2013, 2014, and 2015.” (Id. ¶ 2.) The IRS believes that virtual currency gains are underreported. In particular, approximately 83 to 84 percent of taxpayers file returns electronically which are maintained in various databases including the Modernized Tax Return Data Base (“MTRDB”). (Id. ¶¶ 11-12.) Capital gain or loss for property transactions, including those from virtual currency, is reported on IRS Form 8949, which is attached to Schedule D of a
Form 1040. *(Id. ¶ 11.)* Form 8949 includes a space where the taxpayer is asked to report the type of property sold. *(Id.)* Based upon an IRS search, only 800 to 900 persons electronically filed a Form 8949 that included a property description that is “likely related to bitcoin” in each of the years 2013 through 2015. *(Id. ¶ 13.)*

Mr. Utzke describes Coinbase’s position in the bitcoin exchange business. *(Id. ¶ 20.)* By October 2012, the company launched the ability to sell and buy bitcoin through bank transfers. *(Id. ¶ 20.)* Coinbase offers buy/sell trading functionality in 33 countries, with (according to its website) 5.9 million customers served and $6 billion exchanged in bitcoin. *(Id.)* By the end of 2015, Coinbase was America’s largest platform for exchanging bitcoin into U.S. dollars, and the fourth largest globally. *(Id.)*

C. The Narrowed Summons

Eight months after the Government served the Initial Summons, the IRS filed a “Notice of Narrowed Summons Request For Enforcement” (“Narrowed Summons”). *(Dkt. No. 37.)* As modified, the IRS now seeks information regarding accounts “with at least the equivalent of $20,000 in any one transaction type (buy, sell, send, or receive) in any one year during the 2013-2015 period.” *(Id. ¶ 2.)* The Narrowed Summons “do[es] not include users: (a) who only bought and held bitcoin during the 2013-15 period; or (b) for which Coinbase filed Forms 1099-K during the 2013-15 period.” *(Id. ¶ 2.)* According to Coinbase, the Narrowed Summons requests information regarding 8.9 million transactions and 14,355 account holders. *(Dkt. No. 46-16 ¶¶ 4-6.)* For those accounts, the IRS seeks the following records:

- **Request 1:** Account/wallet/vault registration records for each account/wallet/vault owned or controlled by the user during the period stated above limited to name, address, tax identification number, date of birth, account opening records, copies of passport or driver’s license, all wallet addresses, and all public keys for all accounts/wallets/vaults.

- **Request 2:** Records of Know-Your-Customer diligence.

- **Request 3:** Agreements or instructions granting a third-party access, control, or transaction approval authority.

- **Request 4:** All records of account/wallet/vault activity including transaction logs or other
records identifying the date, amount, and type of transaction (purchase/sale/exchange), the
post transaction balance, the names or other identifiers of counterparties to the transaction;
requests or instructions to send or receive bitcoin; and, where counterparties transact
through their own Coinbase accounts/wallets/vaults, all available information identifying
the users of such accounts and their contact information.

- **Request 5:** Correspondence between Coinbase and the user or any third party with access
to the account/wallet/vault pertaining to the account/wallet/vault opening, closing, or
transaction activity.

- **Request 6:** All periodic statements of account or invoices (or the equivalent).

(Dkt. No. 37 at 2.) Coinbase refused to comply with the Narrowed Summons and it along with
John Doe 4 opposed the Government’s Petition to Enforce.¹ (Dkt. Nos. 44, 46.) Three
organizations also filed amici briefs in opposition: (1) Competitive Enterprise Institute; (2) Coin
Center; and (3) Digital Currency and Ledger Defense Fund. (Dkt. Nos. 50-2, 52-1, 54-1.)

Mr. Utzke submitted a further declaration in support of the Government’s response to
Coinbase’s opposition. (Dkt. No. 65-3.) Mr. Utzke states that a program analyst in the data
analytics unit of the IRS obtained the data on reported property transactions regarding virtual
currency. (Dkt. No. 65-3 ¶ 5.) This analyst ran a query of the data captured from electronically
filed Forms 8949 for years 2013, 2014, and 2015. (Id.) A list of 18 search terms was developed
using variations of the base query terms “Bitcoin,” “Bit Coin,” “BTC” and “XBT.” (Id.) Mr.
Utzke is familiar with the methodology used to conduct the search and discussed the query with
the program analyst. (Id.)

In March 2017, the parties began discussions to explore scenarios under which Coinbase
might agree to provide the IRS with user records. (Id. ¶¶ 11, 12.) The discussions came to an

¹ John Doe 4 also asks the Court take judicial notice of two exhibits: (1) a report by the Treasury
Inspector General for Tax Administration titled “As the Use of Virtual Currencies in Taxable
Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer
Compliance”; and (2) prepared remarks by IRS Commissioner John A. Koskinen before the
4’s request is granted. See Fed. R. Evid. 201(b)(2).
unsuccessful conclusion in July 2017. (Id. ¶ 12.) According to the Government, the information
the IRS learned through these discussions was the “sole basis for its decision to narrow the
summons request for which it now seeks enforcement.” (Id. ¶ 13.) In particular, the IRS learned
that most of Coinbase’s users engage in low volume, low dollar transactions. (Id. ¶ 14.) The IRS
also discovered “what information Coinbase collects and does not collect, and the degree of
difficulty Coinbase would face in producing certain information and its possible corresponding
investigative value.” (Id.) Mr. Utzke clarifies that “[i]f the Coinbase user and account activity
level had been what the IRS expected based on Coinbase’s public information gathered prior to
the issuance of the summons, the IRS would not have narrowed the requests it is now seeking for
enforcement.” (Id. ¶ 15.)

**LEGAL STANDARD**

Under 26 U.S.C. § 7602(a), the IRS may issue a summons for “ascertaining the correctness
of any return, making a return where none has been made, determining the liability of any person
for any internal revenue tax or ... collecting any such liability....” 26 U.S.C. § 7602(a); see
also Crystal v. United States, 172 F.3d 1141, 1143 (9th Cir. 1999) (quoting 26 U.S.C. § 7602(a)).

To obtain a court order enforcing a summons, the IRS must first establish “good faith” by
showing that the summons: (1) is issued for a legitimate purpose; (2) seeks information relevant to
that purpose; (3) seeks information that is not already in the IRS’s possession; and (4) satisfies all
of the administrative steps set forth in the Internal Revenue Code. United States v. Powell, 379
U.S. 48, 57-58 (1964). “The government’s burden is a slight one, and may be satisfied by a
declaration from the investigating agent that the Powell requirements have been met.” Crystal,
172 F.3d at 1144 (quoting United States v. Dynavac, Inc., 6 F.3d 1407, 1414 (9th Cir. 1993)).
The showing need only be minimal “because the statute must be read broadly in order to ensure
that the enforcement powers of the IRS are not unduly restricted.” Liberty Fin. Servs. v. United
States, 778 F.2d 1390, 1392 (9th Cir. 1985).

“Enforcement of a summons is generally a summary proceeding to which a taxpayer has
few defenses.” Crystal, 172 F.3d at 1144 (quoting United States v. Derr, 968 F.2d 943, 945 (9th
Cir. 1992)). Once the government has met its burden in establishing the Powell elements, if the
respondent chooses to challenge the enforcement, he or she bears a "heavy" burden to show an abuse of process or lack of good faith on the part of the IRS. United States v. LaSalle Nat'l Bank, 437 U.S. 298, 316 (1978). "The taxpayer must allege specific facts and evidence to support his allegations of bad faith or improper purpose." Id. (quoting United States v. Jose, 131 F.3d 1325, 1328 (9th Cir. 1997)).

Once a summons is challenged by a respondent, it must be "scrutinized by the court" to determine whether it seeks information relevant to a legitimate investigative purpose, and the court may choose either to refuse enforcement or narrow the scope of the summons. Goldman, 637 F.2d at 668.

DISCUSSION

I. The Government's Petition to Enforce

There is no dispute that the third and fourth Powell factors are satisfied. The Court therefore addresses whether the summons (1) serves a legitimate purpose and (3) seeks relevant information. The answer to the first question is yes and to the second is also yes, albeit in part.

A. Legitimate Purpose

The Narrowed Summons serves the legitimate purpose of investigating the "reporting gap between the number of virtual currency users Coinbase claims to have had during the summons period" and "U.S. bitcoin users reporting gains or losses to the IRS during the summoned years." (Dkt. No. 65 at 11:4-6.) Coinbase is the largest U.S. exchange of bitcoin into dollars with at least 5.9 customers served and 6 billion in transactions while only 800 to 900 taxpayers a year have electronically filed returns with a property description related to bitcoin from 2013 through 2015. This discrepancy creates an inference that more Coinbase users are trading bitcoin than reporting gains on their tax returns. The IRS submitted a declaration from Mr. Utzke attesting to these numbers. This is all that is required to make a "minimal" showing that the Government has met the good faith requirement. See United States v. Samuels, Kramer and Co., 712 F.2d 1342, 1344-1345 (9th Cir. 1983).

Moreover, Coinbase itself admits that the Narrowed Summons requests information regarding 8.9 million Coinbase transactions and 14,355 Coinbase account holders. That only 800
to 900 taxpayers reported gains related to bitcoin in each of the relevant years and that more than
14,000 Coinbase users have either bought, sold, sent or received at least $20,000 worth of bitcoin
in a given year suggests that many Coinbase users may not be reporting their bitcoin gains. The
IRS has a legitimate interest in investigating these taxpayers. See United States v. Bisceglia, 420

Coinbase argues: (1) it is not clear what portions of Mr. Utzke’s declaration are competent
testimony supported by personal knowledge; (2) the investigatory purpose that Mr. Utzke offers in
his declaration is a mere conclusion not supported by a “proper enforcement purpose”; (3) Form
8949 is not the only place a taxpayer could possibly report bitcoin income; (4) taxpayers reporting
digital currency income may in fact disproportionately file paper returns; (5) the term “likely
related to bitcoin” is vague; (6) taxpayers who purchased at high prices in late 2013 and sold in
2014 and 2015 likely experienced losses due to a fall in the price of bitcoin over this period; and
(7) the narrowing of the subpoena is arbitrary. Coinbase’s arguments are unpersuasive.

First, Mr. Utzke has sufficient personal knowledge because he is a senior manager on the
virtual currency investigation team. Mr. Utzke personally supervised the analyst who performed
the search that generated the data to support the Government’s Petition. Neither the statute nor the
caselaw requires more.

Second, the investigatory purpose is not a bare conclusion: it is premised upon Mr. Utzke’s
declaration that Coinbase is the largest bitcoin exchange company in the United States with 5.9
million users yet only 800 to 900 taxpayers have reported property transactions related to bitcoin
in each of the relevant years.

Third, it is reasonable for the IRS to premise an investigation based on the assumption that
taxpayers are reporting bitcoin gains on the correct form - Form 8949. Respondents have not
identified anything that suggests this assumption is made in bad faith or that it is even incorrect.

Fourth, as the Government has offered evidence that 83 to 84 percent of taxpayers file
returns electronically, even if some Coinbase users file paper returns, it is more likely that the
majority of Coinbase users file electronically similar to the rest of the population. Respondents’
lament that Coinbase users may disproportionately file paper tax returns is pure unsupported
speculation; indeed, it seems likely that users of virtual currency would be more likely than the
average taxpayer to file electronic returns.

Fifth, to meet its burden of showing a legitimate purpose the Government is not required to
define “likely related to bitcoin.” It only needs to provide what is has already submitted: a
declaration from an IRS agent making a minimal showing that there are a greater number of
Coinbase users transacting in bitcoin than those filing electronic tax returns and thus the IRS’s
investigation is based on a legitimate purpose.

Sixth, that there was a fall in the price of bitcoin over 2014 and 2015 is unpersuasive
because the Narrowed Summons seeks information regarding accounts “with at least the
equivalent of $20,000 in any one transaction type (buy, sell, send, or receive) in any one year
during the 2013-2015 period.” Respondents have not submitted anything that suggests that bitcoin
account holders are consistently losing money such that during the relevant years they never had
any virtual currency profits to declare.

Last, the Court finds that the Government’s narrowing of the Initial Summons is not
arbitrary. The record reflects that it was based on information the IRS learned after discussions
with Coinbase in an attempt to reach an agreement regarding the records Coinbase would produce
in response to the Initial Summons. While the Initial Summons was broad, that does not convince
the Court that it was issued for some unidentified improper purpose.

Coinbase’s reliance on United States v. Humble Oil & Refining Co., 488 F.2d 953, 962-63
(5th Cir. 1974), to argue the IRS may not use the summons power to conduct general research
absent an investigation of taxpayers from whom the information is sought is misplaced. In
Humble, the court denied enforcement of an IRS summons issued to Humble Oil Company
because the responding entities and individuals were not the object of an investigation for
noncompliance. Id. at 954, 962. Instead, the summons was used to obtain information merely as
part of the IRS’s “research concerning non-compliance with certain provisions of the Internal
Revenue Code.” Id. at 954. An IRS agent testified that “the summons was issued merely to
expedite the research process” and “Humble’s lessors were not reputed to be more likely to evade
the restoration requirements than those of other oil companies.” Id. at 955.
Here, in contrast, the IRS represents that the investigation's purpose is to examine a
“reporting gap between the number of virtual currency users Coinbase claims to have had during
the summons period” and “U.S. bitcoin users reporting gains or losses to the IRS during the
summoned years.” (Dkt. No. 65 at 11:4-7.) The IRS is conducting the investigation to “ascertain
if U.S. taxpayers are correctly filing returns, filing returns at all, or self-reporting their proper tax
liability.” (Id. at 11:9-10.) Therefore, the IRS’s purpose is related to tax compliance, not research.
Further, unlike Humble, the IRS provided a declaration describing how the disparity between the
number of Coinbase users and the number of electronic returns creates an inference that many
Coinbase users are not reporting their bitcoin property gains. Finally, Humble was decided before
26 U.S.C. Section 7609(f)--which outlines the requirements the IRS must meet before a John Doe
summons may be issued--was enacted.

Accordingly, the Government has met its minimal burden to show that the Narrowed
Summons satisfies a legitimate investigative purpose.

B. Relevance

The Government asserts that the records it seeks are relevant because “[a]rmed with the
identity of a Coinbase user and their transaction activity the IRS can determine if that user filed a
tax return that correctly reflected any bitcoin related gain or loss during the summoned period.”
(Dkt. No. 65 at 14:5-7.)

[A]n IRS summons is not to be judged by the relevance standards used in deciding
“may be” reflects Congress’ express intention to allow the IRS to obtain items of
even potential relevance to an ongoing investigation, without reference to its
admissibility. The purpose of Congress is obvious: the Service can hardly be
expected to know whether such data will in fact be relevant until it is procured and
scrutinized. As a tool of discovery, the § 7602 summons is critical to the
investigative and enforcement functions of the IRS . . . ; the Service therefore
should not be required to establish that the documents it seeks are actually relevant
in any technical, evidentiary sense.

what the Government already knows there exists the requisite nexus between taxpayer and records
of another’s affairs to make the investigation reasonable - in short, whether the ‘might’ in the
articulated standard 'might throw light upon the correctness of the return,' is in the particular circumstances an indication of a realistic expectation rather than an idle hope that something may be discovered.” Goldman, 637 F.2d at 667 (citing United States v. Harrington, 388 F.2d 520, 524 (2nd Cir. 1969)). Nonetheless, the Government’s burden, while not great, is also not non-existent. Id. And the summons should be “no broader than necessary to achieve its purpose.” Bisceglia, 420 U.S. at 151.

The Court agrees that the Coinbase account holder’s identity and transaction records will permit the Government to investigate whether the holder had taxable gains that were not properly declared. But the Government seeks more than that information; it also seeks account opening records, copies of passports or driver’s licenses, all wallet addresses, all public keys for all accounts/wallets/vaults, records of Know-Your-Customer diligence, agreements or instructions granting a third-party access, control, or transaction approval authority, and correspondence between Coinbase and the account holder. The Government claims to need these records to verify an account holder’s identity and determine if the holder used others to make transactions on the account holder’s behalf. However, at this stage, where the Government is seeking records on over 10,000 account holders, these requests seek information than is “broader than necessary.” See Bisceglia, 420 U.S. at 151. The first question for the IRS is whether an account holder had a taxable gain. If the account holder did not, then correspondence between Coinbase and a user is not even potentially relevant. Similarly, while the Government needs an account holder’s name, date of birth, taxpayer identification and address to determine if a taxable gain was reported, it only needs additional identity information such as copies of passports and driver’s licenses or “Know Your Customer” due diligence if there is potentially a taxable gain and if there is some doubt as to the taxpayer’s identity. If there is not, these additional records will not shed any light on a legitimate investigation.

At oral argument the Government explained that it included such broad swaths of records in its summons so that it will not need to return to court to ask for them if and when needed. The Court is unpersuaded. Especially where, as here, the Government seeks records for thousands of account holders through a John Doe summons, the courts must ensure that the Government is not
collecting thousands and thousands of personal records unnecessarily. Moreover, if the
Government later determines that it needs more detailed records on a taxpayer, it can issue the
summons directly to the taxpayer or to Coinbase with notice to a named user—a process
preferable to a John Doe summons.

The Court therefore finds that the relevant documents as identified in Request 1 are: (1) the
taxpayer ID number, (2) name, (3) date of birth, and (4) address. The remaining items in Request
1 are not relevant at this stage: account opening records, copies of passports or driver’s licenses,
all wallet addresses, and all public keys for all accounts/wallets/vaults.

The Court also finds that transaction history, as identified in Requests 4 and 6, is relevant
to the Government’s legitimate purpose. Coinbase must produce records of account activity
including transaction logs or other records identifying the date, amount, and type of transaction
(purchase/sale/exchange), the post transaction balance, and the names of counterparties to the
transaction. The remaining information sought by Request 4 is not relevant at this time: requests
or instructions to send or receive bitcoin and information identifying the users of such accounts
where counterparties transact through their own Coinbase accounts/wallets/vaults and their contact
information.

The Court likewise finds the following documents are not necessary to achieve the
Government’s legitimate purpose at this stage:

- **Request 2**: Records of Know-Your-Customer diligence,
- **Request 3**: Agreements or instructions granting a third-party access, control, or transaction
  approval authority, and
- **Request 5**: Correspondence between Coinbase and the user or any third party with access
to the account/wallet/vault pertaining to the account/wallet/vault opening, closing, or
transaction activity.

These records may become necessary for a specific account holder once the IRS reviews the
relevant records; but for many or even most of the account holders they may never be relevant and
thus the Court will not order their production. Accordingly, the Government’s Petition to Enforce
Requests 1, 4 and 6 is GRANTED as set forth above; in all other respects the Petition to Enforce is
DENIED.

Respondents' insistence that the entirety of the Narrowed Summons is overbroad because it is not limited to those accounts that "have some indicia of wrongdoing" misstates the law. Probable cause or even reasonable suspicion of wrongdoing is not required for an IRS summons. See Powell, 379 U.S. at 51; Arthur Young & Co., 465 U.S. at 813-815. The Government has met the burden that it does have: it issued the summons for a legitimate purpose and the information identified above is relevant to that purpose.

II. Abuse of Process

Once the government has met its burden in establishing the Powell elements, the party challenging enforcement bears a "heavy" burden to show an abuse of process or lack of good faith. United States v. LaSalle Nat'l Bank, 437 U.S. 298, 316 (1978). ""The [challenging party] must allege specific facts and evidence to support his allegations of bad faith or improper purpose."" Crystal, 172 F.3d at 1144 (quoting United States v. Jose, 131 F.3d 1325, 1328 (9th Cir. 1997)). An improper purpose includes harassing the taxpayer or putting pressure on him to settle a collateral dispute, or "for any other purpose reflecting on the good faith of the particular investigation." Powell, 379 U.S. at 58.

Coinbase argues that the Government committed an abuse of process because it seeks to enforce "a summons that lacks a proper investigative purpose" and "the production of a vast array of documents relating to 14,000 accounts, without any proper foundation." The Court, however, finds that the Government has met its burden of showing that the Narrowed Summons serves the legitimate investigative purpose of enforcing the tax laws against those who profit from trading in virtual currency. And the information the Court has ordered produced is relevant and no more than necessary to serve that purpose. Coinbase's novel insistence that it has met its burden to show abuse of process by virtue of the Government having narrowed its summons is unpersuasive. No court has even suggested such a rule, and this Court declines to be the first. Coinbase therefore fails to meet its burden to "allege specific facts and evidence to support [its] allegations of bad faith or improper purpose." Crystal, 172 F.3d at 1144 (internal quotation marks and citation omitted).
John Doe 4 argues the Court should at least permit discovery because the IRS’s guidance on how to report virtual currency is insufficient, and the IRS is using the Narrowed Summons to harass taxpayers. The Court disagrees. First, John Doe 4’s argument about the lack of guidance in effect asks this Court to rule that taxpayers can trade virtual currency tax free until the IRS adopts more specific regulations. No law so limits the power of the IRS. If and when the IRS institutes a tax collection action arising from bitcoin profits a taxpayer may make whatever argument he or she desires about a lack of guidance. But it is not a reason to prevent the IRS from even investigating the failure of some bitcoin traders to pay taxes on their profits. The IRS’s failure to provide further guidance after its 2014 notice does not satisfy the “specific facts and evidence” standard to support a finding of an improper purpose.

Second, John Doe 4 provides no statements, documents, or other evidence to support the allegation of harassment. Allegations that the IRS may have abused its power in other investigations have no sway here. Nor are anti-virtual currency statements by politicians and finance leaders sufficient. Without “specific facts and evidence” of harassment related to the investigation at issue, John Doe 4’s harassment allegations carry no weight.

Accordingly, the Court concludes Coinbase and John Doe 4 have failed to meet their heavy burden to show abuse of process.

III. Evidentiary Hearing

In the event the Court does not deny the Government’s petition to enforce outright, which the Court is not doing, Coinbase requests an evidentiary hearing.

If the respondent makes a sufficient showing of bad faith on the Government’s part, the respondent is entitled to a limited evidentiary hearing. *Samuels*, 712 F.2d at 1346-47. The party opposing enforcement is required “to do more than allege an improper purpose.” *United States v. Church of Scientology*, 520 F.2d 818, 824-25 (9th Cir. 1975). Some evidence that raises a sufficient doubt must be introduced. *Id.* Bald allegations of bad faith IRS harassment are insufficient. *Id.* Here, Coinbase and John Doe 4 have not made a showing of bad faith or provided any evidence of harassment or other wrong doing that raises a sufficient doubt regarding the Government’s purpose. Accordingly, Coinbase and John Doe 4 have failed to meet their
burden to allege more than an improper purpose and their request for an evidentiary hearing is denied.

CONCLUSION

For the reasons described above, the Court GRANTS in part and DENIES in part the Government's petition to enforce the IRS summons.

Coinbase is ORDERED to produce the following documents for accounts with at least the equivalent of $20,000 in any one transaction type (buy, sell, send, or receive) in any one year during the 2013 to 2015 period:

(1) the taxpayer ID number,
(2) name,
(3) birth date,
(4) address,
(4) records of account activity including transaction logs or other records identifying the date, amount, and type of transaction (purchase/sale/exchange), the post transaction balance, and the names of counterparties to the transaction, and
(5) all periodic statements of account or invoices (or the equivalent).

In all other respects the Petition to Enforce is DENIED. The Court GRANTS John Doe 4’s request for judicial notice.

This Order disposes of Docket Nos. 1, 37, and 45.

IT IS SO ORDERED.

Dated: November 28, 2017

Jacqueline Scott Coral
United States Magistrate Judge
July 2, 2018
Joint Chiefs of Global Tax Enforcement (J5)
Focus on Cryptocurrency
JOINT CHIEFS OF GLOBAL TAX ENFORCEMENT

Tax enforcement authorities unite to combat international tax crime and money laundering

July 2, 2018 - MONTREAL

Leaders of tax enforcement authorities from Australia, Canada, the Netherlands, the United Kingdom and the United States have established a joint operational alliance, the Joint Chiefs of Global Tax Enforcement (J5), to increase collaboration in the fight against international and transnational tax crime and money laundering.

The alliance focuses on building international enforcement capacity by sharing information and intelligence, enhancing operational capability by piloting new approaches, and conducting joint operations to bring those who enable and facilitate offshore tax crime to account.

Membership of the J5 includes the heads of tax crime and senior officials from the Australian Criminal Intelligence Commission (ACIC) and Australian Taxation Office (ATO), the Canada Revenue Agency (CRA), the Dutch Fiscal Information and Investigation Service (FIOD), Her Majesty’s Revenue & Customs (HMRC), and Internal Revenue Service Criminal Investigation (IRS-CI).

This group formed in response to a call to action from the Organisation for Economic Co-operation and Development (OECD) for countries to do more to tackle the enablers of tax crime. Successes, new approaches and findings from these joint efforts will be shared with the greater tax enforcement community.

At their first meeting last week, the J5 brought together leading experts in tax and other financial crimes from each of the five member countries. Together they developed tactical plans and identified opportunities to pursue cyber criminals and enablers of transnational tax crime. The J5 will do this through the sharing of data and technology, conducting operational activity and taking advantage of collective capabilities.

Will Day, Deputy Commissioner, Australian Taxation Office, said:

"Recognising that tax crime crosses international borders, by participating in the J5, the ATO and ACIC can work with like-minded international tax administrations and law enforcement agency partners to build on our domestic activity and develop strategies to disrupt crime and better position Australia against emerging threats."
Col Blanch, Executive Director Intelligence Operations, Australian Criminal Intelligence Commission said:

“Financial crime occurs on a global scale with proceeds of crime transferred between jurisdictions. This is why we are committed to working with our domestic and international partners to proactively target offshore service providers and cybercriminals who specialise in targeting the financial sector.”

Johanne Charbonneau, Director General, Canada Revenue Agency said:

“The formation of the J5 demonstrates the serious commitment of governments around the globe in enhancing international cooperation in fighting serious international tax and financial crimes, money laundering, and cybercrime through the use of cryptocurrencies. The J5 complements the important international work of the OECD through operational collaboration. Our collective efforts and experience will be shared to jointly identify and address the increasingly sophisticated and global schemes and the professional enablers that facilitate such schemes.”

Hans van der Vlist, General Director FIOD said:

“The unique thing about the J5 is the operational collaboration between five countries on tackling professional enablers that facilitate offshore tax crime, cybercrime and the threat of cryptocurrencies to tax administrations, as well as making best use of internationally available data and technology.”

Simon York, Director HMRC Fraud Investigation Service said:

“Tax crime and money laundering are becoming increasingly global and sophisticated, so it’s crucial we continue to work with international partners to tackle these threats. The formation of the Joint Chiefs of Global Tax Enforcement shows our commitment to leading that fight. Working together we are broadening the horizon of tax crime enforcement, making the world smaller for those seeking to exploit our systems and ensuring no one is beyond our reach.”

Don Fort, Chief of IRS-CI said:

“We cannot continue to operate in the same ways we have in the past, siloing our information from the rest of the world while organized criminals and tax cheats manipulate the system and exploit vulnerabilities for their personal gain. The J5 aims to break down those walls, build upon individual best practices, and become an operational group that is forward-thinking and can pressurize the global criminal community in ways we could not achieve on our own.”

Updates on J5 initiatives are expected in late 2018.

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May 9, 2019
FINCEN notices:
Guidance (to MSBs) and
Advisory (to banks)
The Financial Crimes Enforcement Network (FinCEN) is issuing this interpretive guidance to remind persons subject to the Bank Secrecy Act (BSA) how FinCEN regulations relating to money services businesses (MSBs) apply to certain business models involving money transmission denominated in value that substitutes for currency, specifically, convertible virtual currencies (CVCs).

This guidance does not establish any new regulatory expectations or requirements. Rather, it consolidates current FinCEN regulations, and related administrative rulings and guidance issued since 2011, and then applies these rules and interpretations to other common business models involving CVC engaging in the same underlying patterns of activity.

This guidance is intended to help financial institutions comply with their existing obligations under the BSA as they relate to current and emerging business models involving CVC by describing FinCEN’s existing regulatory approach to the issues most frequently raised by industry, law enforcement, and other regulatory bodies within this evolving financial environment. In this regard, it covers only certain business models and necessarily does not address every potential combination of facts and circumstances. Thus, a person working with a business model not specifically included in this guidance may still have BSA obligations.

The overall structure of this guidance is as follows:

Section 1 defines certain key concepts within the context of the guidance. Although the titles or names assigned to these key concepts may coincide with terms customarily used by industry and share similar attributes, for purposes of the guidance their meaning is limited to the definition provided in the guidance.

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1. For a discussion of the concept of “business model” as used within this guidance, see infra, Section 1.1.
2. For a discussion of the concepts of “value that substitutes for currency” and “convertible virtual currency” as used within this guidance, see infra, Sections 1.2. and 1.3.
Section 2 consolidates and explains current FinCEN regulations, previous administrative rulings, and guidance involving the regulation of money transmission under the BSA. By consolidating and summarizing rules and interpretation in a single Section, this guidance provides a resource to help financial institutions comply with their existing obligations under the BSA as they relate to current and emerging activities involving CVC.

Section 3 summarizes the development and content of FinCEN’s 2013 guidance on the application of money transmission regulations to transactions denominated in CVC.3

Sections 4 and 5 describe FinCEN’s existing regulatory approach to current and emerging business models using patterns of activity involving CVC. This approach illustrates how FinCEN fits existing interpretations about certain activities to other activities that at first may seem unrelated, but conform to the same combination of key facts and circumstances.

Finally, Section 6 contains a list of resources to which interested parties may refer for further explanation about the content of the guidance, or to assist in evaluating facts and circumstances not expressly covered in this guidance.

1. Key Concepts

The following subsections describe how FinCEN frames certain key concepts for purposes of this guidance.

1.1. Business Model

Whether a person is a money transmitter under FinCEN’s regulations is a matter of facts and circumstances.4 Within the context of this guidance, “business model” refers to the subset of key facts and circumstances relevant to FinCEN’s determination of (a) whether the specific person meets the definition of a particular type of financial institution and (b) what regulatory obligations are associated with the specific activities performed within the business model.

This guidance may refer to a pattern of activity as a business model using a title or name (“label”) that may coincide with a label used by industry to designate a general type of product or service. The label, however, will not determine the regulatory application. Rather, this guidance applies to any business model that fits the same key facts and circumstances described in the guidance, regardless of its label. Conversely, the regulatory interpretations in this guidance will not apply to a business model using the same label, but involving different key facts and circumstances.


4. 31 CFR § 1010.100(ff)(5)(ii).
In addition, differences in similar business models may lead to different regulatory applications. The regulatory interpretations contained in this guidance may extend only to other business models consisting of the same key facts and circumstances as the business models described herein. Therefore, a particular regulatory interpretation may not apply to a person if their business model contains fewer, additional, or different features than those described in this guidance.

Lastly, a person who is engaged in more than one type of business model at the same time may be subject to more than one type of regulatory obligation or exemption. For example, a developer or seller of either a software application or a new CVC platform may be exempt from BSA obligations associated with creating or selling the application or CVC platform, but may still have BSA obligations as a money transmitter if the seller or developer also uses the new application to engage as a business in accepting and transmitting currency, funds, or value that substitutes for currency, or uses the new platform to engage as a business in accepting and transmitting the new CVC. Likewise, an exemption may apply to a person performing a certain role in the development or sale of a software application, while a different person using the same application to accept and transmit currency, funds, or value that substitutes for currency would be still subject to BSA obligations.

1.2. Value that Substitutes for Currency

1.2.1. Definitions

In 2011, FinCEN issued a final rule ("2011 MSB Final Rule")\(^5\) defining a money services business as, "a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States," operating directly, or through an agent, agency, branch, or office, who functions as, among other things, a "money transmitter.”\(^6\)

FinCEN’s regulations define the term “money transmitter” to include a “person that provides money transmission services,” or “any other person engaged in the transfer of funds.”\(^7\) A “transmitter,” on the other hand, is “[t]he sender of the first transmittal order in a transmittal of funds. The term transmitter includes an originator, except where the transmitter’s financial institution is a financial institution or foreign financial agency other than a bank or foreign bank.”\(^8\) In other words, a transmitter initiates a transaction that the money transmitter actually executes.

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6. 31 CFR § 1010.100(ff).
7. 31 CFR § 1010.100(ff)(5).
8. 31 CFR § 1010.100(fff).
The term “money transmission services” is defined to mean the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.9 The term “other value that substitutes for currency” encompasses situations in which the transmission does not involve currency,10 or funds, but instead involves something that the parties to a transaction recognize has value that is equivalent to or can substitute for currency.

FinCEN’s regulation does not limit or qualify the scope of the term “value that substitutes for currency.” It can be created either (a) specifically for the purpose of being used as a currency substitute or (b) originally for another purpose but then repurposed to be used as a currency substitute by an administrator (in centralized payment systems) or an unincorporated organization, such as a software agency (in decentralized payment systems).11 In either case, the persons involved in the creation and subsequent distribution of the value (either for the original purpose or for another purpose) may be subject to additional regulatory frameworks (other than the BSA) that govern licensing and chartering obligations, safety and soundness regulations, minimum capital and reserve requirements, general and financial consumer and investor protection, etc. When subject to these other regulatory frameworks, the person may be exempted from MSB status but be covered as a different type of financial institution under FinCEN regulations.

1.2.2. Application of BSA regulations to persons exempt from MSB status engaged in transactions denominated in any type of value that substitutes for currency

The term “money services business” does not include: (a) a bank or foreign bank; (b) a person registered with, and functionally regulated or examined by, the U.S. Securities and Exchange Commission (SEC) or the U.S. Commodity Futures Trading Commission (CFTC), or a foreign financial agency that engages in financial activities that, if conducted in the United States, would require the foreign financial agency to be registered with the SEC or CFTC; or, (c) a natural person who engages in certain identified MSB activity (i.e., dealing in foreign exchange, check cashing, issuing or selling traveler’s checks or money orders, providing prepaid access, or money

9. 31 CFR § 1010.100(ff)(5)(i)(A) (emphasis added).
10. 31 CFR § 1010.100(m) (defining currency as “[t]he coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance. Currency includes U.S. silver certificates, U.S. notes and Federal Reserve notes. Currency also includes official foreign bank notes that are customarily used and accepted as a medium of exchange in a foreign country.”)
11. See 2013 VC Guidance, at 4-5 (discussing centralized and decentralized payment systems).
transmission) but does so on an infrequent basis and not for gain or profit.\textsuperscript{12} Banks and persons registered with, and functionally regulated or examined by, the SEC or the CFTC, that engage in transactions denominated in value that substitutes for currency will be subject to BSA regulations according to the applicable section of 31 CFR Chapter X.\textsuperscript{13}

1.2.3. Application of BSA regulations to persons not exempt from MSB status engaged in transactions denominated in any type of value that substitutes for currency

A person not exempt from MSB status under 31 CFR § 1010.100(ff)(8) may be a money transmitter when the person engages in transactions covered by FinCEN’s definition of money transmission, regardless of the technology employed for the transmittal of value or the type of asset the person uses as value that substitutes for currency, or whether such asset is physical or virtual. In general, persons not covered by 1010.100(ff)(8)(ii) who issue securities and futures, or purchase and sell securities, commodities, and futures, are outside the scope of the BSA. However, such persons could be covered by BSA money transmission regulations under certain facts and circumstances, in accordance with (a) the regulatory definition of money transmitter, (b) any applicable exemption from the definition (see Section 2 below), and (c) regulatory interpretations such as those contained in FIN-2008-G008 and FIN-2015-R001:

a) FIN-2008-G008, “Application of the Definition of Money Transmitter to Brokers and Dealers in Currency and other Commodities,” September 10, 2008, states that as long as a broker or dealer in real currency or other commodities accepts and transmits funds solely for the purpose of effecting a bona fide purchase or sale of the real currency or other commodities for or with a customer, such person is not acting as a money transmitter under the regulations. However, if the broker or dealer transfers funds between a customer and a third party that is not part of the currency or commodity transaction, such transmission of funds is no longer a fundamental element of the actual transaction necessary to execute the contract for the purchase or sale of the currency or the other

\textsuperscript{12} 31 CFR § 1010.100(ff)(8). In the case of 1010.100(ff)(8)(ii), the exemption applies only if the person itself is registered with, and functionally regulated or examined by the SEC or CFTC; the exemption may not apply if it is, for example, the person instrumenting the offer or sale of an asset (and not the person offering or selling the asset) that which must be registered.

\textsuperscript{13} The appropriate definitions and specific regulations may be found as follows: banks (31 CFR §§ 1010.100(d) and 1020, respectively); brokers or dealers in securities (31 CFR §§ 1010.100(h) and 1023, respectively); futures commission merchants (31 CFR §§ 1010.100(x) and 1026, respectively); introducing brokers in commodities (31 CFR §§ 1010.100(bb) and 1026, respectively); and mutual funds (31 CFR §§ 1010.100(gg) and 1024, respectively).
commodity, and the broker or dealer becomes a money transmitter. This regulatory interpretation extends to persons intermediating in the purchase and sale of securities or futures.\textsuperscript{14}

b) FIN-2015-R001, "Application of FinCEN’s Regulations to Persons Issuing Physical or Digital Negotiable Certificates of Ownership of Precious Metals,” August 14, 2015, applies a similar interpretation to digital certificates evidencing the ownership of a certain amount of a commodity. This regulatory interpretation also extends to physical or digital certificates of ownership of securities or futures contracts.

In the regulatory interpretations above, money transmission could involve either (a) the movement of currency of legal tender to or from accounts originally set up to buy or sell commodities (or securities, or futures); or (b) the issuance and subsequent acceptance and transmission of a digital token that evidenced ownership of a certain amount of a commodity, security, or futures contract. At the time of the rulings mentioned above, the commodity, security, or futures contract itself was not used to engage in money transmission primarily because such contracts were fractioned in relatively large individual amounts not suitable for money transmission. However, if assets that other regulatory frameworks define as commodities, securities, or futures contracts were to be specifically issued or later repurposed to serve as a currency substitute, then the asset itself could be a type of value that substitutes for currency, the transfer of which could constitute money transmission.

Therefore, as explained above, money transmission may occur when a person (or an agent, or a mechanical or software agency owned or operated by such person) not exempt from MSB status:

a) uses any representation of currency of legal tender (paper money, coins, Federal Reserve Bank notes, United States notes, funds credited to an account) associated with the purchase or sale of commodities, securities, or futures contracts to engage in money transmission;

\textsuperscript{14} See also 2011 MSB Final Rule, 76 FR at 43594 (stating “[P]ersons that sell goods or provide services other than money transmission services, and only transmit funds as an integral part of that sale of goods or provisioning of services, are not money transmitters. For example, brokering the sale of securities, commodity contracts, or similar instruments is not money transmission notwithstanding the fact that the person brokering the sale may move funds back and forth between the buyer and seller to effect the transaction.”). The 2011 MSB Final Rule updated, streamlined, and clarified MSB regulations based on FinCEN’s large body of guidance and administrative rulings previously issued. 2011 MSB Final Rule, 76 FR at 43586. Such previous guidance or administrative rulings, which FinCEN has not withdrawn, remain instructive and are cited herein to assist in understanding FinCEN’s current interpretation of its MSB regulations.
b) issues physical or digital tokens evidencing ownership of commodities, securities, or futures contracts that serve as value that substitutes for currency in money transmission transactions; or

c) issues or employs commodities, securities, or futures contracts by themselves as value that substitutes for currency in money transmission transactions.

1.3. Convertible Virtual Currency (CVC)

The term “virtual currency” refers to a medium of exchange that can operate like currency but does not have all the attributes of “real” currency, as defined in 31 CFR § 1010.100(m), including legal tender status.\textsuperscript{15} CVC is a type of virtual currency that either has an equivalent value as currency, or acts as a substitute for currency, and is therefore a type of “value that substitutes for currency.”

As mentioned above, the label applied to any particular type of CVC (such as “digital currency,” “cryptocurrency,” “cryptoasset,” “digital asset,” etc.) is not dispositive of its regulatory treatment under the BSA. Similarly, as money transmission involves the acceptance and transmission of value that substitutes for currency by any means, transactions denominated in CVC will be subject to FinCEN regulations regardless of whether the CVC is represented by a physical or digital token, whether the type of ledger used to record the transactions is centralized or distributed, or the type of technology utilized for the transmission of value.

2. General Application of BSA Regulations to Money Transmission

Under the BSA, the term “person” means “[a]n individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities.”\textsuperscript{16}

In general, whether a person qualifies as an MSB subject to BSA regulation depends on the person’s activities and not its formal business status. Thus, whether a person is an MSB will not depend on whether the person: (a) is a natural person or legal entity; (b) is licensed as a business by any state; (c) has employees or other natural persons acting as agents; (d) operates at a brick-and-mortar branch, or through mechanical or software agents or agencies; or (e) is a for profit or nonprofit service.\textsuperscript{17}

\textsuperscript{15} 2013 VC Guidance, at 1; see also, infra, section 3.

\textsuperscript{16} 31 CFR § 1010.100(mm).

\textsuperscript{17} FinCEN clarified these points in the Preamble to the 2011 MSB Final Rule, 76 FR, at 43587.
At the same time, a person still qualifies as a money transmitter if that person's activities include receiving one form of value (currency, funds, prepaid value, value that substitutes for currency—such as CVC, etc.) from one person and transmitting either the same or a different form of value to another person or location, by any means.\(^\text{18}\) Similarly, a money transmitter may accept and transmit value in either order. That is, a person is still a money transmitter under FinCEN regulations if the person transmits value first, and only later accepts corresponding value for this transfer.\(^\text{19}\)

Likewise, a person may be a money transmitter when operating either on a transactional basis or on an account basis.\(^\text{20}\) A transactional basis includes one-off transactions where there is no expectation that the money transmitter will establish an ongoing relationship with the transactor, and the money transmitter retains the currency, funds, or other value that substitutes for currency, only for the time required to effect the transmission. By contrast, an account basis includes circumstances where the transactor is an established customer of the money transmitter, as defined in 31 CFR § 1010.100(p), and the money transmitter may maintain an account for the transactor to store funds or value that substitutes for currency, from which the transactor can instruct the money transmitter to transfer them in whole or in part.

Finally, a person will qualify as a money transmitter if that person accepts value with the intent of transmitting it only under certain conditions. For example, if a person operates a platform that facilitates the conditional exchange of value between two parties—such as the exchange of CVC against currency only when an agreed upon exchange rate and amount is met—such person will be engaged in money transmission every time the conditions (such as the exchange rate and amount) are met and the person completes the reciprocal transfers.\(^\text{21}\)

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18. 2011 MSB Final Rule, 76 FR, at 43592.
19. Ibid.
20. Amendment to the Bank Secrecy Act Regulations Relating to Recordkeeping for Funds Transfers and Transmittals of Funds by Financial Institutions, 60 FR 220, Jan. 3, 1995 (stating "An established customer is defined as a person with an account with a financial institution or a person with respect to which the financial institution has obtained and maintains on file the name and address, as well as the customer's taxpayer identification number or, if none, alien identification number or passport number and country of issuance, and to which the financial institution provides financial services relying on that information.... Such relationships with nonbank financial institutions may include, but are not limited to, accounts with broker/dealers and ongoing contractual relationships between providers of money transmitting services and business customers.")
As discussed above, whether a person is a money transmitter depends on the facts and circumstances of a given case. FinCEN regulations, however, specify certain activities are excluded from the definition of “money transmitter.” Specifically, a person is not a money transmitter if that person only:

a) provides the delivery, communication, or network access services used by a money transmitter to support money transmission services;

b) acts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller;

c) operates a clearance and settlement system or otherwise acts as an intermediary solely between BSA regulated institutions;

d) physically transports currency, other monetary instruments, other commercial paper, or other value that substitutes for currency as a person primarily engaged in such business, such as an armored car, from one person to the same person at another location or to an account belonging to the same person at a financial institution, provided that the person engaged in physical transportation has no more than a custodial interest in the currency, other monetary instruments, other commercial paper, or other value at any time during the transportation;

e) provides prepaid access, as defined in 31 CFR § 1010.100(ff)(4); or

f) accepts and transmits funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds.22

FinCEN interprets these exemptions strictly. Therefore, a person may not take advantage of a particular exemption if the activity it engages in does not conform fully to an exemption.23

2.1. BSA Obligations of Money Transmitters

The BSA regulatory framework begins with the expectation that financial institutions will operate under a culture of compliance supported by senior leadership, including owners, boards of directors, and senior executives. This culture of compliance will dictate the basic norms of behavior, knowledge, and transparency under which the management team, employees, and service providers will be held accountable.24

22. 31 CFR § 1010.100(ff)(5)(ii)(A)-(F).
The BSA and its implementing regulations require MSBs to develop, implement, and maintain an effective written anti-money laundering program ("AML program") that is reasonably designed to prevent the MSB from being used to facilitate money laundering and the financing of terrorist activities. The AML program must, at a minimum: (a) incorporate policies, procedures and internal controls reasonably designed to assure ongoing compliance (including verifying customer identification, filing reports, creating and retaining records, and responding to law enforcement requests); (b) designate an individual responsible to assure day-to-day compliance with the program and BSA requirements; (c) provide training for appropriate personnel, including training in the detection of suspicious transactions; and, (d) provide for independent review to monitor and maintain an adequate program.\textsuperscript{25} The AML program must be approved by the owner of the financial institution, or by the owner's representative (in the case of a corporation, such representative is the Board of Directors).

To assure that an AML compliance program is reasonably designed to meet the requirements of the BSA, MSBs should structure their programs to be risk-based. MSBs should assess their individual exposure to the risk of money laundering, terrorism finance, and financial crime based on the composition of customer base, the geographies served, and the financial products and services offered. MSBs must properly manage customer relationships and effectively mitigate risks by implementing controls commensurate with those risks.\textsuperscript{26}

A well-developed risk assessment is part of sound risk management and assists MSBs in identifying and providing a comprehensive analysis of their individual risk profile. As part of its risk assessment, an MSB should determine both the identity and the profile of its customers and MSBs must know enough about their customers to be able to determine the risk level they represent to the institution.

As an MSB, any non-exempt person engaged in money transmission must register with FinCEN within 180 days of starting to engage in money transmission.\textsuperscript{27} Money transmitters must also comply with the recordkeeping, reporting, and transaction monitoring obligations set forth in Parts 1010 and 1022 of 31 CFR Chapter X.\textsuperscript{28}

\textsuperscript{25} 31 U.S.C. § 5318(g)(1); 31 CFR § 1022.320(a)(2).
\textsuperscript{26} 31 CFR § 1022.210(b).
\textsuperscript{27} 31 CFR § 1022.380.
\textsuperscript{28} Examples of such requirements include the filing of Currency Transaction Reports (31 CFR § 1022.310) and Suspicious Activity Reports (31 CFR § 1022.320), whenever applicable, general recordkeeping maintenance (31 CFR § 1010.410), and recordkeeping related to the sale of negotiable instruments (31 CFR § 1010.415).
To the extent that any of the money transmitter’s transactions constitute a “transmittal of funds” under FinCEN’s regulations, then the money transmitter must also comply with the “Funds Transfer Rule” and the “Funds Travel Rule.” Additionally, as an MSB, the money transmitter must register with FinCEN within 180 days of starting to engage in money transmission.

FinCEN regulations define a “transmittal of funds” as a series of transmittal orders, and define a “transmittal order” as an instruction to pay, among other things “a fixed or determinable amount of money.” FinCEN has stated that transmittal of funds are not limited to wire transfers or electronic transfers. Examples provided in guidance are credits and debits to correspondent accounts, and using a check as a transmittal order within a transmittal of funds, in which case the check and any accompanying instructions are the transmittal order effecting the transmittal of funds.

Because a transmittal order involving CVC is an instruction to pay “a determinable amount of money,” transactions involving CVC qualify as transmittals of funds, and thus may fall within the Funds Travel Rule. Under the Funds Travel Rule, a transmittal of funds of $3,000 or more (or its equivalent in CVC) may trigger certain requirements on a money transmitter acting as either the financial institution for the transmitter or recipient, or as an intermediary financial institution.

The money transmitter must obtain or provide the required regulatory information either before or at the time of the transmittal of value, regardless of how a money transmitter sets up their system for clearing and settling transactions, including those involving CVC. In meeting this obligation, the parties to the transmittal of funds are not required to use the same system or protocol for both the actual transmission of value and the reception or transmission of the required regulatory information. As long as the obligated person provides the required regulatory information either

29. 31 CFR § 1010.100(ddd).
30. See 31 CFR § 1010.410(e).
31. See 31 CFR § 1010.410(f).
32. 31 CFR § 1022.380.
33. 31 CFR § 1010.100(ddd).
34. 31 CFR § 1010.100(ddd).
35. Ibid.
37. “Funds Travel Rule,” see 31 CFR § 1010.410(f).
38. In general, a person that chooses to set up a transaction system that makes it difficult to comply with existing regulations may not invoke such difficulty as a justification for non-compliance or as a reason for preferential treatment.
before or at the time of the transmittal of value, if a given transmission protocol is unable to accommodate such information, the obligated person may provide such information in a message different from the transmittal order itself.\textsuperscript{39}

Persons interested in determining whether a certain new activity or variation on an existing activity may subject them to FinCEN’s regulatory requirements, or that find that FinCEN published regulation or guidance does not clearly reflect their business model, have several options for obtaining preliminary, general guidance, or definitive regulatory interpretation.\textsuperscript{40}

3. Application of BSA Regulations to Money Transmission Involving CVC

The 2011 MSB Final Rule made clear that persons accepting and transmitting value that substitutes for currency, such as virtual currency, are money transmitters. Persons accepting and transmitting CVC are required (like any money transmitter) to register with FinCEN as an MSB and comply with AML program, recordkeeping, monitoring, and reporting requirements (including the filing of SARs and CTRs). These requirements apply equally to domestic and foreign-located CVC money transmitters doing business in whole or in substantial part within the United States, even if the foreign-located entity has no physical presence in the United States.

After the issuance of the 2011 MSB Final Rule, FinCEN received questions from industry on whether the new rule applied to transactions denominated in all types of virtual currency, including, for example, virtual currency that could only be used inside video games. Some persons involved in transactions denominated in CVC sought to register with FinCEN as either currency exchangers or prepaid access providers or sellers, rather than as money transmitters. FinCEN also received questions from persons purchasing CVCs to pay for goods or services, or planning to accept CVCs in payment of goods and services sold, concerned about their potential BSA obligations.

To address these and other issues, on March 18, 2013, FinCEN issued interpretive guidance on the application of FinCEN’s regulations to transactions involving the acceptance of currency or funds and the transmission of CVC (“2013 VC Guidance”).\textsuperscript{41} The 2013 VC Guidance described what CVC is for purposes of FinCEN regulations,

\textsuperscript{39} See 31 CFR § 1010.410(f).

\textsuperscript{40} See infra, Section 6 – Available Resources; see also MSB Examination Materials, available at https://www.fincen.gov/msb-examination-materials

and reminded the public that persons not exempted from MSB status that accept
and transmit either real currency or anything of value that substitutes for currency,
including virtual currency, are covered by the definition of money transmitter.\textsuperscript{42}

The 2013 VC Guidance also identified the participants to generic CVC 
arrangements, including an “exchanger,” “administrator,” and “user,” and further 
clarified that exchangers and administrators generally qualify as money transmitters 
under the BSA, while users do not. An exchanger is a person engaged as a business in 
the exchange of virtual currency for real currency, funds, or other virtual currency, 
while an administrator is a person engaged as a business in issuing (putting into 
circulation) a virtual currency, and who has the authority to redeem (to withdraw 
from circulation) such virtual currency.\textsuperscript{43} A user is “a person that obtains virtual 
currency to purchase goods or services” on the user’s own behalf.\textsuperscript{44}

The 2013 VC Guidance explained that the method of obtaining virtual 
currency (e.g., “earning,” “harvesting,” “mining,” “creating,” “auto-generating,” 
“manufacturing,” or “purchasing”) does not control whether a person qualifies as 
a “user,” an “administrator” or an “exchanger.”\textsuperscript{45} In addition, it confirmed that 
exchangers are subject to the same obligations under FinCEN regulations regardless of 
whether the exchangers are directly brokering the transactions between two or 
more persons, or whether the exchangers are parties to the transactions using their 
own reserves, in either CVC or real currency.\textsuperscript{46} The 2013 VC Guidance also discussed 
the appropriate regulatory treatment of administrators and exchangers under three 
common scenarios: brokers and dealers of e-currencies and e-precious metals; 
centralized CVCs; and decentralized CVCs.\textsuperscript{47}

The 2013 VC Guidance also clarified that FinCEN interprets the term “another 
location” broadly. The definition of money transmitter includes a person that accepts 
and transmits value that substitutes for currency from one person to another person 
or to “another location.” For example, transmission to another location occurs when 
an exchanger selling CVC accepts real currency or its equivalent from a person and

\textsuperscript{42} See, supra, Section 1.3.
\textsuperscript{43} See 2013 VC Guidance, at 2.
\textsuperscript{44} \textit{Ibid}.
\textsuperscript{45} See also FIN-2014-R001, “Application of FinCEN’s Regulations to Virtual Currency Mining 
Operations,” Jan. 30, 2014 (clarifying that a user is a person that obtains virtual currency to purchase 
goods or services on the user’s own behalf).
\textsuperscript{46} See FIN-2014-R012, “Request for Administrative Ruling on the Application of FinCEN’s Regulations 
to a Virtual Currency Payment System,” Oct. 27, 2014. See also, FIN-2014-R011, “Request for 
Administrative Ruling on the Application of FinCEN’s Regulations to a Virtual Currency Trading 
\textsuperscript{47} See 2013 VC Guidance, at 4-5 (discussing centralized and decentralized payment systems).
transmits the CVC equivalent of the real currency to the person’s CVC account with the exchanger. This circumstance constitutes transmission to another location because it involves a transmission from the person’s account at one location (e.g., a user’s real currency account at a bank) to the person’s CVC account with the exchanger.48


This guidance sets forth examples of how FinCEN’s money transmission regulations apply to several common business models involving transactions in CVC.49 The description of each business model does not intend to reflect an industry standard or cover all varieties of products or services generally referred by the same label, but only highlight the key facts and circumstances of a specific product or service on which FinCEN based its regulatory interpretation.

4.1. Natural Persons Providing CVC Money Transmission (P2P Exchangers)

FinCEN’s definition of an MSB includes both natural and legal persons engaged as a business in covered activities, “whether or not on a regular basis or as an organized business concern.”50 Peer-to-Peer (P2P) exchangers are (typically) natural persons engaged in the business of buying and selling CVCs. P2P exchangers generally advertise and market their services through classified advertisements, specifically designed platform websites, online forums, other social media, and word of mouth. P2P exchangers facilitate transfers from one type of CVC to a different type of CVC, as well as exchanges between CVC and other types of value (such as monetary instruments or payment products denominated in real currency). P2P exchangers may provide their services online or may arrange to meet prospective customers in person to purchase or sell CVC. Generally, once there is confirmation that the buyer has delivered or deposited the requested currency or CVC, the P2P exchanger will electronically provide the buyer with the requested CVC or other value.

49. Although when describing a business model this guidance may use a label by which the general type of product or service may be commonly known, the interpretation provided herein applies only to the business model the guidance describes, and may not apply to any other variety or combination of factors that falls under the same generic label. For example, when in Section 4.4, FinCEN discusses how its regulations apply to certain money transmission in CVC executed within the context of ICOs, this interpretation applies exclusively to those transactions described in the guidance and may not apply to any other transactions may also be referred to as ICOs but follow a different business model.
50. 31 CFR § 1010.100(ff).
A natural person operating as a P2P exchanger that engages in money transmission services involving real currency or CVCs must comply with BSA regulations as a money transmitter acting as principal. This is so regardless of the regularity or formality of such transactions or the location from which the person is operating. However, a natural person engaging in such activity on an infrequent basis and not for profit or gain would be exempt from the scope of money transmission.\(^{51}\)

As a money transmitter, P2P exchangers are required to comply with the BSA obligations that apply to money transmitters, including registering with FinCEN as an MSB and complying with AML program, recordkeeping, and reporting requirements (including filing SARs and CTRs).\(^{52}\)

### 4.2. CVC Wallets

CVC wallets are interfaces for storing and transferring CVCs. There are different wallet types that vary according to the technology employed, where and how the value is stored, and who controls access to the value. Current examples of different types of CVC wallets that vary by technology employed are mobile wallets, software wallets, and hardware wallets. Wallets may store value locally, or store a private key that will control access to value stored on an external server. Wallets may also use multiple private keys stored in multiple locations. Wallets where user funds are controlled by third parties are called "hosted wallets" whereas wallets where users control the funds are called "unhosted wallets."

The regulatory interpretation of the BSA obligations of persons that act as intermediaries between the owner of the value and the value itself is not technology-dependent. The regulatory treatment of such intermediaries depends on four criteria: (a) who owns the value; (b) where the value is stored; (c) whether the owner interacts directly with the payment system where the CVC runs; and, (d) whether the person acting as intermediary has total independent control over the value. The regulatory treatment of each type of CVC wallet based on these factors is described in the next subsection.

#### 4.2.1. Hosted and Unhosted Wallet Providers

Hosted wallet providers are account-based money transmitters that receive, store, and transmit CVCs on behalf of their accountholders, generally interacting with them through websites or mobile applications. In this business model, the money transmitter is the host, the account is the wallet, and the accountholder is the wallet.
owner. In addition, (a) the value belongs to the owner; (b) the value may be stored in a wallet or represented as an entry in the accounts of the host; (c) the owner interacts directly with the host, and not with the payment system; and (d) the host has total independent control over the value (although it is contractually obligated to access the value only on instructions from the owner).

The regulatory framework applicable to the host, including the due diligence or enhanced due diligence procedures the host must follow regarding the wallet owner, varies depending on: (a) whether the wallet owner is a non-financial institution (in this context, a user, according to the 2013 VC Guidance), agent, or foreign or domestic counterparty; and (b) the type of transactions channeled through the hosted wallet, and their U.S. dollar equivalent.

When the wallet owner is a user, the host must follow the procedures for identifying, verifying and monitoring both the user’s identity and profile, consistent with the host’s AML program. When the wallet owner is an agent of the host, the host must comply with regulations and internal policies, procedures and controls governing a principal MSB’s obligation to monitor the activities of its agent. When the wallet owner is a financial institution other than an agent, the host must comply with the regulatory requirements applicable to correspondent accounts (or their MSB equivalents).

Similarly, the regulatory requirements that apply to the transactions that host channels from or for the wallet owner will depend on the nature of the transaction. For example, where the transactions fall under the definition of “transmittal of funds,” the host must comply with the Funds Travel Rule based on the host’s position in the transmission chain (either as a transmittor’s, intermediary, or recipient’s financial institution), regardless of whether the regulatory information may be included in the transmittal order itself or must be transmitted separately.

Unhosted wallets are software hosted on a person’s computer, phone, or other device that allow the person to store and conduct transactions in CVC. Unhosted wallets do not require an additional third party to conduct transactions. In the case of unhosted, single-signature wallets, (a) the value (by definition) is the property of the owner and is stored in a wallet, while (b) the owner interacts with the payment system directly and has total independent control over the value. In so far as the person conducting a transaction through the unhosted wallet is doing so to purchase goods or services on the user’s own behalf, they are not a money transmitter.


55. See 31 CFR § 1010.410(f).
4.2.2. Multiple-signature wallet providers

Multiple-signature wallet providers are entities that facilitate the creation of wallets specifically for CVC that, for enhanced security, require more than one private key for the wallet owner(s) to effect transactions. Typically, multiple-signature wallet providers maintain in their possession one key for additional validation, while the wallet owner maintains the other private key locally. When a wallet owner wishes to effect a transaction from the owner’s multiple-signature wallet, the wallet owner will generally submit to the provider a request signed with the wallet owner’s private key, and once the provider verifies this request, the provider validates and executes the transaction using the second key it houses. With respect to an un-hosted multiple-signature wallet, (a) the value belongs to the owner and is stored in the wallet; (b) the owner interacts with the wallet software and/or payment system to initiate a transaction, supplying part of the credentials required to access the value; and (c) the person participating in the transaction to provide additional validation at the request of the owner does not have total independent control over the value.

If the multiple-signature wallet provider restricts its role to creating un-hosted wallets that require adding a second authorization key to the wallet owner’s private key in order to validate and complete transactions, the provider is not a money transmitter because it does not accept and transmit value. On the other hand, if the person combines the services of a multiple-signature wallet provider and a hosted wallet provider, that person will then qualify as a money transmitter. Likewise, if the value is represented as an entry in the accounts of the provider, the owner does not interact with the payment system directly, or the provider maintains total independent control of the value, the provider will also qualify as a money transmitter, regardless of the label the person applies to itself or its activities.

4.3. CVC Money Transmission Services Provided Through Electronic Terminals (CVC Kiosks)

CVC kiosks (commonly called “CVC automated teller machines (ATMs)” or “CVC vending machines”) are electronic terminals that act as mechanical agencies of the owner-operator, to enable the owner-operator to facilitate the exchange of CVC for currency or other CVC. These kiosks may connect directly to a separate CVC exchanger, which performs the actual CVC transmission, or they may draw upon the CVC in the possession of the owner-operator of the electronic terminal.

An owner-operator of a CVC kiosk who uses an electronic terminal to accept currency from a customer and transmit the equivalent value in CVC (or vice versa) qualifies as a money transmitter both for transactions receiving and dispensing real

56. 31 CFR § 1010.100(ff)(5)(ii)(A).
currency or CVC. FinCEN issued guidance clarifying that owners/operators of ATMs that link an accountholder with his or her account at a regulated depository institution solely to verify balances and dispense currency do not meet the definition of a money transmitter.\(^\text{57}\) The guidance addressing BSA coverage of private ATMs does not apply to the owner-operator of a CVC kiosk because CVC kiosks do not link accountholders to their respective accounts at a regulated depository institution. Accordingly, owners-operators of CVC kiosks that accept and transmit value must comply with FinCEN regulations governing money transmitters.

### 4.4. CVC Money Transmission Services Provided Through Decentralized Applications (DAApps)

Decentralized (distributed) application (DAapp) is a term that refers to software programs that operate on a P2P network of computers running a blockchain platform (a type of distributed public ledger that allows the development of secondary blockchains), designed such that they are not controlled by a single person or group of persons (that is, they do not have an identifiable administrator). An owner/operator of a DAApp may deploy it to perform a wide variety of functions, including acting as an unincorporated organization, such as a software agency to provide financial services.\(^\text{58}\) Generally, a DAApp user must pay a fee to the DAApp (for the ultimate benefit of the owner/operator) in order to run the software. The fee is commonly paid in CVC.

The same regulatory interpretation that applies to mechanical agencies such as CVC kiosks applies to DAApps that accept and transmit value, regardless of whether they operate for profit. Accordingly, when DAApps perform money transmission, the definition of money transmitter will apply to the DAApp, the owners/operators of the DAApp, or both.

### 4.5. Anonymity-Enhanced CVC Transactions

Anonymity-enhanced CVC transactions are transactions either (a) denominated in regular types of CVC, but structured to conceal information otherwise generally available through the CVC's native distributed public ledger; or (b) denominated in types of CVC specifically engineered to prevent their tracing through distributed public ledgers (also called privacy coins).

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A money transmitter that operates in anonymity-enhanced CVCs for its own account or for the accounts of others (regardless of the frequency) is subject to the same regulatory obligations as when operating in currency, funds, or non-anonymized CVCs. In other words, a money transmitter cannot avoid its regulatory obligations because it chooses to provide money transmission services using anonymity-enhanced CVC. The regulatory framework that applies to a person participating in anonymity-enhanced CVC transactions depends on the specific role performed by the person, as set forth below in Section 4.5.1.

4.5.1. Providers of anonymizing services for CVCs

Providers of anonymizing services, commonly referred to as “mixers” or “tumblers,” are either persons that accept CVCs and retransmit them in a manner designed to prevent others from tracing the transmission back to its source (anonymizing services provider), or suppliers of software a transmitter would use for the same purpose (anonymizing software provider).

4.5.1(a) Anonymizing services provider

An anonymizing services provider is a money transmitter under FinCEN regulations. The added feature of concealing the source of the transaction does not change that person’s status under the BSA.

FinCEN previously issued a regulatory interpretation that concluded that persons who accept and transmit value in a way ostensibly designed to protect the privacy of the transmitter are providers of secure money transmission services and are not eligible for the integral exemption.\(^{59}\) In order to be exempt from status as a money transmitter under the integral exemption, the person’s business must be different from money transmission itself, and the money transmission activity must be necessary for the business to operate. The subject of this previous regulatory interpretation accepted and transmitted funds in a way designed to protect a consumer’s personal and financial information from a merchant, when the consumer purchased goods or services through the Internet. FinCEN determined that the added feature of protecting consumers’ information did not constitute an activity separate from the funds transmission itself, because the need to protect the consumers’ personal and financial information only arose in connection with the transmission of funds. FinCEN concluded that the company was engaged in the business of offering secure money transmission, rather than security for which money transmission is integrally required. Accordingly, the company qualified as a money transmitter subject to BSA obligations.

The same analysis applies to anonymizing services providers: their business consists exclusively of providing secured money transmission. Therefore, a person (acting by itself, through employees or agents, or by using mechanical or software agencies) who provides anonymizing services by accepting value from a customer and transmitting the same or another type of value to the recipient, in a way designed to mask the identity of the transmitter, is a money transmitter under FinCEN regulations.

4.5.1(b) Anonymizing software provider

An anonymizing software provider is not a money transmitter. FinCEN regulations exempt from the definition of money transmitter those persons providing “the delivery, communication, or network access services used by a money transmitter to support money transmission services.”60 This is because suppliers of tools (communications, hardware, or software) that may be utilized in money transmission, like anonymizing software, are engaged in trade and not money transmission.

By contrast, a person that utilizes the software to anonymize the person’s own transactions will be either a user or a money transmitter, depending on the purpose of each transaction. For example, a user would employ the software when paying for goods or services on its own behalf, while a money transmitter would use it to engage as a business in the acceptance and transmission of value as a transmitter’s or intermediary’s financial institution.

Lastly, FinCEN issued guidance stating that originating or intermediary financial institutions that replace the proper identity of a transmitter or recipient in the transmittal order with a pseudonym or reference that may not be decoded by the receiving financial institution (i.e., substituting the full name of the transmitter with a numeric code) are not complying with their obligations under the Funds Travel Rule.61

4.5.2. Providers of anonymity-enhanced CVCs

A person that creates or sells anonymity-enhanced CVCs designed to prevent their tracing through publicly visible ledgers would be a money transmitter under FinCEN regulations depending on the type of payment system and the person’s activity.62 For example:

(a) a person operating as the administrator of a centralized CVC payment system will become a money transmitter the moment that person issues anonymity-enhanced CVC against the receipt of another type of value.63

60. 31 CFR § 1010.100(ff)(5)(ii).
62. See, supra, Section 1.1.
63. A payment system may change from centralized to decentralized (see Section 5.2). This operational change does not alter the obligations of the person acting as administrator of the system, while the system worked on a centralized basis.
(b) a person that uses anonymity-enhanced CVCs to pay for goods or services on his or her own behalf would not be a money transmitter under the BSA. However, if the person uses the CVC to accept and transmit value from one person to another person or location, the person will fall under the definition of money transmitter, if not otherwise exempted.

(c) a person that develops a decentralized CVC payment system will become a money transmitter if that person also engages as a business in the acceptance and transmission of value denominated in the CVC it developed (even if the CVC value was mined at an earlier date). The person would not be a money transmitter if that person uses the CVC it mined to pay for goods and services on his or her own behalf.⁶⁴

4.5.3. Money Transmitters that accept or transmit anonymity-enhanced CVCs

Many money transmitters involved in CVC transactions comply with their BSA obligations, in part, by incorporating procedures into their AML Programs that allow them to track and monitor the transaction history of a CVC through publicly visible ledgers.

As mentioned above, FinCEN has issued guidance stating that transmitter’s or intermediary’s financial institutions that replace the proper identity of a transmitter or recipient in the transmittal order with a pseudonym or reference that may not be decoded by the receiving financial institution (i.e., substituting the full name of the transmitter with a numeric code) are not complying with their obligations under the Funds Travel Rule.⁶⁵ A money transmitter must follow its AML risk assessment policies and procedures to determine under which circumstances the money transmitter will accept or transmit value already denominated in anonymity-enhanced CVCs. When knowingly accepting anonymity-enhanced CVCs (or regular CVC that has been anonymized), money transmitters engaged in CVC transactions subject to the Funds Travel Rule must not only track a CVC through the different transactions, but must also implement procedures to obtain the identity of the transmitter or recipient of the value.

4.6. Payment Processing Services Involving CVC Money Transmission

CVC payment processors are financial intermediaries that enable traditional merchants to accept CVC from customers in exchange for goods and services sold. CVC payment processors sometimes integrate with a merchant’s point of sale or

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⁶⁴ See 2013 VC Guidance, at 4-5 (discussing centralized and decentralized payment systems).
⁶⁵ See, supra, at 19 n. 59.
online shopping cart solution so that the value of goods being purchased is quoted in CVC. The CVC payment processor may collect the CVC from the customer and then transmit currency or funds to the merchant, or vice versa.

CVC payment processors fall within the definition of a money transmitter and are not eligible for the payment processor exemption because they do not satisfy all the required conditions for the exemption. Under the payment processor exemption, a person is exempt from the definition of “money transmitter” when that person only “[a]cts as a payment processor to facilitate the purchase of, or payment of a bill for, a good or service through a clearance and settlement system by agreement with the creditor or seller.” 66 To be eligible for the payment processor exemption, a person must:

(a) facilitate the purchase of goods or services, or the payment of bills for goods or services (not just the money transmission itself);

(b) operate through clearance and settlement systems that admit only BSA-regulated financial institutions;

(c) provide its service pursuant to a formal agreement; and

(d) enter a formal agreement with, at a minimum, the seller or creditor that provided the goods or services and also receives the funds. 67

A person providing payment processing services through CVC money transmission generally is unable to satisfy the second condition because such money transmitters do not operate, either in whole or in part, through clearing and settlement systems that only admit BSA-regulated financial institutions as members. This condition is critical, because BSA-regulated financial institutions have greater visibility into the complete pattern of activities of the buyer or debtor, on the one hand, and the seller or creditor, on the other hand. Having BSA-regulated financial institutions at either end of the clearance and settlement of transactions reduces the need to impose additional obligations on the payment processor. 68 This same


68. Id. The CVC payment processor in that ruling received real currency payments from the buyer through a clearing and settlement system that only admits BSA-regulated financial institutions as members (specifically, a credit card network), but made payment of the Bitcoin equivalent to the merchant, to a merchant-owned virtual currency wallet or to a larger virtual currency exchange that admits both financial institution and non-financial institution members, for the account of the merchant.
visibility simply does not exist when a CVC payment processor operates through a clearance and settlement system involving non-BSA regulated entities unless the CVC payment processor complies with the reporting obligations of a money transmitter.

Accordingly, in general, persons providing payment processing services in CVC will be money transmitters under the BSA, regardless of whether they accept and transmit the same type of CVC, or they accept one type of value (such as currency or funds) and transmit another (such as CVC).  

4.7. CVC Money Transmission Performed by Internet Casinos

Internet casinos are virtual platforms created for betting on the possible outcome of events related to a number of gaming models (e.g., traditional casinos), but accepting deposits and bets and issuing payouts denominated in CVC. Internet casinos may also include entities known as predictive markets, information markets, decision markets, idea futures, and event derivatives.

FinCEN regulations define a casino, gambling casino or card club, as a person duly licensed or authorized to do business as such in the United States, whether under the laws of a State or a Territory or Insular Possession of the United States, or under the Indian Gaming Regulatory Act or other Federal, State, or tribal law or arrangement affecting tribal land, having gross annual gaming revenue in excess of $1 million, whether denominated in CVC or other value. Any person engaged in the business of gambling that is not covered by the regulatory definition of casino, gambling casino, or card club, but accepts and transmits value denominated in CVC, may still be regulated under the BSA as a money transmitter. Indeed, even when the original transmission or the payout are done on a conditional basis (that is, only if a certain event occurs), money transmission under BSA regulations still occurs at the moment the condition is satisfied and the acceptance or transmission takes place.

5. Specific Business Models Involving CVC Transactions that May be Exempt From the Definition of Money Transmission

5.1. CVC Trading Platforms and Decentralized Exchanges

CVC P2P trading platforms are websites that enable buyers and sellers of CVC to find each other. Sometimes, trading platforms also facilitate trades as an intermediary.

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69. A CVC payment processor will be eligible for the payment processor exemption only when it meets all criteria as described above. See also, supra, at 21 n. 64.

70. 31 CFR § 1010.100(t)(5) and (6).

71. Casinos, as defined above, have their own set of BSA/AML obligations (see 31 CFR Part 1010 –General Provisions – and Part 1021 –Rules for Casinos and Card Clubs). While not specifically exempted from MSB status, when a person falls under FinCEN’s definitions for both casino and MSB, in general the regulatory obligations of a casino satisfy the obligations of an MSB, with the exception of registration.
Under FinCEN regulations, a person is exempt from money transmitter status if the person only provides the delivery, communication, or network access services used by a money transmitter to support money transmission services. Consistent with this exemption, if a CVC trading platform only provides a forum where buyers and sellers of CVC post their bids and offers (with or without automatic matching of counterparties), and the parties themselves settle any matched transactions through an outside venue (either through individual wallets or other wallets not hosted by the trading platform), the trading platform does not qualify as a money transmitter under FinCEN regulations. By contrast, if, when transactions are matched, a trading platform purchases the CVC from the seller and sells it to the buyer, then the trading platform is acting as a CVC exchanger, and thus falls within the definition of money transmitter and its accompanying BSA obligations.

5.2. CVC Money Transmission Performed in the Context of Raising Funding for Development or Other Projects—Initial Coin Offerings

Initial coin offerings (ICOs) are generally a means to raise funds for new projects from early backers. Whether an ICO is subject to BSA obligations is a matter of facts and circumstances. This guidance will address, as an example, the BSA obligations of two common business models involving ICOs: (a) ICOs conducting a preferential sale of CVC to a select group of buyers (sometimes referred to as investors); and (b) ICOs raising funds by offering digital debt or equity instruments among a group of lenders or investors to finance a future project (which in turn may consist of the creation of a new CVC). This discussion does not attempt to address every possible ICO business model.

In the first business model, the ICO consists of a group sale of CVC to a distinct set of preferred buyers. The exchange of CVC for another type of value may be instantaneous or deferred to a later date. The CVC and its application or platform may be already operational or it may be the seller’s purpose to use the value received from the sale, in whole or in part, to develop such CVC, application, or platform. In some cases, after the initial centralized offering, any future creation of the CVC may

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72. 31 CFR § 1010.100(ff)(5)(ii)(A).
73. The obligations of the hosted wallet provider that utilizes the forum as a money transmitter under the BSA remain as described, supra, Section 3.2.
occur through mining using a decentralized model. In any of these scenarios, the seller of the CVC is a money transmitter, acting in the role of administrator, because at the time of the initial offering the seller is the only person authorized to issue and redeem (permanently retire from circulation) the new units of CVC.\textsuperscript{76} The status of the seller as a money transmitter is not impacted by the coordinated or simultaneous sales; the timing of acceptance of one type of value and transmission of the other type (i.e., whether the exchange happens instantaneously or at a later date); or by the fact that the payment system may migrate from one operational status to another at any point in its lifetime (for example, changing from a centralized, administrator-controlled system at origin to a decentralized, protocol-driven system after the initial sale).

In the second business model, the ICO raises funds for new projects by selling an equity stake or a debt instrument to early backers, or hedges a previous investment in CVC through a derivative, such as a futures contract. The funded project generally involves the creation of DApps\textsuperscript{77} new CVCs (as well as the applications or platforms on which the CVCs will run), or new hedging instruments. ICOs are accomplished using distributed ledger platforms, in which investors receive a digital token as proof of investment. Depending on the purpose of the funded project and the seller’s obligations to the investor, when the project is concluded the investor may: (a) receive new CVC in exchange for the token; (b) exchange the token for a DApp coin, which is a digital token that unlocks the use of DApps that provide various services; (c) use the original token itself as a new CVC or DApp coin; or (d) receive some other type of return on the original equity investment or debt instrument.\textsuperscript{78} How BSA regulations apply to each of these scenarios will vary, as set forth below in Sections 5.2.1 to 5.2.3.

5.2.1. Status of Fundraising or Hedging Activity — Overview

Involvement of banks or persons registered with, and functionally regulated or examined by the SEC or CFTC

The applicable AML regulations governing persons involved in an ICO through selling an equity stake or a debt instrument to early backers or through hedging a previous investment will depend on whether such persons are MSBs or exempt from MSB status under FinCEN regulations or rulings. Persons may be exempt from MSB status in two situations. First, FinCEN regulations expressly exempt from the

\textsuperscript{76} Whether by contractual agreement or business strategy an administrator declines to exercise such authorities is not relevant to the person’s status as a money transmitter.

\textsuperscript{77} As discussed, supra, Section 4.4, DApps refer to software programs that run on distributed computing platforms—that is, platforms built across dispersed networks of computers designed to accomplish a shared objective.

\textsuperscript{78} A transaction where a person accepts currency, funds, or value that substitutes for currency in exchange for a new CVC at a preferential rate for a group of initial purchasers, before making the CVC available to the rest of the public, is simply engaging in money transmission, regardless of any specific label (such as “early investors”) applied to the initial purchasers.
definition of an MSB, among other things, (a) a bank or foreign bank; or (b) a person registered with, and functionally regulated or examined by, the SEC or CFTC, or a foreign financial agency that engages in financial activities that, if conducted in the United States, would require the foreign financial agency to be registered with the SEC or CFTC. Therefore, a person involved in ICO fundraising activity as issuer, intermediary, or investor that is a bank, foreign bank, or a person registered with, and functionally regulated or examined by the SEC or CFTC will not be an MSB under FinCEN regulations. The person's AML obligations will flow from FinCEN regulations governing those types of financial institutions.

Second, FinCEN regulations exempt persons from the definition of money transmitter under certain identified facts and circumstances, the most relevant of which is when the acceptance and transmission of value is only integral to the sale of goods or services different from money transmission. Thus, if the person involved in the fundraising activity as an issuer, intermediary, or investor is not a bank, foreign bank, or a person registered with, and functionally regulated or examined by the SEC or CFTC, then any money transmission connected to the fundraising activity performed by the person generally will fall under the integral exemption, unless the asset is issued to serve as value that substitutes for currency.

Purchase and re-sale of digital tokens

The investor may hold the digital token or derivative until the underlying project is complete, or the investor may sell the digital token or derivative during the project's development. A re-sale can occur through a P2P transaction, or through a financial intermediary or secondary market. In general, the re-sale of the token or derivative does not create any BSA obligations for the initial investor. However, if a regulatory framework other than the BSA requires a person that either (a) purchases the token or derivative, or (b) intermediates in transactions in a primary or secondary market, to register as a broker or dealer in securities, futures commission merchant, or introducing broker in commodities, then the person will have the BSA obligations related to its status under these other regulatory frameworks.

79. 31 CFR § 1010.100(ff)(8). See also, supra, Section 1.2.2.
80. See, supra, at 5 n. 13.
82. For additional discussion of the scope of the integral exemption, see FIN-2008-R004 "Whether a Foreign Exchange Consultant is a Currency Dealer or Exchanger or Money Transmitter," May 9, 2008, FIN-2008-R003 "Whether a Person that is Engaged in the Business of Foreign Exchange Risk Management is a Currency Dealer or Exchanger or Money Transmitter," May 9, 2008.
83. See, supra, Section 1.2.3.
84. See, supra, Section 1.2.2.
5.2.2. Status of a DApp Developer

The development of a DApp financed through ICO fundraising activity consists of the production of goods or services, and therefore is outside the definition of money transmission. Thus, the developer of a DApp is not a money transmitter for the mere act of creating the application, even if the purpose of the DApp is to issue a CVC or otherwise facilitate financial activities denominated in CVC.\(^{85}\) However, if the developer of the DApp uses or deploys it to engage in money transmission, then the developer will qualify as a money transmitter under the BSA.

5.2.3. Status of a DApp User conducting financial activities

Once the DApp is finalized and in production, FinCEN regulations may apply to persons who use the DApp to conduct certain financial activities. For example, if an investor or an owner/operator uses or deploys the DApp to engage in money transmission denominated in CVC, then the investor or the owner/operator generally qualifies as a money transmitter under the BSA. Likewise, as mentioned above, if the developer of the DApp uses or deploys the DApp to engage in money transmission, then the developer will also qualify as a money transmitter.

5.3. Status of Creators of CVC and Distributed Applications Conducting CVC Transactions

The creators of a CVC sometimes issue (or “pre-mine”) a certain number of CVC units in advance and then either distribute those units as payment for goods or services or repayment of obligations (such as amounts owed to project investors), or sell the units against currency, funds or another type of CVC once a market is established. To the extent that a person mines CVC and uses it solely to purchase goods or services on its own behalf, the person is not an MSB under FinCEN regulations, because these activities involve neither acceptance nor transmission of the CVC within the regulatory definition of money transmission services. However, if a person mines CVC and uses it to engage in money transmission, such person will be subject to FinCEN’s registration, reporting, monitoring, and recordkeeping regulations for MSBs, as is the case with all money transmitters.\(^{86}\)

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5.4. CVC Money Transmission Performed by Mining Pools and Cloud Miners

In certain cases, persons (pool members) combine their computer processing resources to form a mining pool to enhance their chances of receiving a reward by being the first ones to verify the authenticity of a block of transactions denominated in CVC. A block reward would entitle them to receive consistent payouts, which are fees paid by the parties to a transaction for the service of authenticating its individual CVC transmission. Mining pools may be managed by a controlling person (centralized mining pools) or they may operate on a P2P basis (decentralized mining pools). In some centralized models, the person acting as the leader of the pool claims the total amount of CVC mined or received as fees from participants to the authenticated transactions. The leader then distributes this amount to the pool members in subsequent transfers, presumably in proportion to the computer processing provided, minus its own fee for managing the pool. In other centralized models, such as cloud mining, persons (contract purchasers) may purchase “mining contracts” from a seller of computer processing (the cloud miner) that grants these purchasers permission to use the cloud miner’s computers to mine CVCs on the purchaser’s behalf.

When the leader of the pool, the cloud miner, or the unincorporated organization or software agency acting on behalf of its owner/administrator transfer CVC to the pool members or contract purchasers to distribute the amount earned, this distribution does not qualify as money transmission under the BSA, as these transfers are integral to the provision of services (the authentication of blocks of transactions through the combined efforts of a group of providers, or through the equipment of the cloud miner). However, if the leader, the cloud miner, or the software agency combine their managing and renting services with the service of hosting CVC wallets on behalf of the pool members or contract purchasers, the leader, cloud miner, unincorporated organization or software agency, or the owner-administrator will fall under FinCEN’s definition of money transmitter for engaging in account-based money transmission.

6. Available Resources

FinCEN expects that persons introducing innovative products or services to a highly regulated activity, such as money transmission, will ensure that the innovation complies with the regulatory framework applicable to such activity before the innovation is taken to market. Persons interested in determining whether a certain new activity or variation on an existing activity may subject them to FinCEN’s regulatory requirements have several options for obtaining preliminary, general guidance or definitive regulatory interpretation.
Financial institutions with questions about this guidance, other guidance, administrative rulings or other matters related to compliance with the BSA and its implementing regulations may contact FinCEN’s Resource Center Helpline at (800) 949-2732 or FRC@fincen.gov.

Persons requiring general information about the risk assessment, risk mitigation, recordkeeping, reporting, and transaction monitoring requirements applicable to money services businesses may consult the outreach material, including examiners’ expectations about compliance contained in the Bank Secrecy Act / Anti-Money Laundering Examination Manual for Money Services Businesses (Dec. 2008).

For examples of previous interpretations on the application of FinCEN regulations to specific sets of facts and circumstances, interested persons may review the collection of guidance and administrative rulings.

Finally, in circumstances where neither the general and interpretive material available at FinCEN’s public website, nor the information provided by FinCEN’s Resource Center staff is sufficient to address the particulars of a situation, interested persons or their legal representatives may request FinCEN to provide individual guidance or an administrative ruling, by following the Requirements for Requesting an Administrative Ruling. 87

87. See also 31 CFR §§ 1010.710 - 1010.717.
For convenience, the following chart contains a list of guidance and administrative rulings referencing CVC:

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July 16, 2019
IRS begins issuing letters re: Reporting Virtual Currency Transactions
Reporting Virtual Currency Transactions

Dear [Name]:

Why we're writing to you
We have information that you have or had one or more accounts containing virtual currency but may not know the requirements for reporting transactions involving virtual currency, which include cryptocurrency and non-crypto virtual currencies.

What you need to do
After reviewing the information below, if you believe you didn't accurately report your virtual currency transactions on a federal income tax return, you should file amended returns or delinquent returns if you didn't file a return for one or more taxable years. If you do not accurately report your virtual currency transactions, you may be subject to future civil and criminal enforcement activity. For more information, visit www.irs.gov/filing.

When filing amended or delinquent returns, write "Letter 6174" at the top of the first page of the return. Mail the original amended or delinquent return to:

Internal Revenue Service
2970 Market Street
Philadelphia, PA 19104

Reporting virtual currency transactions
Virtual currency is considered property for federal income tax purposes. Generally, U.S. taxpayers must report all sales, exchanges, and other dispositions of virtual currency. An exchange of a virtual currency (such as Bitcoin, Ether, etc.) includes the use of the virtual currency to pay for goods, services, or other property, including another virtual currency such as exchanging Bitcoin for Ether. This obligation applies regardless of whether the account is held in the U.S. or abroad. More information can be found on www.irs.gov and in Notice 2014-21, found at www.irs.gov/pub/irs-drop/n-14-21.pdf, which describes how general tax principles for property transactions apply to transactions involving virtual currency.

You must report virtual currency transactions on your return, regardless of whether you received a payee statement for the transaction (such as a Form W-2, Form 1099, etc.).

Letter 6174 (6-2019)
Catalog Number 72273Z
Common schedules for reporting virtual currency transactions include the following:

**Schedule C**
If you were an independent contractor and received payment in virtual currency, you must report it in gross income for the amount of the virtual currency's fair market value, measured in U.S. dollars, as of the date and time you received the virtual currency. Gross income derived by an individual from a trade or business, carried on by the individual as other than an employee, is reported on Schedule C. This constitutes self-employment income and is subject to the self-employment tax.

For more information, you can refer to the instructions for Schedule C.

**Schedule D**
If you sold, exchanged, or disposed of virtual currency (e.g. Bitcoin, Ether), or used it to pay for goods or services, you have engaged in a reportable transaction and may have a tax liability. These transactions may be reportable on Schedule D. On the tax return, report the virtual currency received at its fair market value, measured in U.S. dollars, as of the date and time of the transaction.

You should maintain and review all transaction records, including bank, wallet, and exchange reports and statements to determine your basis, amount received, and other information needed for reporting on Schedule D.

For more information, you can refer to the instructions for Schedule D.

**Schedule E**
If you received supplemental income in the form of virtual currency, including income from rental real estate, royalties, partnerships, S corporations, estates, trusts, and residual interests in REMICs, you may need to report this on Schedule E. On the tax return, report the virtual currency received at its fair market value, measured in U.S. dollars, as of the date and time of the transaction.

You may also need to file supplemental forms (e.g. Form 8582, Passive Activity Loss Limitations). See the instructions for Schedule E for any other circumstances that may apply.

For more information, you can refer to the instructions for Schedule E.

**Additional Resources**
- Publication 17, Your Federal Income Tax (For Individuals)
- Instructions for Form 1040, U.S. Individual Income Tax Return
- Instructions for Form 8949, Sales and Other Dispositions of Capital Assets
- Instructions for Form 1041, U.S. Income Tax Return for Estates and Trusts
- Instructions for Form 1120, U.S. Corporation Income Tax Return
- Instructions for Form 1120-S, U.S. Income Tax Return for an S Corporation
- Instructions for Form 1065, U.S. Return of Partnership Income

You can get the forms, instructions, and publications mentioned in this letter by visiting our website at www.irs.gov/forms-pubs or by calling 800-TAX-FORM (800-829-3676).

**You do not need to respond to this letter.**
If you have questions, you can call the hotline telephone number shown at the top of this letter and leave a message. We'll respond to all messages within three business days.

Thank you for your cooperation.

Sincerely,

[Name]
[Title]
October 9, 2019
(Treatment of hard forks)
26 CFR 1.61-1: Gross income.
(Also §§ 61, 451, 1011.)

Rev. Rul. 2019-24

ISSUES

(1) Does a taxpayer have gross income under § 61 of the Internal Revenue Code (Code) as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency?

(2) Does a taxpayer have gross income under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency?

BACKGROUND

Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and a store of value other than a representation of the United States dollar or a foreign currency. Foreign currency is the coin and paper money of a country other than the United States that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance. See 31 C.F.R. § 1010.100(m).
Cryptocurrency is a type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of cryptocurrency are generally referred to as coins or tokens. Distributed ledger technology uses independent digital systems to record, share, and synchronize transactions, the details of which are recorded in multiple places at the same time with no central data store or administration functionality.

A hard fork is unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. Following a hard fork, transactions involving the new cryptocurrency are recorded on the new distributed ledger and transactions involving the legacy cryptocurrency continue to be recorded on the legacy distributed ledger.

An airdrop is a means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple taxpayers. A hard fork followed by an airdrop results in the distribution of units of the new cryptocurrency to addresses containing the legacy cryptocurrency. However, a hard fork is not always followed by an airdrop.

Cryptocurrency from an airdrop generally is received on the date and at the time it is recorded on the distributed ledger. However, a taxpayer may constructively receive cryptocurrency prior to the airdrop being recorded on the distributed ledger. A taxpayer does not have receipt of cryptocurrency when the airdrop is recorded on the distributed ledger if the taxpayer is not able to exercise dominion and control over the
cryptocurrency. For example, a taxpayer does not have dominion and control if the address to which the cryptocurrency is airdropped is contained in a wallet managed through a cryptocurrency exchange and the cryptocurrency exchange does not support the newly-created cryptocurrency such that the airdropped cryptocurrency is not immediately credited to the taxpayer’s account at the cryptocurrency exchange. If the taxpayer later acquires the ability to transfer, sell, exchange, or otherwise dispose of the cryptocurrency, the taxpayer is treated as receiving the cryptocurrency at that time.

FACTS

**Situation 1:** A holds 50 units of Crypto M, a cryptocurrency. On Date 1, the distributed ledger for Crypto M experiences a hard fork, resulting in the creation of Crypto N. Crypto N is not airdropped or otherwise transferred to an account owned or controlled by A.

**Situation 2:** B holds 50 units of Crypto R, a cryptocurrency. On Date 2, the distributed ledger for Crypto R experiences a hard fork, resulting in the creation of Crypto S. On that date, 25 units of Crypto S are airdropped to B’s distributed ledger address and B has the ability to dispose of Crypto S immediately following the airdrop. B now holds 50 units of Crypto R and 25 units of Crypto S. The airdrop of Crypto S is recorded on the distributed ledger on Date 2 at Time 1 and, at that date and time, the fair market value of B’s 25 units of Crypto S is $50. B receives the Crypto S solely because B owns Crypto R at the time of the hard fork. After the airdrop, transactions involving Crypto S are recorded on the new distributed ledger and transactions involving Crypto R continue to be recorded on the legacy distributed ledger.

LAW AND ANALYSIS
Section 61(a)(3) provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including gains from dealings in property. Under § 61, all gains or undeniable accessions to wealth, clearly realized, over which a taxpayer has complete dominion, are included in gross income. See Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). In general, income is ordinary unless it is gain from the sale or exchange of a capital asset or a special rule applies. See, e.g., §§ 1222, 1231, 1234A.

Section 1011 of the Code provides that a taxpayer's adjusted basis for determining the gain or loss from the sale or exchange of property is the cost or other basis determined under § 1012 of the Code, adjusted to the extent provided under § 1016 of the Code. When a taxpayer receives property that is not purchased, unless otherwise provided in the Code, the taxpayer's basis in the property received is determined by reference to the amount included in gross income, which is the fair market value of the property when the property is received. See generally §§ 61 and 1011; see also § 1.61-2(d)(2)(i).

Section 451 of the Code provides that a taxpayer using the cash method of accounting includes an amount in gross income in the taxable year it is actually or constructively received. See §§ 1.451-1 and 1.451-2. A taxpayer using an accrual method of accounting generally includes an amount in gross income no later than the taxable year in which all the events have occurred which fix the right to receive such amount. See § 451.
Situation 1: A did not receive units of the new cryptocurrency, Crypto N, from the hard fork; therefore, A does not have an accession to wealth and does not have gross income under § 61 as a result of the hard fork.

Situation 2: B received a new asset, Crypto S, in the airdrop following the hard fork; therefore, B has an accession to wealth and has ordinary income in the taxable year in which the Crypto S is received. See §§ 61 and 451. B has dominion and control of Crypto S at the time of the airdrop, when it is recorded on the distributed ledger, because B immediately has the ability to dispose of Crypto S. The amount included in gross income is $50, the fair market value of B’s 25 units of Crypto S when the airdrop is recorded on the distributed ledger. B’s basis in Crypto S is $50, the amount of income recognized. See §§ 61, 1011, and 1.61-2(d)(2)(i).

HOLDINGS

(1) A taxpayer does not have gross income under § 61 as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency.

(2) A taxpayer has gross income, ordinary in character, under § 61 as a result of an airdrop of a new cryptocurrency following a hard fork if the taxpayer receives units of new cryptocurrency.

DRAFTING INFORMATION

The principal author of this revenue ruling is Suzanne R. Sinno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding the revenue ruling, contact Ms. Sinno at (202) 317-4718 (not a toll-free number).
Dec 20, 2019
US Lawmakers Ask IRS for Clarity on Airdrops, Forks
The Honorable Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Ave NW  
Washington, DC 20224

Dear Commissioner Rettig:

Cryptocurrencies and the open blockchain networks they power embody a true technological revolution that promises greater efficiencies, vibrant innovation, and financial inclusion. We wrote in April of this year urging the issuance of guidance for taxpayers who use cryptocurrencies and we are pleased to see that you have issued guidance and addressed many questions we posed. We are, however, concerned that this recent guidance creates many new questions related to the topics it seeks to address, namely forks and airdrops. Moreover, the guidance appears inequitable as it comes almost two years after the Bitcoin and Bitcoin Cash fork and three years after the Ethereum fork.

The hypothetical fact patterns concerning forks and airdrops offered in this guidance do not appear to bear a close resemblance to actual forks or airdrops as they have occurred in the cryptocurrency ecosystem. Without clear and accurate hypotheticals for taxpayers to measure against, it is difficult to interpret IRS policy as it relates to actual events.

In addition to the difficulties with the hypotheticals, the IRS appears to adopt as a standard “dominion and control” over forked or airdropped assets in order to determine when a taxable event occurs. The characterization of this standard in the guidance appears to diverge from established rules in other areas such as the receipt of unsolicited prizes or samples. The guidance appears to suggest that taxpayers may have dominion and control, and thus be taxed on forked or airdropped assets when the fork or airdrop occurs, even if the taxpayer has no knowledge, and even if the taxpayer takes no affirmative step, or manifests any intention to claim or access those forked or airdropped tokens. This creates potentially unwarranted tax liability and administrative burdens for users of these important new technologies and would create inequitable results. We do not expect this is the intended effect of the guidance, and we urge the IRS to clarify the matter.

The guidance also does not contemplate the vast variety of products offered in the cryptocurrency market: futures, retirement accounts invested in crypto assets, and interest paid on crypto deposits, to name just a few. The IRS needs to provide guidance to taxpayers as to how income related to all crypto transactions will be treated for tax purposes.
In addition, the IRS has failed to provide any clarity for withholding and tax information reporting purposes. Taxpayers rely on forms like 1099 to help complete their income taxes, and the IRS relies on them to enforce compliance. Since many are either not reporting 1099s at all or are reporting incorrect or incomplete information, it is imperative that the IRS publish clear information in further guidance.

Further, we are concerned that the form of the guidance appears to indicate that this is "established" law. We would hope that the IRS recognizes this area as new and developing and will allow for reasonable interpretations in advance of the issuance of the most recent guidance. While we commend the IRS for attempting to issue guidance, we suggest increased work with the industry into the future.

As you are likely aware, legislation has been introduced in this Congress to insulate taxpayers from liabilities for forked and airdropped assets until the IRS has provided clarity. We strongly believe that the best path to ensuring tax compliance in the cryptocurrency space is affording users of these technologies what all taxpayers need and deserve: clear statements of the law and thoughtful consideration of the types of enforcement actions that are taken in advance of that clarity. Please provide our offices answers to the following questions to the best of your ability:

1. Does the IRS intend to clarify its airdrop and fork hypotheticals to better match the actual nature of these events within the cryptocurrency ecosystem? When does the IRS anticipate issuing that clarification?

2. Does the IRS intend to clarify its standard for finding dominion and control over forked assets wherein some level of knowledge and actual affirmative steps taken are necessary to find that the taxpayer has dominion and control?

3. Does the IRS intend to apply the current guidance or any future guidance retroactively, or will the IRS issue proposed guidance that is subject to notice and comment?

These questions, in particular the first, require clarification as soon as possible. In spite of the recent guidance, cryptocurrency users continue to lack any meaningful clarity about their tax obligations with respect to forks and airdrops. Ambiguity impedes appropriate tax compliance and unfairly targets taxpayers who may not have the ability to understand the positions the IRS has taken in these matters but who have taken a reasonable position. We hope that the IRS will act consistent with decades-long standards for finding dominion and control in the context of forked assets and require knowledge and affirmative steps to exercise such dominion and control. Lastly, until there is clear guidance that is prospective in nature, we urge the IRS to use its authority for penalty relief in those instances in which taxpayers made a good faith effort to comply.

We eagerly await your response and thank you for your careful consideration.
Sincerely,

Tom Emmer  
Member of Congress

Bill Foster  
Member of Congress

David Schweikert  
Member of Congress

Darren Soto  
Member of Congress

Lance Gooden  
Member of Congress

French Hill  
Member of Congress

Matt Gaetz  
Member of Congress

Warren Davidson  
Member of Congress
Dec 31, 2019
IRS updated FAQs, including new FAQ 35 & 36 on Charitable Donations of Cryptocurrency
Frequently Asked Questions on Virtual Currency Transactions

In 2014, the IRS issued Notice 2014-21, 2014-16 I.R.B. 938 (PDF), explaining that virtual currency is treated as property for Federal income tax purposes and providing examples of how longstanding tax principles applicable to transactions involving property apply to virtual currency. The frequently asked questions ("FAQs") below expand upon the examples provided in Notice 2014-21 and apply those same longstanding tax principles to additional situations.

Comments on these FAQs may be submitted electronically via email to Notice.Comments@irs.counsel.treas.gov. The email should include “FAQs on Virtual Currency” in the subject line. All comments submitted by the public will be available for public inspection and copying in their entirety.

Note: Except as otherwise noted, these FAQs apply only to taxpayers who hold virtual currency as a capital asset. For more information on the definition of a capital asset, examples of what is and is not a capital asset, and the tax treatment of property transactions generally, see Publication 544, Sales and Other Dispositions of Assets.

Q1. What is virtual currency?

A1. Virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency ("real currency"), that functions as a unit of account, a store of value, and a medium of exchange. Some virtual currencies are convertible, which means that they have an equivalent value in real currency or act as a substitute for real currency. The IRS uses the term “virtual currency” in these FAQs to describe the various types of convertible virtual currency that are used as a medium of exchange, such as digital currency and cryptocurrency. Regardless of the label applied, if a particular asset has the characteristics of virtual currency, it will be treated as virtual currency for Federal income tax purposes.

Q2. How is virtual currency treated for Federal income tax purposes?
A2. Virtual currency is treated as property and general tax principles applicable to property transactions apply to transactions using virtual currency. For more information on the tax treatment of virtual currency, see Notice 2014-21. For more information on the tax treatment of property transactions, see Publication 544, Sales and Other Dispositions of Assets.

Q3. What is cryptocurrency?

A3. Cryptocurrency is a type of virtual currency that uses cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. A transaction involving cryptocurrency that is recorded on a distributed ledger is referred to as an “on-chain” transaction; a transaction that is not recorded on the distributed ledger is referred to as an “off-chain” transaction.

Q4. Will I recognize a gain or loss when I sell my virtual currency for real currency?

A4. Yes. When you sell virtual currency, you must recognize any capital gain or loss on the sale, subject to any limitations on the deductibility of capital losses. For more information on capital assets, capital gains, and capital losses, see Publication 544, Sales and Other Dispositions of Assets.

Q5. How do I determine if my gain or loss is a short-term or long-term capital gain or loss?

A5. If you held the virtual currency for one year or less before selling or exchanging the virtual currency, then you will have a short-term capital gain or loss. If you held the virtual currency for more than one year before selling or exchanging it, then you will have a long-term capital gain or loss. The period during which you held the virtual currency (known as the “holding period”) begins on the day after you acquired the virtual currency and ends on the day you sell or exchange the virtual currency. For more information on short-term and long-term capital gains and losses, see Publication 544, Sales and Other Dispositions of Assets.

Q6. How do I calculate my gain or loss when I sell virtual currency for real currency?
A6. Your gain or loss will be the difference between your adjusted basis in the virtual currency and the amount you received in exchange for the virtual currency, which you should report on your Federal income tax return in U.S. dollars. For more information on gain or loss from sales or exchanges, see Publication 544, Sales and Other Dispositions of Assets.

Q7. How do I determine my basis in virtual currency I purchased with real currency?

A7. Your basis (also known as your “cost basis”) is the amount you spent to acquire the virtual currency, including fees, commissions and other acquisition costs in U.S. dollars. Your adjusted basis is your basis increased by certain expenditures and decreased by certain deductions or credits in U.S. dollars. For more information on basis, see Publication 551, Basis of Assets.

Q8. Do I have income if I provide someone with a service and that person pays me with virtual currency?

A8. Yes. When you receive property, including virtual currency, in exchange for performing services, whether or not you perform the services as an employee, you recognize ordinary income. For more information on compensation for services, see Publication 525, Taxable and Nontaxable Income.

Q9. Does virtual currency received by an independent contractor for performing services constitute self-employment income?

A9. Yes. Generally, self-employment income includes all gross income derived by an individual from any trade or business carried on by the individual as other than an employee. Consequently, the fair market value of virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income and is subject to the self-employment tax.

Q10. Does virtual currency paid by an employer as remuneration for services constitute wages for employment tax purposes?
A10. Yes. Generally, the medium in which remuneration for services is paid is immaterial to the determination of whether the remuneration constitutes wages for employment tax purposes. Consequently, the fair market value of virtual currency paid as wages, measured in U.S. dollars at the date of receipt, is subject to Federal income tax withholding, Federal Insurance Contributions Act (FICA) tax, and Federal Unemployment Tax Act (FUTA) tax and must be reported on Form W-2, Wage and Tax Statement. See Publication 15 (Circular E), Employer’s Tax Guide, for information on the withholding, depositing, reporting, and paying of employment taxes.

Q11. How do I calculate my income if I provide a service and receive payment in virtual currency?

A11. The amount of income you must recognize is the fair market value of the virtual currency, in U.S. dollars, when received. In an on-chain transaction you receive the virtual currency on the date and at the time the transaction is recorded on the distributed ledger.

Q12. How do I determine my basis in virtual currency I receive for services I’ve provided?

A12. If, as part of an arm’s length transaction, you provided someone with services and received virtual currency in exchange, your basis in that virtual currency is the fair market value of the virtual currency, in U.S. dollars, when the virtual currency is received. For more information on basis, see Publication 551, Basis of Assets.

Q13. Will I recognize a gain or loss if I pay someone with virtual currency for providing me with a service?

A13. Yes. If you pay for a service using virtual currency that you hold as a capital asset, then you have exchanged a capital asset for that service and will have a capital gain or loss. For more information on capital gains and capital losses, see Publication 544, Sales and Other Dispositions of Assets.

Q14. How do I calculate my gain or loss when I pay for services using virtual currency?
A14. Your gain or loss is the difference between the fair market value of the services you received and your adjusted basis in the virtual currency exchanged. For more information on gain or loss from sales or exchanges, see Publication 544, Sales and Other Dispositions of Assets.

**Q15. Will I recognize a gain or loss if I exchange my virtual currency for other property?**

A15. Yes. If you exchange virtual currency held as a capital asset for other property, including for goods or for another virtual currency, you will recognize a capital gain or loss. For more information on capital gains and capital losses, see Publication 544, Sales and Other Dispositions of Assets.

**Q16. How do I calculate my gain or loss when I exchange my virtual currency for other property?**

A16. Your gain or loss is the difference between the fair market value of the property you received and your adjusted basis in the virtual currency exchanged. For more information on gain or loss from sales or exchanges, see Publication 544, Sales and Other Dispositions of Assets.

**Q17. How do I determine my basis in property I’ve received in exchange for virtual currency?**

A17. If, as part of an arm’s length transaction, you transferred virtual currency to someone and received other property in exchange, your basis in that property is its fair market value at the time of the exchange. For more information on basis, see Publication 551, Basis of Assets.

**Q18. Will I recognize a gain or loss if I sell or exchange property (other than U.S. dollars) for virtual currency?**

A18. Yes. If you transfer property held as a capital asset in exchange for virtual currency, you will recognize a capital gain or loss. If you transfer property that is not a capital asset in exchange for virtual currency, you will recognize an ordinary gain or loss. For more information on gains and losses, see Publication 544, Sales and Other Dispositions of Assets.
Q19. How do I calculate my gain or loss when I exchange property for virtual currency?

A19. Your gain or loss is the difference between the fair market value of the virtual currency when received (in general, when the transaction is recorded on the distributed ledger) and your adjusted basis in the property exchanged. For more information on gain or loss from sales or exchanges, see Publication 544, Sales and Other Dispositions of Assets.

Q20. How do I determine my basis in virtual currency that I have received in exchange for property?

A20. If, as part of an arm's length transaction, you transferred property to someone and received virtual currency in exchange, your basis in that virtual currency is the fair market value of the virtual currency, in U.S. dollars, when the virtual currency is received. For more information on basis, see Publication 551, Basis of Assets.

Q21. One of my cryptocurrencies went through a hard fork but I did not receive any new cryptocurrency. Do I have income?

A21. A hard fork occurs when a cryptocurrency undergoes a protocol change resulting in a permanent diversion from the legacy distributed ledger. This may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. If your cryptocurrency went through a hard fork, but you did not receive any new cryptocurrency, whether through an airdrop (a distribution of cryptocurrency to multiple taxpayers' distributed ledger addresses) or some other kind of transfer, you don't have taxable income.

Q22. One of my cryptocurrencies went through a hard fork followed by an airdrop and I received new cryptocurrency. Do I have income?

A22. If a hard fork is followed by an airdrop and you receive new cryptocurrency, you will have taxable income in the taxable year you receive that cryptocurrency.

Q23. How do I calculate my income from cryptocurrency I received following a hard fork?
A23. When you receive cryptocurrency from an airdrop following a hard fork, you will have ordinary income equal to the fair market value of the new cryptocurrency when it is received, which is when the transaction is recorded on the distributed ledger, provided you have dominion and control over the cryptocurrency so that you can transfer, sell, exchange, or otherwise dispose of the cryptocurrency.

Q24. How do I determine my basis in cryptocurrency I received following a hard fork?

A24. If you receive cryptocurrency from an airdrop following a hard fork, your basis in that cryptocurrency is equal to the amount you included in income on your Federal income tax return. The amount included in income is the fair market value of the cryptocurrency when you received it. You have received the cryptocurrency when you can transfer, sell, exchange, or otherwise dispose of it, which is generally the date and time the airdrop is recorded on the distributed ledger. See Rev. Rul. 2019-24 (PDF). For more information on basis, see Publication 551, Basis of Assets.

Q25. I received cryptocurrency through a platform for trading cryptocurrency; that is, through a cryptocurrency exchange. How do I determine the cryptocurrency’s fair market value at the time of receipt?

A25. If you receive cryptocurrency in a transaction facilitated by a cryptocurrency exchange, the value of the cryptocurrency is the amount that is recorded by the cryptocurrency exchange for that transaction in U.S. dollars. If the transaction is facilitated by a centralized or decentralized cryptocurrency exchange but is not recorded on a distributed ledger or is otherwise an off-chain transaction, then the fair market value is the amount the cryptocurrency was trading for on the exchange at the date and time the transaction would have been recorded on the ledger if it had been an on-chain transaction.

Q26. I received cryptocurrency in a peer-to-peer transaction or some other type of transaction that did not involve a cryptocurrency exchange. How do I determine the cryptocurrency’s fair market value at the time of receipt?
A26. If you receive cryptocurrency in a peer-to-peer transaction or some other transaction not facilitated by a cryptocurrency exchange, the fair market value of the cryptocurrency is determined as of the date and time the transaction is recorded on the distributed ledger, or would have been recorded on the ledger if it had been an on-chain transaction. The IRS will accept as evidence of fair market value the value as determined by a cryptocurrency or blockchain explorer that analyzes worldwide indices of a cryptocurrency and calculates the value of the cryptocurrency at an exact date and time. If you do not use an explorer value, you must establish that the value you used is an accurate representation of the cryptocurrency's fair market value.

Q27. I received cryptocurrency that does not have a published value in exchange for property or services. How do I determine the cryptocurrency’s fair market value?

A27. When you receive cryptocurrency in exchange for property or services, and that cryptocurrency is not traded on any cryptocurrency exchange and does not have a published value, then the fair market value of the cryptocurrency received is equal to the fair market value of the property or services exchanged for the cryptocurrency when the transaction occurs.

Q28. When does my holding period start for cryptocurrency I receive?

A28. Your holding period begins the day after it is received. For more information on holding periods, see Publication 544, Sales and Other Dispositions of Assets.

Q29. Do I have income when a soft fork of cryptocurrency I own occurs?

A29. No. A soft fork occurs when a distributed ledger undergoes a protocol change that does not result in a diversion of the ledger and thus does not result in the creation of a new cryptocurrency. Because soft forks do not result in you receiving new cryptocurrency, you will be in the same position you were in prior to the soft fork, meaning that the soft fork will not result in any income to you.
Q30. I received virtual currency as a bona fide gift. Do I have income?

A30. No. If you receive virtual currency as a bona fide gift, you will not recognize income until you sell, exchange, or otherwise dispose of that virtual currency. For more information about gifts, see Publication 559, Survivors, Executors, and Administrators.

Q31. How do I determine my basis in virtual currency that I received as a bona fide gift?

A31. Your basis in virtual currency received as a bona fide gift differs depending on whether you will have a gain or a loss when you sell or dispose of it. For purposes of determining whether you have a gain, your basis is equal to the donor's basis, plus any gift tax the donor paid on the gift. For purposes of determining whether you have a loss, your basis is equal to the lesser of the donor's basis or the fair market value of the virtual currency at the time you received the gift. If you do not have any documentation to substantiate the donor's basis, then your basis is zero. For more information on basis of property received as a gift, see Publication 551, Basis of Assets.

Q32. What is my holding period for virtual currency that I received as a gift?

A32. Your holding period in virtual currency received as a gift includes the time that the virtual currency was held by the person from whom you received the gift. However, if you do not have documentation substantiating that person's holding period, then your holding period begins the day after you receive the gift. For more information on holding periods, see Publication 544, Sales and Other Dispositions of Assets.

Q33. If I donate virtual currency to a charity, will I have to recognize income, gain, or loss?

A33. If you donate virtual currency to a charitable organization described in Internal Revenue Code Section 170(c), you will not recognize income, gain, or loss from the donation. For more information on charitable contributions, see Publication 526, Charitable Contributions.
Q34. How do I calculate my charitable contribution deduction when I donate virtual currency?

A34. Your charitable contribution deduction is generally equal to the fair market value of the virtual currency at the time of the donation if you have held the virtual currency for more than one year. If you have held the virtual currency for one year or less at the time of the donation, your deduction is the lesser of your basis in the virtual currency or the virtual currency’s fair market value at the time of the contribution. For more information on charitable contribution deductions, see Publication 526, Charitable Contributions.

Q35. When my charitable organization accepts virtual currency donations, what are my donor acknowledgment responsibilities? (12/2019)

A35. A charitable organization can assist a donor by providing the contemporaneous written acknowledgment that the donor must obtain if claiming a deduction of $250 or more for the virtual currency donation. See Publication 1771, Charitable Contributions Substantiation and Disclosure Requirements (PDF), for more information.

A charitable organization is generally required to sign the donor’s Form 8283, Noncash Charitable Contributions, acknowledging receipt of charitable deduction property if the donor is claiming a deduction of more than $5,000 and if the donor presents the Form 8283 to the organization for signature to substantiate the tax deduction. The signature of the donee on Form 8283 does not represent concurrence in the appraised value of the contributed property. The signature represents acknowledgement of receipt of the property described in Form 8283 on the date specified and that the donee understands the information reporting requirements imposed by section 6050L on dispositions of the donated property (see discussion of Form 8282 in FAQ 36). See Form 8283 instructions for more information. (12/2019)

Q36. When my charitable organization accepts virtual currency donations, what are my IRS reporting requirements? (12/2019)

A36. A charitable organization that receives virtual currency should treat the donation as a noncash contribution. See Publication 526, Charitable Contributions, for more information. Tax-exempt charity responsibilities include the following:
- Charities report non-cash contributions on a Form 990-series annual return and its associated Schedule M, if applicable. Refer to the Form 990 and Schedule M instructions for more information.
- Charities must file Form 8282, Donee Information Return, if they sell, exchange or otherwise dispose of charitable deduction property (or any portion thereof) - such as the sale of virtual currency for real currency as described in FAQ #4 - within three years after the date they originally received the property and give the original donor a copy of the form. See the instructions on Form 8282 for more information. (12/2019)

Q37. Will I have to recognize income, gain, or loss if I own multiple digital wallets, accounts, or addresses capable of holding virtual currency and transfer my virtual currency from one to another?

A37. No. If you transfer virtual currency from a wallet, address, or account belonging to you, to another wallet, address, or account that also belongs to you, then the transfer is a non-taxable event, even if you receive an information return from an exchange or platform as a result of the transfer.

Q38. I own multiple units of one kind of virtual currency, some of which were acquired at different times and have different basis amounts. If I sell, exchange, or otherwise dispose of some units of that virtual currency, can I choose which units are deemed sold, exchanged, or otherwise disposed of?

A38. Yes. You may choose which units of virtual currency are deemed to be sold, exchanged, or otherwise disposed of if you can specifically identify which unit or units of virtual currency are involved in the transaction and substantiate your basis in those units.

Q39. How do I identify a specific unit of virtual currency?

A39. You may identify a specific unit of virtual currency either by documenting the specific unit's unique digital identifier such as a private key, public key, and address, or by records showing the transaction information for all units of a specific virtual currency, such as Bitcoin, held in a single account, wallet, or address. This information must show (1) the date and time each unit was acquired, (2) your basis and the fair market value of each unit at the time it was acquired, (3) the date and time each unit was sold,
exchanged, or otherwise disposed of, and (4) the fair market value of each unit when sold, exchanged, or disposed of, and the amount of money or the value of property received for each unit.

Q40. How do I account for a sale, exchange, or other disposition of units of virtual currency if I do not specifically identify the units?

A40. If you do not identify specific units of virtual currency, the units are deemed to have been sold, exchanged, or otherwise disposed of in chronological order beginning with the earliest unit of the virtual currency you purchased or acquired; that is, on a first in, first out (FIFO) basis.

Q41. If I engage in a transaction involving virtual currency but do not receive a payee statement or information return such as a Form W-2 or Form 1099, when must I report my income, gain, or loss on my Federal income tax return?

A41. You must report income, gain, or loss from all taxable transactions involving virtual currency on your Federal income tax return for the taxable year of the transaction, regardless of the amount or whether you receive a payee statement or information return.

Q42. Where do I report my capital gain or loss from virtual currency?

A42. You must report most sales and other capital transactions and calculate capital gain or loss in accordance with IRS forms and instructions, including on Form 8949, Sales and Other Dispositions of Capital Assets, and then summarize capital gains and deductible capital losses on Form 1040, Schedule D, Capital Gains and Losses.

Q43. Where do I report my ordinary income from virtual currency?

A43. You must report ordinary income from virtual currency on Form 1040, U.S. Individual Tax Return, Form 1040-SS, Form 1040-NR, or Form 1040, Schedule 1, Additional Income and Adjustments to Income (PDF), as applicable.

Q44. Where can I find more information about the tax treatment of virtual currency?
A44. Information on virtual currency is available at Virtual Currencies (IRS.gov/virtual_currency). Many questions about the tax treatment of virtual currency can be answered by referring to Notice 2014-21 (PDF) and Rev. Rul. 2019-24 (PDF).

Q45. What records do I need to maintain regarding my transactions in virtual currency?

A45. The Internal Revenue Code and regulations require taxpayers to maintain records that are sufficient to establish the positions taken on tax returns. You should therefore maintain, for example, records documenting receipts, sales, exchanges, or other dispositions of virtual currency and the fair market value of the virtual currency.