

The IRS is Coming for Your Cryptocurrency

Over the summer of 2019, the IRS significantly increased its efforts to police the taxation of Bitcoin, Ethereum, and other similar cryptocurrencies. On July 26, 2019, [the IRS announced that it had begun sending letters to taxpayers](#) who potentially failed to pay cryptocurrency taxes associated with digital currency transactions or failed to properly report those transactions. By the end of August, the IRS anticipates that it will have sent over 10,000 letters to taxpayers.

However, the question remains: will the IRS's cryptocurrency-policing efforts evolve into a full-fledged compliance program, [similar to the OVDP with foreign bank accounts](#), or will it be resolved with the current letter-writing campaign? Similar to the foreign account and information-reporting campaign in 2009, the IRS's only realistic solution may be to create a voluntary disclosure program for non-compliant taxpayers trading, paying, or receiving cryptocurrency. Given the vast amount of cryptocurrency being used and potentially being improperly reported, the IRS has very few other administrative options.

Cryptocurrency Taxes

The IRS has issued a single piece of guidance on the taxation of cryptocurrency: [IRS Notice 2014-21](#) which provides that, for federal tax purposes, virtual currency is treated as property. In short, the IRS has taken the position that cryptocurrency is not a true currency. Instead, individuals who pay in, receive, or trade cryptocurrency are considered to be bartering property.

The implications of this viewpoint are significant. A Silicon Valley company that decides to pay employees and contractors in cryptocurrency will likely incur taxes on such payments. Under IRC section 1001, the employer is subject to tax on the difference between the amount it originally paid for the cryptocurrency and the fair market value of the cryptocurrency at the time of payment. Such a regime creates a huge administrative burden for taxpayers who elect to pay service providers or pay for goods in cryptocurrency.

Individuals who receive cryptocurrency in exchange for these services or goods are also subject to tax under general income tax principles. These individuals should report and pay tax on



by Christopher A. Karachale &
Peter Banyai



such income, including appropriate payroll taxes. Similarly, because the Tax Cuts and Jobs Act [excluded personal property from 1031 exchanges](#), cryptocurrency traders can no longer take the position that their trades are like-kind and not subject to immediate tax. Such traders should also report and pay tax on their exchanges.

However, by taking the position that cryptocurrency is property, the IRS appears to have placed itself in an untenable position. As cryptocurrency becomes more prominent, whether with a current currency like Bitcoin or a future currency like Facebook's Libra, the administrative hurdles to treat cryptocurrency as property appear to be too significant. Ultimately, the IRS will either have to change its position or create a whole new information reporting and tax regime for cryptocurrency.

Letter Writing Campaign

The letter writing campaign is the IRS's first attempt to police the taxation of cryptocurrency. The IRS is sending three forms of letter to individuals and entities who have engaged in cryptocurrency transactions. All three letters indicate the IRS has information that the taxpayer receiving the letter currently has or has had virtual currency. However, the three letters differ regarding the IRS's expected response. [Letter 6173](#) states that the taxpayer may have not have met his or her U.S. tax filing and reporting requirements for the transactions involving virtual currency. Letter 6173 requires taxpayers to respond to the IRS and either file delinquent returns for tax years 2013 through 2017 or amend previously filed returns and include the applicable forms or schedules reporting cryptocurrency transactions.

In contrast, [Letter 6174-A](#) and [Letter 6174](#) are notice letters. Letter 6174-A states that taxpayer receiving the letter may not have properly reported transactions involving virtual currency. Letter 6174 states that taxpayer receiving the letter may not know the requirements for reporting transactions involving cryptocurrency. Both of these letters are informational and do not require a response.

Conclusion

The IRS's crypto-compliance program is just beginning. Given the IRS's wooden treatment of cryptocurrency as property and the vast use cryptocurrency by U.S. taxpayers, noncompliance may be more extensive than the IRS currently believes. As with the foreign compliance program, we believe that the IRS will ultimately need to create an amnesty program to address the scope of cryptocurrency and noncompliance.

Tax attorneys at Hanson Bridgett LLP can provide guidance to both taxpayers and advisors regarding cryptocurrency taxation and the current IRS letters. Taxpayers or their representatives with questions should contact Christopher Karachale at ckarachale@hansonbridgett.com or Peter Banyai at pbanyai@hansonbridgett.com.

For more information, please contact:

Christopher A. Karachale, Partner
415-995-5863
ckarachale@hansonbridgett.com

Peter Banyai, Law Clerk
415-995-6469
PBanyai@hansonbridgett.com