

Voluntary disclosure window closing for bitcoin users

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On November 30 2016 a federal court in San Francisco authorised the Internal Revenue Service (IRS) to issue a John Doe summons to Coinbase Inc, which operates a web-based global convertible digital currency wallet and platform and the largest platform in the United States for the conversion of bitcoins to dollars. The summons seeks a wide array of records from 2013 to 2015 for any Coinbase user with a US address, telephone number, email domain or bank account. The records sought include account profiles, transaction logs, payment processing data, customer correspondence or emails, statements of account and all records reflecting or relating to the disbursement of funds to any user. In light of the court's ruling, US taxpayers using virtual currency transactions involving Coinbase who are not in tax compliance have an extremely short window to avoid potentially serious IRS action against them.

This is the first nationwide IRS enforcement initiative in the field of convertible virtual currency. It is the latest step by tax authorities to address emerging issues in the growing digital economy. In 2014 the IRS issued a formal notice (2014-21) describing how various income recognition and other US tax principles apply to virtual currency transactions. The primary point of the notice was to remind US taxpayers that virtual currencies that are convertible to traditional currency are property for purposes of the US tax laws, meaning that a taxpayer will have a reportable gain (or loss) on any sale or exchange of such currency, and that the receipt of virtual currency by any taxpayer may be reportable ordinary income. More than 1,000 virtual currencies are traded worldwide, with bitcoin the largest and most visible. Given the growing 'mining' usage and trading of such digital currency, and its fluctuating value, the amounts of unreported income and capital gains (or losses) are becoming material to the Treasury, and as to a given individual taxpayer, enough money could be involved to provoke IRS interest.

Any US taxpayer who has engaged in transactions involving digital currency should have reported any income received. If such transactions were conducted through corporations or other entities – especially offshore companies or other structures – or through foreign bank accounts, additional information returns may have been due. The omission of income or failure to file required information returns, if wilful, could be a criminal tax offence. Even innocent or negligent non-compliance can subject a taxpayer to the assessment of tax, interest and severe civil penalties.

The IRS filings in the summons case reflect the IRS's strong suspicion that virtual currency is often used in a manner that results in tax avoidance or evasion. The IRS obviously wants to obtain customer names and other data to compare that material with taxpayer filings. The IRS has been aggressively pursuing all kinds of offshore tax evasion for the last decade and will therefore be particularly interested in cases where virtual currency transactions with Coinbase involve foreign banks or non-US corporations or trusts. Coinbase is almost certain to comply with the John Doe summons and should do so relatively soon. Once it does, the IRS will have a database of names and other information to allow it to open civil tax audits or criminal investigations.

US taxpayers who are not in tax compliance arising from virtual currency transactions involving Coinbase have an extremely short window to avoid serious tax problems. The IRS has a longstanding voluntary disclosure policy, which allows taxpayers – without any public disclosure – to correct prior tax non-compliance, avoid criminal prosecution and usually receive more lenient treatment than one would see in a criminal or civil tax proceeding. The IRS policy is clear that the issuance of a John Doe summons does not disqualify a taxpayer from making a voluntary disclosure, but once

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Coinbase complies and gives the IRS its customers' names, any disclosure is likely to be too late. Anyone who has a Coinbase account and who has tax exposure should contact a tax professional immediately.

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