

Voluntary Disclosure Window Closing on Bitcoin Users

December 2, 2016

On November 30, 2016, a federal court in San Francisco authorized the 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 U.S. for conversion of Bitcoin to dollars. The summons seeks a wide array of records for 2013 through 2015 for any Coinbase user with a U.S. 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 disbursement of funds to any user. *In light of the court’s ruling, U.S. 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 into 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 U.S. tax principles apply to virtual currency transactions. The primary point of the notice was to remind U.S. taxpayers that virtual currencies that are convertible to “traditional” currency are property for purposes of the U.S. tax laws, meaning that a taxpayer would 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. There are more than a thousand virtual currencies traded worldwide, Bitcoin being 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) is becoming material to the Treasury, and as to a given individual taxpayer, there could be enough money involved to provoke IRS interest.

Any U.S. 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 as well. The omission of income or failure to file required information returns, if willful, could be a criminal tax offense. 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 customer names and other data to compare that material to taxpayer filings. The Service has been aggressively pursuing all kinds of offshore tax evasion for the last decade, so to the extent any virtual currency transactions with Coinbase involve foreign banks or non-U.S. corporations or trusts, we expect the Service to be particularly interested in such cases. Coinbase is almost certain to comply with the John Doe summons, and 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.

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

Attorneys in [Caplin & Drysdale's Tax Controversies Group](#) have handled thousands of voluntary disclosures and tax investigations and examinations, involving both offshore and domestic issues. For further information, please contact:

[Scott D. Michel](#)
202.862.5030
smichel@capdale.com

[Mark E. Matthews](#)
202.862.5082
mmatthews@capdale.com



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Washington, DC Office:
One Thomas Circle, NW
Suite 1100
Washington, DC 20005

New York, NY Office:
600 Lexington Avenue
21st Floor
New York, NY 10022

202.862.5000

212.379.6000

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