

Crypto Up Next for IRS Enforcement



In March 2018, in a sign that changes were brewing, the IRS reminded taxpayers that they must report income from virtual currency transactions on their tax returns.



BY:
[Kathleen Pakenham](#), Partner
COOLEY



BY:
[Adriana Wirtz](#), Partner
COOLEY

IN AN EFFORT TO MAXIMIZE ITS LIMITED RESOURCES, THE IRS' Large Business and International Division has been identifying issues that present greater risks of noncompliance. The list of identified issues has been growing since January 2017. Recently, the IRS added cryptocurrency to its list of compliance campaigns.

In 2014, the IRS issued guidance (IRS Notice 2014-21) setting out its position concerning the US federal tax treatment of virtual currency transactions. Among other things, the notice provided that the IRS will treat virtual currency as property for federal tax purposes and that a taxpayer who receives virtual currency as payment for goods or services must include the fair market value of that currency in computing gross income. Thereafter, the IRS remained silent on virtual currency and we saw very little enforcement activity until earlier this year. In March 2018, in a sign that changes were brewing, the IRS reminded taxpayers that they must report income from virtual currency transactions on their tax returns.

On July 2, the IRS announced the addition of virtual currency to its list of compliance campaigns. The IRS explained that the "Virtual Currency Compliance campaign will address noncompliance ... through multiple treatment streams including outreach and examinations." The IRS' announcement urges taxpayers with unreported transactions involving virtual currency "to correct their returns as soon as practical" and notes that "[t]he IRS is not contemplating a voluntary disclosure program specifically to address tax noncompliance involving virtual currency."

Although there had been rumors that the IRS would announce a voluntary disclosure program for virtual currency (as it had done for undisclosed offshore assets), IRS representatives have indicated that no separate voluntary disclosure program is on the horizon. It is important to understand, however, that

the IRS' announcement does not prohibit taxpayers from making a voluntary disclosure with respect to unreported virtual currency transactions under the ordinary voluntary disclosure principles set forth in the Internal Revenue Manual. Experienced counsel can guide you through the voluntary disclosure process. Be aware that you should not delay if you think you might want to make a voluntary disclosure. A taxpayer is not eligible to make a voluntary disclosure if the IRS already has initiated (or notified the taxpayer that it intends to initiate) a civil examination or criminal investigation of the taxpayer or has received information concerning the taxpayer's noncompliance from a third party or through a criminal enforcement action, such as a search warrant.

“TAXPAYERS WHO OMITTED THESE TRANSACTIONS ON PRIOR YEAR RETURNS SHOULD CONSIDER CORRECTING THOSE PRIOR YEAR RETURNS TO MINIMIZE PENALTIES TO THE EXTENT POSSIBLE.”

The IRS obviously is on notice that there is a substantial risk of noncompliance relating to virtual currency transactions. Taxpayers who omitted these transactions on prior year returns should consider correcting those prior year returns to minimize penalties to the extent possible. In the meantime, we can probably expect further guidance from the IRS on the tax treatment of virtual currency transactions, as its announcement notes that the IRS will “consider and solicit taxpayer and practitioner feedback in education efforts [and] future guidance.” ■