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IRS Crypto Crackdown Poised To Go Global

By **Joshua Rosenberg**

Law360 (May 28, 2021, 12:04 PM EDT) -- The Internal Revenue Service's continued use of information demands to cryptocurrency exchanges in its fight against tax avoidance may soon be entering a new, ambitious era of global reach and cooperation.

That's because even as the IRS has demonstrated a willingness to repeatedly employ a powerful information-gathering mechanism, the John Doe summons, when contending with American-based exchanges, there are many exchanges based overseas that would perhaps be of interest to the IRS.

And if the IRS becomes inclined to employ similar information-gathering tactics for foreign-based exchanges, the agency would likely be able to rely, in part, on global infrastructure in the form of the Joint Chiefs of Global Tax Enforcement, or J5. If the IRS does pursue that type of initiative, it will likely bear striking similarities to the Swiss Bank Program.

For now, U.S.-based cryptocurrency exchanges will likely continue facing information requests from the IRS, in volume and consistency that are somewhat reflective of the government's oversight role in the banking industry. But exchanges based abroad may soon feel the same pressure.

"Right now, they're going after the low-hanging fruit, which are the U.S. exchanges, because that's easy," Charles Kolstad, partner at Withers, told Law360. "But at some point, they will start going after the foreign exchanges to the extent that they can."

The Internal Revenue Service began investigating potential cases of cryptocurrency-facilitated tax evasion after a 2013 Government Accountability Office report identified tax compliance risks posed by the use of cryptocurrency. Among these risks were the lack of third-party reporting on the transactions and a lack of knowledge among taxpayers over how transactions and gains made via cryptocurrency exchanges are taxed.

In the years since, the IRS has signaled, in both word and deed, a commitment to enforcement in the cryptocurrency arena. For example, in November 2016, a California federal judge authorized a John Doe summons by the IRS to obtain information from an exchange called Coinbase. Coinbase challenged the summons, and the following November the judge ordered the company to comply with a narrowed request for information on accounts with transactions greater than $20,000.

Similarly, in March of this year, the U.S. government filed a petition asking the court to approve its summons on the Kraken cryptocurrency exchange. The IRS sought information on people who have accounts with Kraken and have conducted at least $20,000 in transactions in any given year from 2016 through 2020. The government succeeded in its petition.

And separately, the agency successfully utilized a John Doe summons to pursue records for those who "engaged in business with or through" Circle Internet Financial Inc. and its affiliates.

"The John Doe summons is probably one of the most powerful tools the government has," Joshua Smeltzer, counsel at Gray Reed, told Law360.

"Every time the IRS gets information from John Doe summonses, or from audits, or from the threatening letters that they sent out previously — all of that stuff generates data," he said. "The IRS can then use that data to decide what indicators are available to narrow the field."

Smeltzer was referring to some 10,000 letters the IRS sent to cryptocurrency users in 2019, warning them to fulfill their tax obligations.

In light of the government's sustained interest in policing the cryptocurrency space, exchanges should prepare themselves for future summonses and other requests for information, Michelle Gitlitz, partner at Crowell & Moring LLP, told Law360.

"What we're seeing is — as crypto becomes more of a mainstream asset — these exchanges and crypto companies are going to be treated like every other financial institution and every other company that gets subpoenas," she said.

Given that a limited number of cryptocurrency exchanges are based in the U.S., it seems all but inevitable that the IRS would look at exchanges based overseas in pursuit of a more comprehensive enforcement strategy, Kolstad said. And when it does, he said, it'll likely rely on the J5.

The J5 collaborative tax enforcement effort was launched in 2018 by five countries: the U.S., Canada, the United Kingdom, the Netherlands and Australia. The group, which is focused on tracking down instances of tax crimes, recently identified fintech companies that will be part of their investigations.

Eventually, international collaboration in the cryptocurrency space may begin to resemble the efforts brought to bear by the Department of Justice-led Swiss Bank Program, Kolstad said.

"What you'll see is, to the extent that the non-U.S. exchanges are in treaty countries, there'll be what they call an exchange of information requested by the IRS to the tax authorities in Malta or Cyprus or wherever, saying, 'Hi, can you get us this information?'" he said. "And at some point, the exchanges will probably do what the Swiss banks and the Turkish banks and Israeli banks and everybody else did, which is they'll just turn over the records."

The Swiss Bank Program, started in 2013, was designed by the Department of Justice as a way for banks in Switzerland to avoid criminal prosecution if they fully disclosed pertinent information to, and cooperate with, law enforcement officials relating to efforts by Americans to avoid paying taxes to the Internal Revenue Service. Banks that were already subject to prosecution before the program was announced or that missed the deadline for submission were not eligible to participate.

While not a perfect analogue, the Swiss Bank Program may serve as something of a template for international enforcement of cryptocurrency-facilitated tax evasion, Starling Marshall, partner in Crowell & Moring's tax and litigation groups, told Law360. Marshall previously served at the DOJ.

For instance, one major puzzle piece that's currently missing in the crypto space is the voluntary disclosure program that was part of the Swiss Bank initiative, she said. Voluntary disclosure in that context allowed Swiss banks the opportunity to avoid criminal prosecution if they cooperated with the U.S. government by providing detailed information of interest.

Practitioners are watching closely to see if the government institutes a similar program in the cryptocurrency space when the time is right, Marshall said.

"In my corner of the world, people are looking to see whether the government would roll some kind of voluntary disclosure program — if they're going to approach this like they approached the Swiss Bank Program," she said.

The IRS declined to provide a comment for this story.

--Additional reporting by David van den Berg. Editing by Robert Rudinger and Vincent Sherry.