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What Crypto Holders Can Learn From Early-2000s Tax Scandal

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The Internal Revenue Service has not been shy about its concern for tax compliance related to cryptocurrency. The U.S. Department of the Treasury has indicated that cryptocurrency is a current focus of IRS compliance.

In that effort, the IRS recently [issued](#) several John Doe summonses to various cryptocurrency exchanges. For taxpayers and their attorneys that were involved in the Swiss bank account conundrum, the actions of the IRS are eerily reminiscent.

In the early 2000s, many U.S. taxpayers placed their financial assets in foreign offshore accounts, Swiss bank accounts becoming particularly popular. Many of those taxpayers utilized these foreign banks as mechanisms to shield their money from the U.S. government and evaded paying taxes on those assets. In an attempt to combat tax evasion, the IRS began issuing John Doe summonses to Swiss banks, to gather information about U.S. taxpayers with undisclosed foreign accounts.

To comply with the terms of the summonses, banks released the identities of thousands of U.S. citizen foreign bank account holders, which resulted in numerous tax evasion prosecutions for the failure to disclose assets on individual tax returns. Additionally, the banks themselves were punished with multimillion-dollar penalties for their participation assisting U.S. taxpayers with hiding assets from the IRS.

A John Doe summons is an instrument through which the IRS, by a court order, can obtain the personal information of individuals, or a class of individual taxpayers, from third parties without identifying said persons or group in the summons. In order to obtain these anonymous summonses, the IRS must show:

- The summons relates to the investigation of a particular person or ascertainable group or class of persons;
- There is a reasonable basis for believing that such person, group or class of persons may fail or may have failed to comply with any provision of any Internal Revenue law; and
- The information sought to be obtained from the examination, records or testimony — and the identity of the person or persons with respect to whose liability the summons is issued — is not readily available from other sources.

A John Doe summons may only be used to acquire information that pertains to the failure of the individual or group to comply with one or more of the provisions of the Internal Revenue Code. The idea is that the IRS knows, or highly suspects, there is tax noncompliance related to cryptocurrency but does not know specific names of taxpayers, so they issue a John Doe summons to obtain the names of taxpayers who have accounts at these cryptocurrency exchanges.

Once the IRS has the names, they can move forward with their more traditional investigatory procedures, such as initiating an audit or issuing summonses directly to the taxpayers for their returns. In the Swiss bank matters, the IRS used the information to go after taxpayers, both criminally and civilly, for failure to report income and disclose foreign bank accounts. In this era, the IRS has begun using John Doe summonses to investigate possible tax evasion in the unregulated investing of cryptocurrency.

Cryptocurrency is a top priority for the IRS, which launched Operation Hidden Treasure, a joint task force between the civil office of fraud enforcement and the criminal investigations unit. The partnership team includes agents trained in virtual currency tracking who are looking for tax evasion signatures, to find cryptocurrency account holders who have not complied with their tax obligations.

As of June 1, the IRS had been authorized to issue John Doe summonses to Kraken, Coinbase Global Inc. and Circle Internet Financial Inc., for payment records and account information on users who had at least \$20,000 in cryptocurrency transactions within the past four years. As the IRS continues its efforts to expose tax evasion via virtual currency investing the criteria for John Doe summonses will likely expand.

The IRS is utilizing the same tactics to combat cryptocurrency tax evasion as they did during the Swiss bank account investigations. Starting with 2020, income tax returns include a disclosure, conspicuously located on page one, where taxpayers check yes or no in answer to the question, "At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?"

This is basically the same thing the IRS did during the Swiss bank account investigations, when they added a disclosure on Schedule B for taxpayers to indicate whether they had an interest in a foreign bank account.

It is important to note that tax returns are signed under penalty of perjury. Failure to disclose an investment of cryptocurrency on a tax return is punishable by up to five years in prison and a fine of up to \$100,000 if convicted.

There are additional requirements for those taxpayers who utilize foreign cryptocurrency exchange accounts. If a U.S. taxpayer has in excess of \$10,000, at any time, held in a foreign crypto account, they are required to file the Financial Crimes Enforcement Network's foreign bank account report.

For taxpayers invested in high amounts of cryptocurrency that were undisclosed on their 2020 returns, a viable option may be a voluntary disclosure. The program allows a taxpayer to willingly inform the IRS of a failure to report income and pay tax on financial assets in exchange for avoiding criminal liability and setting terms for resolution of civil liability.

Many taxpayers caught up in the Swiss bank account scandal utilized the voluntary disclosure program to come into tax compliance with the IRS by filing returns — either original or amended — and paying taxes, interest and penalties. Other taxpayers were not dealt with so lightly and were criminally prosecuted.

The IRS' current actions related to cryptocurrency should sound a warning to both taxpayers and their counsel about what might come next. The issuance of a John Doe summons is not a baby step — it is a major step.

Once the IRS has the names of taxpayers with accounts at one of these cryptocurrency exchanges, the game changes in favor of the IRS, which can quickly review tax returns, obtain bank account information and determine whether there was any noncompliance, often without the taxpayer knowing.

Taxpayers who have had any dealings with cryptocurrency, whether as a capital asset or as a form of payment, should consider their compliance obligations, and do it soon. The IRS is taking cryptocurrency matters seriously, and so should taxpayers and their counsel.

For any questions or more information on cryptocurrency tax issues, please contact [Thomas H. Barnard](#).

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