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Pay Toll with Coins: Looking Back on FBAR Penalties and Prosecutions to Inform the Future of Cryptocurrency Taxation

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PAY TOLL WITH COINS: LOOKING BACK ON FBAR PENALTIES AND PROSECUTIONS TO INFORM THE FUTURE OF CRYPTOCURRENCY TAXATION

Caroline T. Parnass[*]

Cryptocurrencies are gaining a foothold in the global economy, and the government wants its cut. However, few people are reporting cryptocurrency transactions on their tax returns. How will the IRS solve its cryptocurrency noncompliance problem? Its response so far bears many similarities to the government's campaign to increase Reports of Foreign Bank and Financial Accounts (FBARs). FBAR noncompliance penalties are notoriously harsh, and the government has pursued them vigorously. This Note explores the connections and differences between cryptocurrency reporting and foreign bank account reporting in an effort to predict the future regime of cryptocurrency tax compliance.

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I. INTRODUCTION

In 2018, the Internal Revenue Service (IRS) announced the Virtual Currency Compliance campaign to address what it believed to be an issue of noncompliance with virtual currency transaction reporting.[1] While this campaign begins to address the issues inherent in the taxation of cryptocurrency, the resolution of these issues is still on the horizon.[2] However, the IRS appears to be following a familiar pattern; the current response to taxation of cryptocurrency resembles the government's attempts to increase compliance in foreign bank account reporting. To anticipate the possible future of cryptocurrency taxation, this Note will explore that connection.

Three reasons likely explain the IRS's focus on taxation of cryptocurrency. First, cryptocurrencies could potentially generate a great deal of income.[3] Of course, the market for cryptocurrencies is known to be volatile, and cryptocurrencies have their skeptics.[4] Nevertheless, at the time of writing, one bitcoin, the cryptocurrency

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[1] *See IRS Announces the Identification and Selection of Five Large Business and International Compliance Campaigns*, IRS (July 2, 2018), https://www.irs.gov/businesses/irs-lbi-compliance-campaigns-july-2-2018 (including a virtual currency campaign as one of five new compliance campaigns aimed at addressing issues representing a risk of non-compliance in large businesses). The 2019–2020 Priority Guidance Plan, an annual release that sets forth the priorities of the Treasury and the IRS for the coming year, listed taxation of virtual currency as one of the general tax issues they plan to address. *See* U.S. DEP'T OF THE TREASURY, 2019–2020 PRIORITY GUIDANCE PLAN 1, 15–16 (2019), https://www.irs.gov/pub/irs-utl/2019-2020_pgp_initial.pdf. Note that the term "virtual currency" used by the IRS is a broad term that includes cryptocurrency. *See Virtual Currencies*, IRS, https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies (last updated Sept. 23, 2020) (describing cryptocurrency as "a type of virtual currency that utilizes cryptography to validate and secure transactions that are digitally recorded on a distributed ledger").

[2] *See infra* notes 17–20, 59–60 and accompanying text.

[3] *See* DAVID W. PERKINS, CONG. RESEARCH SERV., R45427, CRYPTOCURRENCY: THE ECONOMICS OF MONEY AND SELECTED POLICY ISSUES 8 (2020), https://crsreports.congress.gov/product/pdf/R/R45427 ("For example, as of March 10, 2020, one industry group purported to track 5,170 cryptocurrencies trading at prices that suggest an aggregate value in circulation of more than $231 billion.").

[4] *See* Christopher Swenor, *Is Volatility in Cryptocurrency a Good Thing?*, FORBES (July 9, 2019, 8:30 AM), https://www.forbes.com/sites/theyec/2019/07/09/is-volatility-in-cryptocurrency-a-good-thing (noting that "[s]keptics see volatility as a sign of the danger of cryptocurrency" and as "proof that the technology is too risky to stake any real commodities or have any value").

that makes up a large portion of the market, is worth around $8700, and more than 18,000,000 bitcoins are in circulation.[5] Because the government is empowered to tax "all income from whatever source derived,"[6] taxation of cryptocurrency may represent an attractive source of revenue for the IRS.

Second, cryptocurrency is a significant area of tax reporting noncompliance.[7] In an address concerning cryptocurrency and tax administration at a conference held by the Urban-Brookings Tax Policy Center, the IRS Chief Counsel Michael Desmond estimated that about eight percent of adults in the United States own "some form of virtual currency."[8] Of the approximately 150 million tax returns the IRS receives each year, Desmond estimated that the IRS should be seeing somewhere around twelve million annual tax returns that report some transaction in virtual currency.[9] But, he said, the IRS is not receiving twelve million returns reporting virtual currency transactions—in fact, it is receiving "nowhere near that."[10] Desmond noted that although the IRS wants to be helpful by issuing guidance on specific issues, like basis computation and valuation, "the greatest threat presented to us by virtual currency transactions is . . . these transactions not ending up on the tax return at all."[11] Thus, the IRS is interested in issuing guidance to help taxpayers accurately report income from cryptocurrency but also, and perhaps more so, in increasing compliance in reporting overall.[12]

Finally, another possible motive for the IRS's focus on cryptocurrency is the perception that cryptocurrencies are used in

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[5] *Bitcoin Price Index*, COINDESK, https://www.coindesk.com/price/bitcoin (last visited Nov. 15, 2020).

[6] I.R.C. § 61(a) (2018).

[7] *See* Lee A. Sheppard, *Nerds and Cops, Part 2: IRS CI Looking for A Few Good Cases*, 90 TAX NOTES INT'L 611, 611 (2018) (noting that "[h]ardly anyone is paying tax on bitcoin gains or bitcoin hard forks").

[8] Urban Institute, *Cryptocurrency and Tax Administration*, YOUTUBE (Oct. 17, 2019), https://www.youtube.com/watch?v=_HbZhVU6X4Q.

[9] *Id.*

[10] *Id.*; *see also* United States v. Coinbase, Inc., No. 17-cv-01431-JSC, 2017 WL 5890052, at *1 (N.D. Cal. Nov. 28, 2017) ("Based upon an IRS search, only 800 to 900 persons electronically filed a Form 8949 that included a property description that is 'likely related to bitcoin' in each of the years 2013 through 2015.").

[11] Urban Institute, *supra* note 8.

[12] For further discussion of the IRS's efforts to increase compliance in the area of virtual currency, see *infra* Part III.

illicit online dealings. One study in 2018 estimated that nearly half of all bitcoin transactions involve illegal activity.[13] Famously, Ross Ulbricht was convicted in 2013 for founding and operating the website "Silk Road," an illicit online marketplace where users transacted in bitcoin.[14] Through stricter tax compliance measures, the government will be able to track more of the illegal activity that occurs through cryptocurrency transactions.[15]

For these reasons, the IRS has initiated efforts to increase tax compliance by cryptocurrency users.[16] But taxation of cryptocurrency and the possible implications of the IRS's focus also pose problems for taxpayers because there are many unanswered questions in the tax treatment of cryptocurrency.[17] The IRS has clearly expressed that it regards cryptocurrency and other virtual currencies as property, not currency.[18] However, questions linger about the taxation of cryptocurrency and the penalties that might be assessed for failure to report cryptocurrency transactions.[19] The IRS has not addressed some of the myriad problems created by the broad-stroke description of cryptocurrency as property, and it recognizes that taxpayers require more specific and specialized guidance to accurately report the tax consequences of their virtual

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[13] Sean Foley, Jonathan R. Karlsen & Tālis J. Putniņš, *Sex, Drugs, and Bitcoin: How Much Illegal Activity Is Financed Through Cryptocurrencies?*, 32 REV. FIN. STUD. 1798, 1800 (2019) ("[A]pproximately one-quarter of all users (26%) and close to one-half of bitcoin transactions (46%) are associated with illegal activity.").

[14] *See* PAUL VIGNA & MICHAEL J. CASEY, THE AGE OF CRYPTOCURRENCY 126 (2015) (noting that the "traceability" of bitcoin allowed law enforcement to link Ross Ulbricht to the Silk Road's illegal transactions).

[15] *See* Foley et al., *supra* note 13, at 1799 (describing how government seizures of bitcoin can help develop means of identifying illegal activity).

[16] *See infra* Part III.

[17] *See* JAMES T. FOUST, COIN CTR., A DUTY TO ANSWER: SIX BASIC QUESTIONS AND RECOMMENDATIONS FOR THE IRS ON CRYPTO TAXES 2 (2019), https://www.coincenter.org/app/uploads/2020/05/crypto-tax.pdf ("U.S. taxpayers lack answers to basic questions about the federal tax and reporting effects of transactions involving cryptocurrencies.").

[18] *See* I.R.S. Notice 2014-21, 2014-16 I.R.B. 938 ("For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.").

[19] For example, an open question exists regarding how taxpayers should distinguish between convertible and nonconvertible virtual currencies for the purposes of Notice 2014-21. *See* FOUST, *supra* note 17, at 9–11 (describing difficulties in distinguishing between convertible and nonconvertible virtual currencies).

currency transactions.[20] Nevertheless, the IRS will still hold taxpayers responsible for accurately reporting their dealings in cryptocurrency.[21]

Some commentators have noted that the IRS's enforcement efforts in the area of virtual currency mirror to some extent the enforcement efforts the government has employed in the case of foreign bank account reporting.[22] While some of the concerns surrounding virtual currency transaction reporting and foreign bank account reporting are the same—secrecy, criminal activity, and tax evasion—the subjects are fundamentally different. A bank account is a bank account,[23] but cryptocurrency is an emerging technology that has only begun to scratch the surface of the world economy. Nevertheless, an analysis and comparison of the Treasury's past treatment of foreign bank accounts with the current issue of cryptocurrency transactions may shed light on what the future holds for taxpayers dealing in cryptocurrency. Therefore, this Note explores the similarities and differences between the development of enforcement efforts, penalties, and criminal prosecutions in the case of foreign bank account reporting and the emerging efforts to address virtual currencies.

Part II of this Note explains what cryptocurrencies are, how they are obtained and used, and how a taxpayer might realize a taxable gain when dealing in them. Part III describes the IRS's response, so far, to taxation of cryptocurrency. Part IV explores the history, enforcement, penalties, and prosecutions associated with foreign financial accounts. Part V compares and contrasts the IRS's current response to the taxation of cryptocurrency with the treatment of

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[20] Urban Institute, *supra* note 8 (noting a high level of tax reporting noncompliance for virtual currency due in part to a lack of guidance from the IRS).

[21] *See id.* (stating that ensuring accurate cryptocurrency tax reporting is a high priority for the IRS); Robert Green, *Watch Out Cryptocurrency Owners, The IRS Is on the Hunt*, FORBES: GREAT SPECULATIONS (July 31, 2019, 1:49 PM), https://www.forbes.com/sites/greatspeculations/2019/07/31/watch-out-cryptocurrency-owners-the-irs-is-on-the-hunt/#7bbde5626990 ("The massive tax bust of crypto owners has begun. . . .").

[22] *See* Green, *supra* note 21 (noting that "[i]n retrospect, it seems the IRS made a mistake in (unofficially) waiving foreign bank account report [filing requirements] for offshore virtual currency accounts"). This Note uses the terms "foreign bank account" and "foreign financial account" interchangeably when referring to accounts that are subject to the reporting requirements discussed herein.

[23] *See* 31 C.F.R. § 1010.350(c) (2019) (defining "reportable accounts" for the purposes of foreign bank and financial account reporting).

foreign bank accounts. This Part also discusses the possible paths the government may take to address the multifarious issue of taxation of cryptocurrency. Part VI concludes. If history is any indication of the IRS's future actions, a storm of strict enforcement with harsh penalties is likely on the horizon for those who fail to comply with cryptocurrency reporting requirements.

II. WHAT IS CRYPTOCURRENCY?

Unlike traditional currencies, which are centrally regulated by issuing authorities, cryptocurrencies[24] are decentralized. This means that account holders can carry out verified transactions without a trusted central authority, such as a bank or a clearinghouse.[25] Cryptocurrency transactions are trusted and verifiable because of the nature of the blockchain—a cryptographic ledger in which "blocks" of information about transactions are publicly verified and added to a "chain" by multiple users to avoid falsification.[26] The key characteristic of a blockchain is its decentralized ledger, meaning that the ledger is not stored in a singular place and is accessible by everyone.[27]

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[24] Many different types of cryptocurrencies exist. This Note will focus only on payment tokens that are intended as a medium of monetary exchange. *See* REBECCA M. NELSON, CONG. RESEARCH SERV., TE10034, EXAMINING REGULATORY FRAMEWORKS FOR DIGITAL CURRENCIES AND BLOCKCHAIN 1–2 (2019), https://crsreports.congress.gov/product/pdf/TE/TE10034 (discussing different types of cryptocurrencies and distinguishing payment tokens from utility tokens). Many sources focus on bitcoin, which was the first cryptocurrency developed in 2009, but since then, a great proliferation of so-called "altcoins"—founded on similar technology—has occurred. *See* Arjun Kharpal, *All You Need to Know About the Top 5 Cryptocurrencies*, CNBC (Dec. 14, 2017, 4:32 AM), https://www.cnbc.com/2017/12/14/bitcoin-ether-litecoin-ripple-differences-between-cryptocurrencies.html (describing key differences between some popular cryptocurrencies). The description in this Part does not necessarily apply to every type of cryptocurrency but is based on the typical model, such as the Bitcoin protocol. This Part only provides a brief introduction to the concept of cryptocurrency without going into much technical detail.

[25] *See What is Bitcoin?*, COINDESK (Aug. 17, 2020, 10:37 PM), https://www.coindesk.com/learn/bitcoin-101/what-is-bitcoin (describing the Bitcoin protocol's use of a distributed ledger).

[26] *See* Ameer Rosic, *What is Blockchain Technology? A Step-by-Step Guide for Beginners*, BLOCKGEEKS, https://blockgeeks.com/guides/what-is-blockchain-technology/ (last visited Aug. 11, 2020) (describing the process behind adding transactions to a blockchain).

[27] *See* Marc Pilkington, *Blockchain Technology: Principles and Applications*, *in* RESEARCH HANDBOOK ON DIGITAL TRANSFORMATIONS 225, 230–31 (F. Xavier Olleros & Majlinda Zhegu eds., 2016) (describing the decentralized blockchain).

Maintenance of the blockchain's ledger requires that transactions be verified.[28] Only when the validity of a transaction is agreed upon by all nodes (or users) will the transaction appear in the ledger.[29] Cryptocurrency "miners" are those who devote computing power to verifying transactions.[30] Verification is a process that requires solving a mathematical problem, and the first miner to solve it is rewarded with cryptocurrency.[31] Thus, cryptocurrency is the asset that incentivizes maintenance of the blockchain's public ledger.[32] Part of cryptocurrency's value is its inherent scarcity, as only a limited amount can be mined over the life of the blockchain.[33]

Ownership of cryptocurrency is represented by possession of a pair of keys—bits of code generated by a wallet.[34] A public key identifies the owner, and a private key provides access to the cryptocurrency and acts as the user's trusted signature.[35] The owner of a wallet has pseudonymity—in that the owner does not need to provide credentials such as a name and address—yet methods exist to track users because the blockchain ledger is public information.[36] However, some cryptocurrencies are now focusing on making

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[28] *See What is Bitcoin?*, *supra* note 25 (explaining the necessity of verification for the confirmation of a transaction).

[29] *See* Ian Pattinson, *4 Characteristics That Set Blockchain Apart*, IBM: CLOUD COMPUTING BLOG (Apr. 11, 2017) https://www.ibm.com/blogs/cloud-computing/2017/04/11/characteristics-blockchain/ (describing the "consensus" aspect of blockchain).

[30] *See* Pilkington, *supra* note 27, at 228 (describing "miners").

[31] *See id.* (describing the mathematics of blockchain verification).

[32] *See id.* at 230 (discussing blockchain's incentive mechanism).

[33] *See, e.g.*, VIGNA & CASEY, *supra* note 14, at 122 ("[B]itcoin's software is preprogrammed to generate a consistent amount of new bitcoins over a 130-year period . . . .").

[34] *See* Jamie Redman, *How to Prove Ownership With a Bitcoin Cash Address and Digital Signature*, BITCOIN.COM (May 18, 2019), https://news.bitcoin.com/how-to-prove-ownership-with-a-bitcoin-cash-address-and-digital-signature/ ("With a private key, an owner can create a message like 'I own this address,' show the public address, and provide a valid signature which essentially proves ownership of the address.").

[35] *See id.*

[36] *See* PERKINS, *supra* note 3, at 16 ("Although the accounts may be identified with a pseudonym on the cryptocurrency platform, law enforcement can exercise methods involving analysis of transaction patterns to link those pseudonyms to real-life identities."); Tyler G. Newby & Ana Razmazma, *An Untraceable Currency? Bitcoin Privacy Concerns*, FINTECH WEEKLY (Apr. 7, 2019), https://www.fintechweekly.com/magazine/articles/an-untraceable-currency-bitcoin-privacy-concerns (describing different ways an encrypted cryptocurrency transaction can be traced to an individual).

transactions more anonymous and private than they already are.[37] One cryptocurrency, Monero, uses a verification protocol on its blockchain that attempts to make users harder to track.[38] Keeping up with the rapidly changing technology in this area will therefore be a challenging enforcement priority for the government.

One early question in the development of cryptocurrency was how it could be used. Some cryptocurrencies can be sold online through exchanges, such as Coinbase, in return for fiat (or government-backed) currency.[39] Some businesses have been reluctant to accept cryptocurrency as payment because of its volatility and high transaction fees.[40] However, many businesses are beginning to accept cryptocurrencies as payment.[41] One amusing example is the website De Louvois, a "Bitcoin Elite Marketplace" where individuals can purchase fine art, real estate, and even a Lamborghini using bitcoin.[42]

Cryptocurrencies can be obtained in several ways. As mentioned above, cryptocurrency miners use their computers' resources to

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[37] Alex Lielacher, *10 Awesome Uses of Cryptocurrency*, BRAVE NEW COIN (July 2, 2020, 1:10 PM), https://bravenewcoin.com/insights/10-awesome-uses-of-cryptocurrency ("Privacy-centric digital currencies such as Monero (XMR), Zcash (ZEC), and PIVX (PIVX) enable users to make anonymous financial transactions. That means individuals can make money transfers without having to explain to a bank why they are sending a large sum of money, what the sources of the funds are and who they are sending it to, which can delay the transaction and involve unnecessarily bureaucratic processes.").

[38] *See* Newby & Razmazma, *supra* note 36 (describing how privacy-centric cryptocurrencies work "based on unique one-time keys and ring signatures" wherein "the actual signer is pooled together with a group of possible signers, forming a 'ring'").

[39] Reed Schlesinger, *How to Cash Out or Sell Bitcoin for Fiat (USD, EUR, Etc.)*, COIN CENTRAL (May 25, 2019), https://coincentral.com/how-to-turn-bitcoin-into-cash-usd/ (describing various methods and exchanges for "cash[ing] out").

[40] Jon Swartz & Avi Salzman, *Bitcoin Is the Hottest Thing Around. So Why Is It So Hard to Use?*, BARRON'S (Dec. 15, 2017, 9:19 AM) https://www.barrons.com/articles/bitcoin-is-the-hottest-thing-around-so-why-is-it-so-hard-to-use-1513347597 ("Online gaming site Steam stopped allowing Bitcoin payments this month because of the 'high fees [as much as $20] and volatility.'") (alteration in original).

[41] Kayla Sloan, *7 Major Companies that Accept Cryptocurrency*, DUE (Jan. 31, 2018), https://due.com/blog/7-companies-accept-cryptocurrency/ ("[I]ncreasing numbers of companies are accepting [cryptocurrency] as a form of payment for goods and services every day.").

[42] *2017 Lamborghini Aventador SV Roadster LP750-4*, DE LOUVOIS, https://delouvois.com/browse/all_categories/2017-lamborghini-aventador-sv-roadster-lp750-4/ (last visited Aug. 12, 2020) (accepting bitcoin for purchasing a Lamborghini online); DE LOUVOIS, https://delouvois.com (last visited Sept. 20, 2020) (boasting a menu of available items including art, antiques, jewelry, cars, homes, and properties).

obtain cryptocurrency by verifying transactions.[43] Cryptocurrency also can be purchased in a marketplace.[44] In some cases, taxpayers might receive cryptocurrency through a "hard fork," where a coin splits into two different cryptocurrencies, or an "airdrop," in which cryptocurrency users may be given something of a "freebie."[45] One very interesting way someone might acquire cryptocurrency is through an "initial coin offering" or "ICO."[46] An ICO, similar to an initial public offering of corporate stock, is a means for emerging companies to raise money by exchanging a new cryptocurrency token for established cryptocurrencies or fiat currency.[47]

The versatility and protean nature of virtual currencies and blockchains cannot be underestimated.[48] In order to enforce tax reporting compliance, the IRS must stay on the cutting edge of these technologies.[49] Thus, regulating and enforcing taxation of cryptocurrencies is somewhat like playing a game of whack-a-mole—just when the government might believe it has a handle on the subject, consumers and special interest groups are quick to point out the flaws of its approach.[50]

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[43] Pilkington, s*upra* note 27, at 228 (describing how "[m]iners fiercely (and anonymously) compete on the network to solve the mathematical problem in the most efficient way" in order to earn "newly minted coins").

[44] *See, e.g.*, COINBASE, https://www.coinbase.com/ (last visited Nov. 15, 2020) (describing Coinbase as "the easiest place to buy, sell, and manage your cryptocurrency portfolio").

[45] Nathan Reiff, *Cryptocurrency Forks vs. Airdrops: What's the Difference?*, INVESTOPEDIA (July 3, 2018), https://www.investopedia.com/tech/cryptocurrency-forks-vs-airdrops-whats-difference/ (stating that hard forks "essentially create a second branch of [the] currency using the same basic code," while airdrops supply free tokens to select cryptocurrency investors).

[46] Lielacher, *supra* note 37 (describing how "anyone with an Internet connection" can use cryptocurrency to invest in a startup by purchasing a "newly-issued token . . . to trade in the secondary market").

[47] *Id.* ("[T]he digital tokens of the most successful ICOs have increased in value by several thousand percent and cryptocurrency-based fundraising has helped startups to raise over $12 billion in the past two years.").

[48] For an exploration of the power of blockchain to transform financial markets, see Samuel N. Weinstein, *Blockchain Neutrality*, 55 GA. L. REV. (forthcoming 2021) (manuscript at 2–3) (on file with author).

[49] *See* Marie Sapirie, *A New Era for Crypto Enforcement*, 165 TAX NOTES FED. 1095, 1096 (2019) ("[C]ryptocurrency poses a novel challenge to law enforcement and guidance development because it forces the agency to get ahead of the technological changes, something that has historically challenged the IRS.").

[50] *See infra* note 60 (citing several comments by interested groups discussing areas of contention such as hard forks, airdrops, and stablecoin).

III. THE IRS'S RESPONSE TO CRYPTOCURRENCY

The IRS has begun to meet the challenge of increasing tax compliance of cryptocurrency transactions in several ways, including issuing notices and updated forms and filing summonses in court. This Part describes what has been done thus far, separating the IRS's responses between administrative acts and legal action.

A. ADMINISTRATIVE ACTS

Notice 2014-21[51] was the IRS's first response to the problem of underreporting of income from cryptocurrency transactions. In this Notice, the IRS stated that it will regard virtual currency as property for tax purposes, with all the attendant tax consequences of property transactions.[52] The Notice also provides some additional information regarding reporting cryptocurrency transactions and proposes penalties for noncompliance.[53]

Under the federal tax law, all taxpaying entities—including individuals—are responsible for maintaining records of their transactions and filing the correct forms with the IRS each year.[54] Notice 2014-21 advises that payment of virtual currency may require information reporting of that amount on a form 1099-MISC in the case of payment to an independent contractor or a form 1099-K in the case of third-party network transactions.[55] The Notice does not address all possible situations in which information reporting

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[51] I.R.S. Notice 2014-21, 2014-16 I.R.B. 938 (addressing the application of general tax principles to virtual currency transactions).

[52] *Id.* ("For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.") For basic tax consequences of property transactions, see I.R.C. § 1001 (2018).

[53] I.R.S. Notice 2014-21, 2014-16 I.R.B. 938, 940 (discussing penalties for inaccurate information reporting).

[54] 26 U.S.C. § 6001 (2018) ("Every person liable for any tax . . . shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.").

[55] I.R.S Notice 2014-21, 2014-16 I.R.B. 938, 939–40 (noting certain examples of information-reporting requirements). In the case of cryptocurrencies, third-party network transactions would include transactions made on cryptocurrency exchanges. *See Form 1099-K Tax Information for Coinbase Pro and Prime*, COINBASE, https://support.coinbase.com/customer/en/portal/articles/2721660-1099-k-tax-forms-faq-for-coinbase-pro-prime-merchant (last visited Sept. 12, 2020).

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might be necessary, and the IRS has said that information reporting under I.R.C. § 6045 is an area on which it intends to issue further guidance.[56] But Notice 2014-21 warns that taxpayers who fail to comply with the reporting requirements will be subject to penalties.[57]

More recently, the IRS issued Revenue Ruling 2019-24, which addressed some questions about how the tax law should be applied to some virtual currency issues, such as realizations of income in the event of a cryptocurrency hard fork.[58] Revenue Ruling 2019-24 and the accompanying FAQs have not been without controversy.[59] Several commentators and interest groups have criticized the ruling's treatment of hard forks and airdrops.[60] In a

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[56] U.S. DEP'T OF THE TREASURY, *supra* note 1, at 20. Information reporting under § 6045 is relevant to the tax treatment of cryptocurrency because it requires brokers to report information about their customers to the IRS. *See* I.R.C. § 6045(a) (2018) ("Every person doing business as a broker shall, when required by the Secretary, make a return . . . showing the name and address of each customer, with such details regarding gross proceeds and such other information as the Secretary may . . . require . . . ."). The IRS likely wants to require cryptocurrency exchanges to file information reports.

[57] I.R.S Notice 2014-21, 2014-16 I.R.B. 938, 940 ("[U]nderpayments attributable to virtual currency transactions may be subject to penalties, such as accuracy-related penalties under section 6662.").

[58] Rev. Rul. 2019-24, 2019-44 I.R.B. 1004, 1004–05 (noting that realization of income upon a hard fork depends on the occurrence of an airdrop). For more discussion of forks and airdrops, see Reiff, *supra* note 45.

[59] The form, as well as the contents, of the IRS's most recent guidance have been criticized by the Government Accountability Office and commentators. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-20-188, VIRTUAL CURRENCIES: ADDITIONAL INFORMATION REPORTING AND CLARIFIED GUIDANCE COULD IMPROVE TAX COMPLIANCE 20–21 (2020), https://www.gao.gov/assets/710/704573.pdf (noting that because the FAQs were not published in the Internal Revenue Bulletin, they "are not binding on IRS, are subject to change, and cannot be relied upon by taxpayers as authoritative or as precedent for their individual facts and circumstances" and recommending that the FAQs include a disclaimer notifying taxpayers of this fact because "taxpayers should be alerted to any limitations that could make some IRS information less authoritative than others"); Monte A. Jackel, *A Question or Two About FAQs*, 166 TAX NOTES FED. 1463, 1467 (2020) (questioning the IRS's use of FAQs because they "lack[] both prior public notice and prior public comment," lack authority, and are not easy for taxpayers to find).

[60] *See, e.g.*, Letter from Am. Inst. of CPAs to the Hon. Charles P. Rettig, Comm'r, IRS, and the Hon. Michael J. Desmond, Chief Counsel, IRS (Feb. 28, 2020), https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20200228-aicpa-letter-on-irs-virtual-currency-guidance.pdf (noting that the IRS guidance does not properly address significant blockchain events); Letter from Wall Street Blockchain All. to Suzanne R. Sinno, Office of Assoc. Chief Counsel (Income Tax & Accounting), IRS (Jan. 2020), https://www.wsba.co/uploads/3/7/9/4/3794101/wsba_irs_response_letter_-_final.pdf [https://web.archive.org/web/20200319195836/https://www.wsba.co/uploads/3/7/9/4/3794101/

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contemporaneous press release, the IRS again warned that it is actively addressing issues of noncompliance with cryptocurrency reporting requirements and will initiate audits and even criminal investigations if necessary.[61]

The day after the press release, the IRS released a draft version of the Form 1040 Schedule 1 with a new question at the top asking, "[a]t any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?"[62] This added question—perhaps more than anything else—signals the IRS's seriousness about enforcing virtual currency transaction reporting.[63] Failure to accurately answer a question on the Form 1040 could lead to serious consequences for taxpayers.[64]

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wsba_irs_response_letter_-_final.pdf] (arguing, among other things, for separate treatment for stablecoin); Letter from N.Y. State Bar Ass'n Tax Section to the Hon. David J. Kautter, Assistant Sec'y, Dep't of the Treasury, the Hon. Charles P. Rettig, Comm'r, IRS, and the Hon. Michael J. Desmond, Chief Counsel, IRS (Jan. 26, 2020), https://nysba.org/app/uploads/2020/03/Report-1433.pdf (proposing a distinction between contentious and non-contentious hard forks).

[61] I.R.S. News Release IR-2019-167 (Oct. 9, 2019) ("The IRS is actively addressing potential noncompliance in this area [of virtual currency transactions] through a variety of efforts, ranging from taxpayer education to audits to criminal investigations.").

[62] U.S. DEP'T OF THE TREASURY, FORM 1040 SCHEDULE 1: ADDITIONAL INCOME AND ADJUSTMENTS TO INCOME (2019), https://www.irs.gov/pub/irs-pdf/f1040s1.pdf. Note that the Schedule 1 attachment to Form 1040 generally needs to be filed by individuals who have additional income or special deductions that would not be shown on the ordinary Form 1040. *See About Form 1040, U.S. Individual Income Tax Return*, IRS, https://www.irs.gov/forms-pubs/about-form-1040 (last visited Nov. 15, 2020) (detailing the circumstances in which a person would be required to fill out the Schedule 1 Form 1040). Therefore, those who would not otherwise attach a Schedule 1 may not be aware that they are now required to do so. *See* Kelly Phillips Erb, *There's A New Question On Your 1040 As IRS Gets Serious About Cryptocurrency*, FORBES (Oct. 12, 2019, 8:55 AM), https://www.forbes.com/sites/kellyphillipserb/2019/10/12/theres-a-new-question-on-your-1040-as-irs-gets-serious-about-cryptocurrency/ ("But taxpayers who don't have to file Schedule 1 for any other purpose may not be aware that they need to file Schedule 1 to answer . . . this question if it applies to them.").

[63] *See* Erb, *supra* note 62 (explaining the possibility that the IRS will use the proposed Schedule 1 cryptocurrency question to crack down on cryptocurrency in the future, just as it did with offshore accounts using Schedule B, Part III).

[64] In addition to accuracy-related penalties, the IRS may choose to pursue civil fraud charges or even criminal charges where there is an element of intent. For further discussion of tax-related penalties and charges, see *infra* Part IV.

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B. LEGAL ACTION

In 2016, the IRS sent a John Doe summons to a company called Coinbase, Inc., a cryptocurrency exchange service where users can buy, sell, and store cryptocurrency.[65] The initial summons sent to Coinbase requested information that included user profiles, transaction logs, invoices, and records of payments from all of Coinbase's customers.[66] Coinbase refused to comply with the initial summons, which eventually led the government to file a more narrowed summons asking only about users who transacted in "at least the equivalent of $20,000."[67] In 2017, a court enforced the narrowed summons and required Coinbase to produce the names, addresses, records, and statements of "accounts with at least the equivalent of $20,000 in any one transaction type (buy, sell, send, or receive) in any one year during the 2013 to 2015 period."[68] Coinbase informed its affected customers that it would provide the IRS with the requested identifying information, and it has begun issuing Form 1099s for some of its customers.[69]

After receiving information from the Coinbase enforcement action, the IRS sent three different letters (Letters 6173, 6174, and 6174-A) to some Coinbase clients in July 2019, advising them to pay

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[65] *See* United States v. Coinbase, Inc., No. 3:17-cv-01431-JSC, 2017 WL 5890052, at *1–2 (N.D. Cal. Nov. 28, 2017) ("By the end of 2015, Coinbase was America's largest platform for exchanging bitcoin into U.S. dollars, and the fourth largest globally."). A John Doe summons is a third-party summons with no individual named liable; the IRS must have a reasonable basis to believe there has been a violation of the tax code and must demonstrate that the information it seeks is not otherwise available. *See* I.R.C. § 7609(f) (2018) (describing additional requirements for a John Doe summons).

[66] *See Coinbase, Inc.*, 2017 WL 5890052, at *1 ("[The Initial Summons] requested nine categories of documents including: complete user profiles, know-your-customer due diligence, documents regarding third-party access, transaction logs, records of payments processed, correspondence between Coinbase and Coinbase users, account or invoice statements, records of payments, and exception records produced by Coinbase's AML system.").

[67] *Id.* at *2.

[68] United States v. Coinbase, Inc., No. 3:17-cv-01431-JSC, 2017 WL 6997649, at *1 (N.D. Cal. Nov. 29, 2017).

[69] *See IRS Notification*, COINBASE, https://support.coinbase.com/customer/portal/articles/2924446-irs-notification (last visited Oct. 18, 2019) (announcing the court order to Coinbase users); *see also Form 1099-K Tax Information for Coinbase Pro and Prime*, *supra* note 55 (informing Coinbase users that "[o]nly transactions that took place on Coinbase Pro and Prime are subject to reporting requirements"). The Form 1099-K means that Coinbase is now reporting some users' transactions to the IRS.

back taxes and file amended returns.[70] Letter 6173 was the most serious of these letters, warning the recipients that they "may not have met [their] U.S. tax filing and reporting requirements for transactions involving virtual currency" and requiring them to reply to the letter by submitting amended or corrected returns.[71] Letter 6173 goes on to say that a lack of response may lead to audit examination.[72] Letters 6174 and 6174-A state that the taxpayer "may not know the requirements for reporting"[73] or "may not have properly reported" transactions in virtual currency.[74] These are educational letters that do not require a response from the taxpayer.[75] They should, however, be considered serious warnings to taxpayers transacting in virtual currency to accurately report their transactions.[76]

In addition to the Coinbase third-party summons, the IRS has also issued individual summonses to ascertain cryptocurrency transaction details from taxpayers.[77] In 2018, the IRS began an examination into the return of individual taxpayer William A. Zietzke.[78] Zietzke evidently tipped off the IRS by filing an amended return seeking a refund for transactions in bitcoin that he initially reported but then claimed were mistakenly included for the year

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[70] *See* I.R.S. News Release IR-2019-132 (July 26, 2019); *see also* Green, *supra* note 21 ("This letter campaign seems a bit like a fishing expedition: The IRS wants more tax returns to analyze before it tackles tax treatment issues further.").

[71] *Letter 6173 (6-2019),* I.R.S. (July 16, 2019), https://www.irs.gov/pub/notices/letter_6173.pdf.

[72] *Id.* (warning that the IRS "may refer [the recipient's] tax account for examination" if the IRS does not "hear from" the recipient by a certain date).

[73] *Letter 6174 (6-2019)*, I.R.S. (July 16, 2019), https://www.irs.gov/pub/notices/letter_6174.pdf.

[74] *Letter 6174-A (6-2019)*, I.R.S. (July 16, 2019), https://www.irs.gov/pub/notices/letter_6174-a.pdf.

[75] *See Letter 6174 (6-2019)*, *supra* note 73; *Letter 6174-A (6-2019)*, *supra* note 74.

[76] *See, e.g.*, Andrew Velarde, *Taxpayers Can Expect More Virtual Currency Compliance Letters*, 165 TAX NOTES FED. 652, 652 (2019) (describing a statement by an IRS employee "that taxpayers who received letters that didn't require a response aren't guaranteed to be free of examination and that risk assessment would be performed at that level as well").

[77] The IRS has this authority under I.R.C. § 7602(a) (2018).

[78] *See* Allyson Versprille, *Judge Tells IRS to Narrow Summons on Cryptocurrency Exchange (2)*, BLOOMBERG TAX (Nov. 26, 2019, 12:42 PM), https://news.bloombergtax.com/tech-and-telecom-law/judge-tells-irs-to-narrow-summons-on-cryptocurrency-exchange (noting that in June 2018, the IRS decided to examine Zietzke's 2016 return).

2016 when they had taken place in a different year.[79] Upon examination, Zietzke only partially complied with the Revenue Agent's requests for information concerning cryptocurrency accounts; he did not disclose his account on the cryptocurrency marketplace Bitstamp.[80] When the IRS learned of Zietzke's additional account, it sent a summons to Bitstamp "direct[ing] Bitstamp to produce for examination books, records, papers, and other data relating to [Zietzke's] holdings with Bitstamp."[81]

In its decision on Zietzke's motion to quash the summons, the district court denied the motion but also required the government to narrow its summons.[82] The court found that the summons sought irrelevant material because it required Bitstamp to disclose information concerning years other than the one for which Zietzke was being audited.[83] Joseph P. Wilson, Zietzke's attorney, was quoted as saying that "if [the government] had just at the beginning restricted the summons, we wouldn't have had to go through this entire process [of litigating the scope of the summons],"[84] perhaps suggesting that the IRS was embarking on a fishing expedition rather than seeking information directly about Zietzke's 2016 return.

The IRS's publications and actions concerning virtual currencies make it crystal clear that it regards transactions utilizing such currencies as taxable.[85] As such, it fully expects taxpayers to report their dealings in virtual currencies and to pay a tax on any gain.[86] Failure to comply will result in tax assessments, fines, penalties, and perhaps criminal prosecution.[87] These warnings and threats are reminiscent of those issued to taxpayers with unreported foreign

[79] *See* Zietzke v. United States, 426 F. Supp. 3d 758, 762–63 (W.D. Wash. 2019).

[80] *See id.* at 763.

[81] *Id.*

[82] *See id.* at 761.

[83] *See id.* at 764 ("[A]s written, the Bitstamp summons seeks irrelevant material because it lacks a temporal limitation.").

[84] *See* Versprille, *supra* note 78.

[85] *See supra* notes 51–52.

[86] I.R.S. News Release IR-2019-167 (Oct. 9, 2019) ("The IRS is aware that some taxpayers with virtual currency transactions may have failed to report income and pay the resulting tax or did not report their transactions properly. The IRS is actively addressing potential non-compliance in this area through a variety of efforts, ranging from taxpayer education to audits to criminal investigations.").

[87] *See id.*

bank accounts.[88] Those engaging in transactions involving virtual currency would therefore be well advised to familiarize themselves with the experiences of those hapless individuals who failed to report their foreign bank accounts.

IV. FOREIGN BANK ACCOUNT REPORTING

In 1970, Congress passed the Currency and Foreign Transactions Reporting Act, commonly referred to as the "Bank Secrecy Act."[89] The Act and its associated regulations require U.S. citizens and residents to report any financial interest in a foreign financial account worth more than $10,000 on the Report of Foreign Bank and Financial Accounts (FBAR) directly to the Treasury Department.[90]

The purpose of the Bank Secrecy Act is "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings."[91] These requirements stemmed from concerns that Americans were using foreign banks to evade domestic laws.[92] The FBAR is meant to provide law enforcement agencies with a "paper trail" that can reveal criminal enterprises.[93]

The concern for tracking criminal activity through cashflow was recontextualized in 2001 to combat international terrorism.[94] At that time, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and

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[88] *See infra* Part IV.

[89] *See* 31 U.S.C. §§ 5311–14, 5316–22 (2018).

[90] *See* 31 U.S.C. § 5314 (2018); 31 C.F.R. § 1010.306(c) (2019); 31 C.F.R. § 1010.350 (2019). The specific requirements of who must file and what financial interests are covered can be found in the regulations. For further discussion of reporting requirements, see *infra* Section IV.A.

[91] 31 U.S.C. § 5311 (2018).

[92] *See* United States v. Clines, 958 F.2d 578, 581 (4th Cir. 1992) (noting concerns "that foreign financial institutions located in jurisdictions having laws of secrecy with respect to bank activity were being extensively used to violate or evade domestic criminal, tax, and regulatory requirements").

[93] MICHAEL I. SALTZMAN & LESLIE BOOK, IRS PRACTICE & PROCEDURE ¶ 12.04[3][a] (2020), Westlaw IRSPRAC ("Congress's purpose was to identify cash movements for use in law enforcement by creating a paper trail from financial institutions back to the criminal organization.").

[94] *See id.* ("[R]eports required for financial institutions can also be helpful in identifying or tracking the flow of funds needed for substantial terrorist activities.").

Obstruct Terrorism (USA PATRIOT) Act, which required the Treasury to "study methods for improving compliance with the reporting requirements" of the Bank Secrecy Act and to report periodically on its study.[95]

In its first such report in April of 2002, the Secretary of the Treasury estimated that less than twenty percent of taxpayers who were statutorily required to file an FBAR did so in 2001.[96] The report also noted an extremely low rate of criminal conviction and civil penalties for FBAR violations between 1993 and 2000.[97] The report attributed lack of compliance with FBAR reporting requirements not only to lack of education and outreach to taxpayers, but also to sheer dishonesty and criminality.[98] Reaching those dishonest individuals, the report concluded, "[would] require a series of highly publicized criminal actions against intentional violators in order to raise the cost of being an FBAR scofflaw."[99] The report resolved to establish a "joint Task Force" focused on prosecution and enforcement.[100] As outlined below, the government has not fallen short of its promised intention to make an example of noncompliant taxpayers.

A. REPORTING AND ADMINISTRATION

Because the Bank Secrecy Act is contained in Title 31 of the U.S. Code and not in Title 26 (the Internal Revenue Code), the IRS is not the administering agency for FBAR requirements and

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[95] Uniting and Strengthening America by Providing Appropriate Tools Required to Interrupt and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, Pub. L. No. 107-56, 115 Stat. 272, 331.

[96] *See* SEC'Y OF THE TREASURY, A REPORT TO CONGRESS IN ACCORDANCE WITH §361(B) OF THE UNITING AND STRENGTHENING AMERICA BY PROVIDING APPROPRIATE TOOLS REQUIRED TO INTERCEPT AND OBSTRUCT TERRORISM ACT OF 2001, at 6 (2002), https://www.treasury.gov/press-center/press-releases/Documents/fbar.pdf (stating that the IRS computing center received 177,151 FBAR forms while estimating that one million U.S. citizens and residents had qualifying foreign accounts).

[97] *See id.* at 8–10 (discussing the "reasons for the limited number of FBAR charges").

[98] *See id.* at 10–11 ("[T]here appear to be a number of taxpayers who fail to file because of lack of knowledge or confusion about the filing requirements . . . . [T]here also appear to be taxpayers who fail to file because they are concealing income or are engaged in some kind of criminal activity such as money laundering.").

[99] *Id.* at 11.

[100] *Id.* at 13.

regulations.[101] The FBAR form is administered by the Financial Crimes Enforcement Network (FinCEN), a branch of the Treasury that "safeguard[s] the financial system from illicit use."[102] However, the authority to enforce civil FBAR matters has been delegated to the IRS.[103] Therefore, "the IRS may assess and collect civil penalties, investigate potential violations, and take any other action reasonably necessary for FBAR enforcement purposes."[104]

Additionally, the IRS has its own form on which taxpayers are required to disclose foreign financial accounts: Form 8938, Statement of Specified Foreign Financial Assets.[105] Many individuals who are subject to the FBAR requirements are also required to file a Form 8938, though the threshold amounts for Form 8938 are greater and the penalties are generally not as severe.[106] While the FBAR and Form 8938 reporting requirements make it more difficult for criminals to hide their ill-gotten gains, the requirements also apply to law-abiding people, such as U.S. citizens who work or live abroad and residents who retain accounts in other countries, who, if not vigilant, can face civil and criminal penalties, as outlined below.[107]

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[101] *See* 31 U.S.C. § 310 (2018) (describing FinCEN's administrative powers and responsibilities).

[102] *What We Do*, FINCEN, https://www.fincen.gov/what-we-do (last visited Jan. 21, 2020).

[103] *See* 31 C.F.R. § 1010.810(g) (2019) (delegating the authority to enforce civil FBAR matters from FinCEN to the IRS).

[104] Patrick J. McCormick, *Handling an FBAR Examination and Assessment*, 164 TAX NOTES FED. 185, 187 (2019).

[105] *See About Form 8938, Statement of Specified Foreign Financial Assets*, IRS, https://www.irs.gov/forms-pubs/about-form-8938 (last visited Aug. 12, 2020) (stating that Form 8938 is used to report specified foreign assets when the total value of one's "specified foreign financial assets" is greater than "the appropriate reporting threshold").

[106] *See Comparison of Form 8938 and FBAR Requirements*, IRS, https://www.irs.gov/businesses/comparison-of-form-8938-and-fbar-requirements (last visited Aug. 12, 2020) (comparing individuals required to file and the reporting threshold of Form 8938 and FBAR); SALTZMAN & BOOK, *supra* note 93, ¶ 12.04[4] ("The criminal penalties related to [Form 8938] are the standard criminal penalties for tax obligations. The most likely criminal penalties are evasion (Section 7201) . . . and tax perjury (Section 7206(1)) . . . . The civil penalty for failure to file the form or failure to file a complete and correct form is $10,000 with an additional incrementing penalty if the taxpayer fails to provide the information to the Service after the Service notifies the individual of the failure to disclose. . . . In addition, a 40 percent accuracy-related penalty applies to any understatement attributable to undisclosed foreign financial assets.").

[107] *See* SALTZMAN & BOOK, *supra* note 93, ¶ 12.04[1] (noting that such penalties may "trap the unwary" that are required to file a Form 8938 or FBAR).

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B. OFFSHORE VOLUNTARY DISCLOSURE INITIATIVES

Since 2003, the IRS has allowed limited voluntary disclosures of unreported offshore accounts through several different programs.[108] The first, in 2003, was the Offshore Voluntary Compliance Initiative (OVCI).[109] The OVCI offered taxpayers who came forward and voluntarily reported their offshore accounts avoidance of certain penalties and criminal prosecution.[110] The 2003 program saw limited success.[111] Importantly, however, the OVCI also allowed the IRS to "gather information about promoters of offshore schemes."[112]

Two significant events occurred between 2003 and 2009, when the next voluntary disclosure program—the Offshore Voluntary Disclosure Program (OVDP)—was initiated.[113] First, in a further effort to increase FBAR reporting compliance, Congress greatly increased the statutory penalties for noncompliance in 2004.[114] The civil penalty for willful violations of FBAR reporting requirements was changed from the greater of $25,000 or the amount of any transaction, to the greater of $100,000 or 50% of all of the taxpayer's foreign balances.[115] Because the penalties can be assessed on a "per-

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[108] *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-318, OFFSHORE TAX EVASION: IRS HAS COLLECTED BILLIONS OF DOLLARS, BUT MAY BE MISSING CONTINUED EVASION 1 (2013) (stating that the IRS has implemented four voluntary disclosure programs for unreported offshore accounts since 2003).

[109] *See* I.R.S. News Release IR-2003-5 (Jan. 14, 2003) (announcing the "launch" of the Offshore Voluntary Compliance Initiative).

[110] *Id.* ("Under the Offshore Voluntary Compliance Initiative, eligible taxpayers who step forward will not face civil fraud and information return penalties.").

[111] *See* Stephan Michael Brown, *One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance*, 18 CHAP. L. REV. 243, 250 (2014) (noting "a 17% increase in FBAR filings from 2000 to 2003, believed to be in significant part from the 2003 OVCI").

[112] *Id.* at 249.

[113] *See* I.R.S. News Release IR-2009-84 (Sept. 21, 2009) (announcing an extension for voluntary disclosures).

[114] *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 821, 118 Stat. 1418, 1586 (increasing the penalty for willful violations of 31 U.S.C. § 5314 to the greater of $100,000 or 50% of the account balance).

[115] *Compare* 31 U.S.C. § 5321(a)(5)(C) (2018) (instituting a maximum penalty for a willful violations of FBAR reporting requirements of the greater of $100,000 or 50% of taxpayer's foreign balances), *with id.* § 5321(a)(5)(B) (2000) (stating the maximum penalty for willful violations of FBAR reporting requirements to be the greater of the amount of the transaction or the balance of the account at the time of the transaction (not to exceed $100,000) or $25,000), *amended by id.* § 5321(a)(5) (Supp. IV 2004).

account-per-year basis," and the statute of limitations is six years, the current penalties for FBAR noncompliance can be "enormous."[116] Second, the Justice Department began investigating UBS's clientele after an employee at Swiss bank UBS disclosed the bank's strategy of encouraging wealthy Americans to become customers for the purpose of evading the U.S. tax laws.[117] This investigation led to an eventual settlement and the disclosure of the names of thousands of American UBS customers suspected of tax evasion using offshore accounts.[118] The combination of harsher penalties and a heightened fear of being discovered likely contributed to the success of the 2009 OVDP, which raised "$3.4 billion in back taxes, interest and penalties."[119]

The 2009 program required payment of tax due for the previous six years and imposed penalties of up to twenty percent of the taxpayer's total account balances.[120] Similar voluntary disclosure programs were implemented in 2011, 2012, and 2014.[121] These programs were successful as revenue-raising strategies.[122] However, they were not without criticism due to their relatively

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[116] Hale E. Sheppard, *Third Time's the Charm: Government Finally Collects 'Willful' FBAR Penalty in* Williams, 117 J. TAX'N, 319, 320 (2012). For more on FBAR penalties, see *infra* Section IV.D.

[117] Brown, *supra* note 111, at 251.

[118] *Id.* ("Following an agreement between the United States and Swiss governments, a settlement was reached in the case, with UBS agreeing to supply the names of close to 4450 American account holders the IRS suspected of evading taxes.").

[119] I.R.S. News Release FS-2014-6 (June 2014).

[120] *See* Brown, *supra* note 111, at 251–52 (explaining that "in lieu of all other penalties . . . participants in the program had to pay a penalty equal to 20% of the amount in foreign accounts in the year with the highest aggregate balance during the six-year period").

[121] *See* I.R.S. News Release IR-2011-84 (Aug. 8, 2011) (detailing the 2011 initiative's "new penalty framework that requires individuals to pay a penalty of 25 percent of the amount in the foreign bank accounts in the year with the highest aggregate account balance covering the 2003 to 2010 time period"); I.R.S. News Release IR-2012-5 (Jan. 9, 2012) (explaining that the 2012 program is "similar to the 2011 program in many ways" and that "[t]he overall penalty structure . . . is the same for 2011"); I.R.S. News Release IR-2018-52 (Mar. 13, 2018) ("The current OVDP began in 2014 and is a modified version of the OVDP launched in 2012, which followed voluntary programs offered in 2011 and 2009.").

[122] *See* I.R.S. News Release FS-2014-6, *supra* note 119 (noting that the IRS has recovered around $6.5 billion from voluntary disclosures as of 2014); *see also* SALTZMAN & BOOK, *supra* note 93, ¶ 12.05[11][e] ("The voluntary disclosure practice is a win-win for the Service. If it were to prosecute one or more taxpayers who actually met or were perceived to have met the conditions for voluntary disclosure, it would cost the Service far more [than] it could ever hope to gain, because voluntary disclosures would dry up.").

harsh "across-the-board" penalties with no allowable defense for "reasonable cause."[123] The most recent offshore voluntary disclosure program ended on September 28, 2018, because of its unpopularity and a dwindling number of disclosures.[124] Taxpayers who wish to come forward now are left with limited options for voluntary disclosure through the Criminal Investigation Voluntary Disclosure Practice.[125]

C. CIVIL PENALTIES

An individual taxpayer who fails to adequately report foreign accounts on the FBAR may be subject to civil penalties for both willful and non-willful violations.[126] The allowable penalties for these two types of violations are different, but in both cases they can be quite severe.[127]

1. Non-Willful Violations. The current penalties for non-willful FBAR violations[128] were authorized in 2004.[129] Under the Bank Secrecy Act, the civil penalty for a non-willful violation of the FBAR

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[123] Brown, *supra* note 111, at 260 ("[T]here is a perception of unfairness as a result of the severe across-the-board penalty for failing to report foreign bank accounts, regardless of the circumstances."); 31 U.S.C. § 5321(a)(5)(B)(ii) (2018) (establishing a reasonable cause defense for FBAR violations).

[124] *See* Sheppard, *supra* note 7, at 612 ("OVDP is ending . . . because the penalties are so high it has become unpopular. There were a mere 600 submissions last year."); *Closing the 2014 Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, IRS, https://www.irs.gov/individuals/international-taxpayers/closing-the-2014-offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers (last updated Sept. 26, 2018) ("The IRS will close the OVDP effective September 28, 2018.").

[125] U.S. DEP'T OF THE TREASURY, FORM 14457: VOLUNTARY DISCLOSURE PRACTICE PRECLEARANCE REQUEST AND APPLICATION (2020), https://www.irs.gov/pub/irs-pdf/f14457.pdf (detailing the information that must be provided to the IRS in order to participate in the Criminal Investigation Voluntary Disclosure Practice).

[126] *See* 31 U.S.C. § 5314(a) (2018) (requiring U.S. persons and persons "doing business in" the United States to file a report when they "make[] a transaction or maintain[] a relation for any person with a foreign financial agency"); *id.* § 5321(a)(5)(A) (2018) (authorizing the Secretary of the Treasury to impose civil penalties on any person who violates § 5314).

[127] For explanation of the penalties for non-willful and willful violations, see *infra* text accompanying notes 130 & 136, respectively.

[128] In general, an FBAR reporting violation is non-willful if it does not satisfy the willfulness requirements discussed below. *See infra* Section IV.C.*2*.

[129] *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418, 1586 (amending § 5321(a)(5) to authorize civil penalties for any person who violates the FBAR reporting requirement); *see supra* notes 114–115 and accompanying text.

reporting requirements may be no more than $10,000.[130] However, the IRS takes the position—and some courts have agreed—that this provision means that a taxpayer may be assessed up to a $10,000 penalty for each unreported account.[131] For example, if a taxpayer has ten foreign accounts that were non-willfully omitted from an FBAR report, the IRS could assess a penalty of $100,000 against this taxpayer for a single year. In one case, the government initially assessed a per-account penalty on a taxpayer's non-willfully unreported foreign financial accounts with balances of as little as thirty dollars; in its briefing, the government stated that it would not "seek to . . . collect penalties assessed on accounts with a balance of less than $10,000" in this particular case, but held open that possibility for the future.[132]

The Internal Revenue Manual offers further insight on assessing non-willful penalties, providing that "in most cases, examiners will recommend one penalty per open year, regardless of the number of unreported foreign accounts,"[133] but that in some circumstances penalties on a per-year basis will still be warranted, especially when indicators of willful conduct exist but do not rise to the required level to sustain a willful penalty.[134] Judicial resolution of this "per-account/per-FBAR" issue is not yet certain, but it is important because it "potentially affects many individuals."[135]

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[130] *See* 31 U.S.C. § 5321(a)(5)(B)(i) (2018).

[131] *See* United States v. Boyd, No. 2:18-cv-00803-MWF-JEM, slip op. at 7 (C.D. Cal. Apr. 23, 2019) (holding that the IRS could penalize an aspect of noncompliance for each of the taxpayer's foreign financial accounts). Note that the issue is currently on appeal. *See* United States v. Boyd, No. 19-55585 (9th Cir. argued Sept. 1, 2019).

[132] United States of America's Opposition to Defendants' Motion for Summary Judgment at 11 n.3, United States v. Patel, No. 8:19-cv-00792-JLS-JDE (C.D. Cal. June 9, 2019). *See also* Michael D. Kummer & Saul Mezei, *The Non-Willful FBAR Per-Account/Per-Form Issue Deserves Closer Scrutiny*, 164 TAX NOTES FED. 365, 365 n.2 (2019) (noting that the government in *Patel* "left open the possibility that it might [assess per-account penalties on low-balance accounts] in other cases"). Note that *Patel* is currently stayed pending the Ninth Circuit's decision in *Boyd*. *See* Order Staying Action Pending Ninth Circuit's Determination of *Boyd*, United States v. Patel, No. 8:19-cv-00792-JLS-JDE (C.D. Cal. July 8, 2019).

[133] IRM 4.26.16.6.4.1(1) (Nov. 6, 2015).

[134] *See* IRM 4.26.16.6.4.1(3) (Nov. 6, 2015) ("For other cases, the facts and circumstances . . . may indicate that asserting a separate nonwillful penalty for each unreported foreign financial account, and for each year, is warranted.").

[135] Kummer & Mezei, *supra* note 132, at 365 (reasoning that non-willful FBAR violations may be assessed against any individual who has an obligation to file, whether or not the individual knew about that obligation).

2. Willful Violations. The maximum statutory penalty for a willful violation of FBAR reporting requirements is the greater of $100,000 or 50% of the balance in the unreported account at the time of the violation.[136] The Internal Revenue Manual provides that "in most cases, the total penalty amount for all years under examination will be limited to 50 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination."[137] Yet the IRS has assessed the fifty-percent penalty for each year, within the statute of limitations, in which the reporting was noncompliant, as the language of the IRM leaves open this possibility.[138]

The test for willfulness is whether there was a "voluntary, intentional violation of a known legal duty."[139] However, taxpayers who are "willful[ly] blind[]" or reckless may also be determined to have committed a willful violation.[140] Willful blindness can be established when someone deliberately acts to avoid learning of reporting requirements.[141] Recklessness can be established when someone ought to have known of the reporting requirements.[142]

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[136] 31 U.S.C. § 5321(a)(5)(C)(i)–(D)(ii). Note that the statutory language here differs from the paragraph for non-willful violations in that it refers to "the account" specifically, implying that the IRS can assess the aforementioned penalty for each of an individual's unreported accounts. *Compare* 31 U.S.C. § 5321(a)(5)(B)(i) ("[T]he amount of any civil penalty . . . shall not exceed $10,000."), *with* 31 U.S.C. § 5321(a)(5)(C)(i)(II), (a)(5)(D)(ii) ("[T]he maximum penalty . . . shall be . . . 50 percent of . . . the balance in the account at the time of the violation.").

[137] IRM 4.26.16.6.5.3(2) (Nov. 6, 2015).

[138] SALTZMAN & BOOK, *supra* note 93, ¶ 12.04[3][b] ("The Service takes the position that the 50 percent willful penalty can apply to each year for which the statute of limitations is open."). *But see* United States v. Warner, 792 F.3d 847, 860 (7th Cir. 2015) (questioning whether the multi-year penalties for willful FBAR violations are proper).

[139] Cheek v. United States, 498 U.S. 192, 200–01 (1991) (quoting United States v. Bishop, 412 U.S. 346, 360 (1973)); *see also* I.R.M. 4.26.16.5.1(1) (Nov. 6, 2015) (implementing the *Cheek* definition of willfulness in the context of willful FBAR violations).

[140] IRM 4.26.16.6.5.1 (Nov. 6, 2015).

[141] *See* United States v. Williams, 489 F. App'x 655, 658 (4th Cir. 2012) ("Willfulness . . . can be inferred from a conscious effort to avoid learning about reporting requirements." (quoting United States v. Sturman, 951 F.2d 1466, 1476 (6th Cir. 1991))).

[142] *See* United States v. Vespe, 868 F.2d 1328, 1335 (3d Cir. 1989) (discussing a company's recklessness for paying other creditors instead of the taxes it should have known it did not previously pay); *see also* Robert W. Wood & Joshua D. Smeltzer, *What the IRS Says Is 'Willful' Keeps Expanding*, 164 TAX NOTES FED. 217, 218 (2019) (noting that the recklessness standard "can be even more broad" than willful blindness).

One way willfulness may be determined is by incorrectly completing a Form 1040 Schedule B, which asks "[a]t any time during [the year], did you have a financial interest in or signature authority over a financial account . . . located in a foreign country? . . . If 'Yes,' are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority?"[143] In *United States v. Williams*, the Fourth Circuit noted that the plaintiff had incorrectly completed a Form 1040 Schedule B under penalty of perjury and concluded that he had "constructive knowledge" of his requirement to file an FBAR.[144] The taxpayer in *Williams* claimed that he did not have knowledge of the filing requirements because he did not review his Form 1040 before signing and submitting it, but the court found "[t]his conduct constitute[d] willful blindness to the FBAR requirement."[145] The level of conduct that can be subject to the Bank Secrecy Act's harsh fines for willful violations is thus relatively low.

D. CRIMINAL PENALTIES AND PROSECUTION

Section 5322 of Title 31 makes it a felony to "willfully violat[e]" certain provisions of the Bank Secrecy Act, including the reporting requirement of § 5314, and sets the maximum statutory penalty at five years of incarceration and a $250,000 fine.[146] In general, the difference between tax evasion crimes and tax avoidance is an element of willfulness or purposeful evasion.[147] Thus, willful

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[143] U.S. DEP'T OF THE TREASURY, FORM 1040, SCHEDULE B—INTEREST AND ORDINARY DIVIDENDS (2019), https://www.irs.gov/pub/irs-pdf/f1040sb.pdf.

[144] *Williams*, 489 F. App'x at 659 (quoting Greer v. Comm'r, 595 F.3d 338, 347 n.4 (6th Cir. 2010)).

[145] *Id.* at 659; *see also* United States v. McBride, 908 F. Supp. 2d 1186, 1205–06 (D. Utah 2012) (holding that signing a tax return constitutes constructive knowledge of the FBAR filing requirement); Hale E. Sheppard, *What Constitutes a 'Willful' FBAR Violation?*, 129 J. TAX'N 24, 28 (2018) (noting an "[e]dging toward strict liability" for the willfulness culpability standard).

[146] 31 U.S.C. § 5322(a) (2018).

[147] *See* CAMILLA E. WATSON, TAX PROCEDURE AND TAX FRAUD IN A NUTSHELL 377–78 (5th ed. 2016) ("The complexity of the tax laws, and the human tendency to make errors, require that our society impose some sort of buffer between taxpayers and the threat of a prison sentence. The buffer provided by Congress is the willfulness requirement, which shields from conviction those who make innocent or even negligent errors, or who genuinely misunderstand the law.").

violations of the FBAR reporting requirement may lead to both civil and criminal action.[148]

In 2009, several years after a whistleblower informed the U.S. government that the Swiss bank UBS was facilitating tax evasion, the bank entered into a deferred prosecution agreement with the government, agreeing to pay a settlement of $780 million and to disclose the identities of the clients it assisted in evading U.S. taxes.[149] The disclosed names spawned a number of cases brought by the government against the holders of these Swiss accounts.[150] One of the cases that followed was that of Mary Estelle Curran.[151]

When Curran's husband passed away, he left her several foreign financial accounts that he had failed to declare.[152] During the next few years, when Curran filed her taxes, she also did not report the foreign financial accounts and did not indicate on her Form 1040 that she had such accounts.[153] When she learned about the FBAR reporting requirements, Curran soon thereafter attempted to make a voluntary disclosure of her failures to file FBARs in the past.[154] Unfortunately for Mrs. Curran, the government had already received her name from UBS and had begun a criminal investigation against her, making it too late for her to qualify for the OVDP requirements.[155] The government prosecuted Curran, and the parties entered into a plea agreement.[156] Under the agreement, Curran was required to pay back taxes plus an FBAR

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[148] *See supra* Section IV.C.*2*.

[149] *See* Deferred Prosecution Agreement at 3, 6, United States v. UBS AG, No. 09-cr-60033-JIC (S.D. Fla. Feb. 18, 2009).

[150] *See* Laura Saunders, *U.S. Is Preparing More Tax-Evasion Cases*, WALL ST. J. (Jan. 30, 2013, 7:32 PM) (recalling estimates that after the UBS disclosures "federal prosecutors are conducting at least 100 criminal investigations against suspected tax evaders").

[151] *Id.*

[152] *See* Defendant's Sentencing Memorandum in Support of a Sentence of Probation at 2, United States v. Curran, No. 9:12-cr-80206-KLR (S.D. Fla. Apr. 19, 2013) (describing how Curran's husband acquired the foreign financial accounts).

[153] *Id.* at 2–4.

[154] *See* Martha Neil, *Widow Who Owed $21.6M to Feds Gets 'Effectively 5 Seconds' of Probation, as Judge Scolds Government*, ABA J. (Apr. 26, 2013, 3:50 PM), http://www.abajournal.com/news/article/widow_who_owed_21.6m_to_feds_gets_effectively_5_seconds_of_probation_as_jud (describing Curran's attempt to voluntarily disclose failures to file FBARs).

[155] *Id.*

[156] *See* Plea Agreement, United States v. Curran, No. 9:12-cr-80206-KLR (S.D. Fla. Jan. 8, 2013).

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penalty of a whopping $21,666,929, as well as submit to a possible six-year prison sentence.[157] The judge called this a "tragic situation," stating that "the government should have used a little more discretion."[158] The judge sentenced Curran to probation but lifted it a few moments later, allowing Curran, then seventy-nine years old, to walk away free, apart from her multimillion-dollar tax and penalty liability.[159] The government pursued the case, perhaps "to send a message that no one is too old, or too rich, or too poor, or too sympathetic to escape criminal prosecution" for FBAR violations.[160] Curran pled guilty, but the judge in her case found her sympathetic enough to escape the harsh criminal penalties she faced.[161]

The consequences of not filing an FBAR to declare certain foreign financial accounts can be extremely severe—so much so that some taxpayers have claimed that these penalties violate the Eighth Amendment's excessive fines clause, an argument that courts have not endorsed.[162] Nevertheless, the scheme of penalties under the Bank Secrecy Act is harsh because of its inequity, with larger accounts yielding larger fines,[163] and lower levels of conduct (such as willful blindness) resulting in draconian penalties.[164]

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[157] *Id.* at 2, 6 (noting a "statutory maximum term of imprisonment of up to six years" and an obligation to "pay a penalty in the amount of $21,666,929, which is 50% of the year-end balances of the undeclared accounts for the year 2007, the year with the highest balances at year end").

[158] Neil, *supra* note 154 (quoting Judge Kenneth Ryskamp's comments about the case).

[159] *Id.* ("[Mrs. Curran] got 'effectively five seconds' of probation from a federal judge in an offshore tax-evasion case after paying a $21.6 million penalty and back taxes.").

[160] Saunders, *supra* note 150 (quoting Bryan Skarlatos, a lawyer with Kostelanetz & Fink in New York, theorizing why U.S. officials prosecuted Curran).

[161] *See* Neil, *supra* note 154 (noting that the judge's sentencing in this case was "unprecedented").

[162] *See* United States v. Bussell, 699 F. App'x 695, 696 (9th Cir. 2017) (holding that the defendant failed to establish that the penalties assessed against her were grossly disproportional "because [she] defrauded the government and reduced public revenues"), *cert. denied*, 138 S. Ct. 1697 (2018). *But see* United States v. Bajakajian, 524 U.S. 321, 324, 337 (1998) (holding that, under a different provision of the Bank Secrecy Act—namely, the requirement to report transportation of more than $10,000 in currency out of the country—a forfeiture of the entire amount of the transported currency was excessive under the Eighth Amendment).

[163] *See supra* text at notes 136–137.

[164] *See supra* text at notes 140–142.

V. ANALYSIS

Knowledge of the past treatment of foreign bank accounts and FBAR reporting requirements may help taxpayers prepare for the approaching storm of fines, penalties, prosecutions, and litigation over taxation of cryptocurrencies. Many similarities can be drawn between the government's concerns about foreign bank accounts and concerns about cryptocurrency.[165] And to the extent that the two topics are different, we may ask what material effect those differences will have on the government's response.[166]

A. PARALLELS

1. Criminal Activity. The Bank Secrecy Act was originally passed in 1970 because the government wanted to prevent criminal activity that was being promoted through the use of offshore accounts.[167] After the 9/11 terrorist attacks put the nation on heightened alert about illegal international activity, the government began taking FBAR enforcement more seriously.[168] Furthermore, the Treasury remains concerned with domestic tax crimes—wealthy individuals evading the tax law by moving assets offshore—and tax havens, which likely cost the Treasury $32 billion "in 2016 alone."[169] The government was able to recover just a portion of its lost revenue after the 2009 revelations concerning UBS and the ensuing success of the OVDP.[170] Many of the government's original concerns about foreign bank accounts apply with equal force to cryptocurrency.

A likely warranted perception exists that many people use cryptocurrencies to transact in contraband and to avoid banking

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[165] *See infra* Section V.A.

[166] *See infra* Section V.B.

[167] *See supra* notes 89–91 and accompanying text.

[168] *See supra* notes 94–100 and accompanying text.

[169] David Scharfenberg, *Trillions of Dollars Have Sloshed Into Offshore Tax Havens. Here's How to Get It Back*, BOSTON GLOBE (Jan. 20, 2018, 8:40 AM), https://www.bostonglobe.com/ideas/2018/01/20/trillions-dollars-have-sloshed-into-offshore-tax-havens-here-how-get-back/2wQAzH5DGRw0mFH0YPqKZJ/story.html; *see also* I.R.S. News Release FS-2014-6, *supra* note 119 ("Stopping offshore tax cheating and bringing individuals, especially high net-worth individuals, back into the tax system has been a top priority of the Internal Revenue Service for several years.").

[170] *See supra* note 119 and accompanying text.

and governmental scrutiny over monetary transactions.[171] The IRS may further believe that taxpayers are using cryptocurrencies to move money offshore or to repatriate funds clandestinely.[172] These concerns might lead Congress to curtail criminals' ability to use cryptocurrency to evade the law, just as it did in the case of foreign financial accounts. Whether Congress would again enact such harsh civil penalties after the unpopularity of the FBAR penalties is unknown, but owners of virtual currency should be prepared for such a contingency. Nevertheless, the IRS will continue its enforcement efforts.[173]

2. Underreporting. Another similarity between foreign bank account reporting and cryptocurrency transactions is the known lack of reporting compliance.[174] As noted, underreporting of foreign bank accounts prompted the government to pay a great deal of attention to FBAR compliance.[175] The government's response included special voluntary disclosure initiatives,[176] hiked penalties for failure to report,[177] criminal prosecutions,[178] and an ensnaring question on the Form 1040 Schedule B.[179] The response has been not merely educational, but aggressive.[180]

Virtual currency transactions experience a similar—and perhaps even more severe—lack of reporting,[181] and the IRS's response has in some ways been the same. As with the Justice Department's 2009 investigation of UBS, the IRS has begun seeking information from

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[171] *See* Foley et al., *supra* note 13, at 1800 (discussing widespread illicit use of cryptocurrency).

[172] *See* Sheppard, *supra* note 7, at 612 (noting that repatriation of offshore assets is often what "blows open" tax evasion cases).

[173] For examples of the IRS's enforcement efforts, see *supra* Part III.

[174] *See supra* notes 96–100 and accompanying text.

[175] *Id.*

[176] *See supra* Section IV.B.

[177] *See supra* Section IV.C.

[178] *See supra* Section IV.D.

[179] *See supra* Section IV.C.*2*.

[180] *See* SEC'Y OF THE TREASURY, *supra* note 96, at 11 (claiming that "[n]o amount of education and outreach will result in increased FBAR filings from" those who are "concealing income or are engaged in some kind of criminal activity").

[181] *Compare supra* note 96 and accompanying text (noting less than twenty percent compliance with FBAR reporting requirements in 2001), *with supra* notes 9–10 and accompanying text (noting perhaps less than one percent compliance with reporting requirements by cryptocurrency users from 2013 through 2015).

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cryptocurrency exchanges.[182] The government's actions against UBS were a prelude to actions against individuals.[183] Similarly, the IRS's actions against cryptocurrency exchanges like Coinbase are seeking user profiles including names, addresses, and transaction histories.[184] This approach portends a high degree of scrutiny of cryptocurrency reporting in the coming months and years, and it is likely only a matter of time before individual civil penalties and criminal prosecutions follow. Significantly, the IRS is now asking about virtual currencies on the Form 1040 Schedule 1.[185] The government may use the nondisclosure of virtual currencies on the Form 1040 to assert penalties for willful tax noncompliance, just as it did in *Williams*.[186] The IRS Chief Counsel Michael Desmond has threatened that there may be "serious consequences" in the case of a "mistake or misstatement" on the Schedule 1 when the transactions concern virtual currency.[187]

B. DISTINCTIONS

Certain differences between foreign bank account reporting and cryptocurrencies, however, may change the government's response.

1. Legislation. The taxation of cryptocurrency gains and the requirement to file an FBAR—regardless of the existence of income—are conceptually different. Taxation of gains from dealings in property is a well-established tenant of income tax law,[188] while

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[182] *See supra* Section III.B.

[183] *See supra* note 150 and accompanying text.

[184] *See supra* notes 65–68 and accompanying text; *see also* Michelle Ann Gitlitz, Carlos Ortiz, Jeffrey Rosenthal & Jed Silversmith, *IRS Not Contemplating Separate Voluntary Disclosure Program to Assist Taxpayers Who've Not Reported Cryptocurrency Income*, JDSUPRA (Nov. 15, 2018), https://www.jdsupra.com/legalnews/irs-not-contemplating-separate-20987/ (noting that the IRS is "following the playbook from the successful Swiss Bank program" and "will obtain information pertaining to tens of thousands of cryptocurrency account holders, which could be used to conduct civil audits and commence criminal investigations").

[185] *See supra* Section III.A. Note that under the Internal Revenue Code, as opposed to the Bank Secrecy Act, the IRS may rely on civil fraud charges. *See* I.R.C. § 6663(a) (2018) (imposing a seventy-five percent penalty on "any underpayment . . . attributable to fraud").

[186] *See* United States v. Williams, 489 F. App'x 655, 656–57, 660 (4th Cir. 2012) (finding willful tax noncompliance when the defendant incorrectly filled out a Form 1040 Schedule B and subsequently did not file an FBAR).

[187] Urban Institute, *supra* note 8.

[188] *See* I.R.C. § 61(a)(3) (2018) (listing "[g]ains derived from dealings in property" as a source of gross income).

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the FBAR only exists because the Bank Secrecy Act, motivated by desires to monitor international criminal activity, requires it.[189] Although enforcement of cryptocurrency taxation is also, to some extent, rooted in concerns about criminal activity, it does not require an act of Congress.[190]

If cryptocurrencies become more widely used and accepted, and if cryptocurrency developers continue to work to make transactions more private,[191] Congress may act to prevent people from shielding their funds from the government.[192] But this task would be challenging. Unlike financial accounts, blockchain is an emerging and developing technology.[193] As privacy-centric cryptocurrencies continue to attempt to evade detection, criminals become more technologically savvy, and the world economy becomes more decentralized, any grasp that Congress or the Treasury thinks it has on cryptocurrency may slip away without the government being able to keep up.

A separate legislative initiative might save taxpayers some headache in reporting their virtual currency gains. The Virtual Currency Tax Fairness Act of 2020[194] has been introduced in the House of Representatives. The Act would create an exclusion from income of any gains derived from virtual currency in personal transactions where the gain would not otherwise exceed $200.[195] If passed by Congress, this Act would by no means be a cure-all for the unanswered questions surrounding virtual currency transactions. For instance, the Act would require the IRS to issue regulations on how gains from virtual currency transactions are computed for

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[189] 31 U.S.C. § 5314(a) (2018) (mandating that the Secretary of the Treasury keep records of citizens doing business with foreign financial agencies); 31 C.F.R. § 1010.350(a) (2019) (requiring individuals to record their relationships with foreign financial entities through the Report of Foreign Bank and Financial Accounts).

[190] *See* Sapirie, *supra* note 49, at 1095–97 (listing criminal investigations as one aspect of the IRS cryptocurrency enforcement campaign, led by the agency, regardless of congressional action).

[191] *See* Lielacher, *supra* note 37 (discussing privacy-centric cryptocurrencies).

[192] *Cf.* Brown, *supra* note 111, at 250 (describing Congress's decision to enact new laws when FBAR compliance was insufficient for proper oversight of foreign transactions).

[193] *See, e.g.*, Rosic, *supra* note 26 (discussing new uses for blockchain and potential results from increased blockchain use); Weinstein, *supra* note 48 (discussing potential developments in financial industries based on blockchain).

[194] H.R. 5635, 116th Cong. (2020).

[195] *Id.* § 2(a).

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transactions where the taxpayer's gain would exceed $200.[196] However, the bill would legitimize virtual currencies as a means of everyday exchange, and it would avoid the imposition of penalties for minor transgressions.[197]

2. Subject for Criminal Prosecution. One open question is whether taxation of cryptocurrency is currently a proper target for criminal prosecution. Consider the case of *United States v. Garber*.[198] The defendant in *Garber* had an extremely rare blood antibody that made her blood particularly valuable.[199] The defendant sold her blood plasma in exchange for significant payments, some of which were not reported as income on her tax returns.[200] As a result, the IRS pursued a conviction "for knowingly misstating her income."[201] The Fifth Circuit reversed the trial court's conviction.[202] In doing so, the court found a lack of willfulness because of the unsettled nature of the law, in which no one could agree on the proper tax treatment of the defendant's income from selling her own plasma.[203] The court said that "[w]hen the taxability of unreported income is problematical as a matter of law, the unresolved nature of the law is relevant to show that defendant may not have been aware of a tax liability or may have simply made an error in judgment."[204]

The difficulties associated with determining an accurate representation of a transaction for blood plasma are very different

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[196] *See id.* § 2(c) (authorizing the Secretary to issue regulations for information returns on virtual currency transactions).

[197] *Contra supra* text accompanying note 132 (noting that the government reserves the possibility of assessing $10,000 non-willful FBAR penalties against accounts with relatively small balances).

[198] United States v. Garber, 607 F.2d 92, 100 (5th Cir. 1979) (holding that "[a] criminal proceeding pursuant to [the income tax code] is an inappropriate vehicle for pioneering interpretations of tax law").

[199] *Id.* at 93–94 (stating that Garber's "rare antibody [was] useful in the production of [a] blood group typing serum" and that several laboratories offered her "increasingly attractive price[s] for her plasma").

[200] *Id.* at 94 (noting that Garber did not pay income taxes on some payments she received).

[201] *Id.* at 93.

[202] *Id.* at 100.

[203] *Id.* (noting that although Garber was advised to include the income, "the tax question was completely novel and unsettled by any clearly relevant precedent"); *see also* United States v. Harris, 942 F.2d 1125, 1132 (7th Cir. 1991) ("If the obligation to pay a tax is sufficiently in doubt, willfulness is impossible as a matter of law . . . .").

[204] *Garber*, 607 F.2d at 98.

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when it comes to cryptocurrency. Yet one could argue that cryptocurrency, like the sale of blood plasma, is not currently an appropriate area for criminal prosecution because it may be difficult or impracticable to ascertain attributes such as basis, value, character, and timing needed for reporting. This argument is not without issues, however, because the IRS has provided guidance in the area of virtual currency, making it clear that all virtual currency transactions should be reported and clarifying the tax consequences of some common transactions.[205] Therefore, the possibility of a court's finding, under *Garber*, that taxation of cryptocurrency is not a proper subject for criminal prosecution is unlikely, but perhaps not impossible.

3. Voluntary Disclosure Initiatives. Some practitioners and commentators have suggested that the IRS implement a special voluntary disclosure program for those who want to disclose previously unreported cryptocurrency transactions.[206] Despite this call for relief, the IRS has said that it will not do so.[207] Therefore, taxpayers should not expect a more lenient way to come clean other than by existing IRS procedures.[208]

Considering that the offshore voluntary disclosure initiatives were (at times) very successful, one might ask why the IRS would not launch a similar program for cryptocurrency holders.

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[205] The IRS has made clear that cryptocurrency transactions will be treated like property transactions for tax purposes. *See supra* note 18. However, some of the IRS's more recent guidance has been criticized for its lack of authoritative and precedential value. *See supra* note 59. Compare this fact with the conclusion in *Harris*:

> [A] reasonably diligent taxpayer is entitled to look at the reported cases with the most closely analogous fact patterns when trying to determine his or her liability. When, as here, a series of such cases favors the taxpayer's position, the taxpayer has not been put on notice that he or she is in danger of crossing the line into criminality by adhering to that position.

Harris, 942 F.2d at 1134. Although there is no case law interpreting whether certain cryptocurrency transactions are taxable or not, there is disagreement about the validity of agency guidance.

[206] *See* Gitlitz et al., *supra* note 184 ("[M]any practitioners felt that a logical next step for the IRS would be to offer taxpayers a way to come back into compliance through a disclosure initiative similar to the program the IRS offered to taxpayers who had undisclosed foreign bank accounts.").

[207] *See id.* (reporting on a statement from the IRS Office of Chief Counsel).

[208] *See id.* ("While a special voluntary disclosure program may not be available, the IRS still offers a domestic voluntary disclosure program that enables taxpayers to come back into compliance in a manner that mitigates the risk of criminal prosecution.").

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Additionally, if part of the purpose of offshore voluntary disclosure was to "gather information about promoters of offshore schemes,"[209] could the IRS not use a voluntary cryptocurrency disclosure program to discover taxpayers' unreported virtual gains?

The likely answer is that the IRS believes it can obtain cryptocurrency transaction information another way. Many cryptocurrency transactions are not going to show up on anyone's Form 1099.[210] Nevertheless, Chief Counsel Michael Desmond has stated that "even without [information reporting], there are lots of sources of information for the IRS" concerning cryptocurrency transactions.[211] Part of what Desmond's reference includes is the John Doe summons to Coinbase from which the IRS received information about thousands of transactions.[212] This summons likely is not the end of the IRS's attempts to obtain a larger number of filings reporting cryptocurrency transactions by threatening to discover taxpayers' failures to report itself.

VI. CONCLUSION

Taxation of virtual currencies is far from simple. The correct and sensible result is more complex than a blanket statement that virtual currency transactions should be taxed as property transactions. The IRS has recognized this and has, in the last few years (even as this Note was being written), attempted to answer some of the many open questions created by the evolving landscape of virtual currencies.

As one commentator has noted, a lack of guidance on the issue of virtual currency reporting may be better for taxpayers.[213] As long as taxpayers can claim a reasonable basis for their beliefs about their reporting of their dealings in virtual currencies, they have some

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[209] *See* Brown, *supra* note 111, at 249.

[210] Coinbase has begun issuing 1099 information reports to its customers and has begun reporting transactions to the IRS, but this is not yet broadly required. *See* COINBASE, *supra* note 69 (answering questions about Form 1099-K).

[211] Urban Institute, *supra* note 8.

[212] *See* United States v. Coinbase, Inc., No. 17-cv-01431-JSC, 2017 WL 6997649, at *1 (N.D. Cal. Nov. 29, 2017) (outlining the documents Coinbase must turn over to the IRS).

[213] Jonathan Curry, *Lack of Virtual Currency Guidance May Not Be So Bad After All*, 161 TAX NOTES 1027, 1027 (2018) ("[T]axpayers might be better off without [additional guidance on how to report virtual currency] for now anyway, one official says.").

defense against penalties and charges.[214] But if a taxpayer fails to include a sale of cryptocurrency on their tax returns at all—when the IRS has been clear that virtual currencies are taxable as property—then the taxpayer may have a hard time arguing that they had a reasonable basis to exclude income from the transaction.[215]

Undoubtedly, the IRS will continue to focus on taxing gains from dealings in cryptocurrency. The only question is what form that focus will take. To tackle cryptocurrencies, the IRS cannot use the draconian statutory penalties of the Bank Secrecy Act. Moreover, the issues surrounding taxation of cryptocurrency are less clearly defined than the simpler issue of foreign financial accounts. Therefore, the taxpayer may have less to fear.

However, the IRS is tracking cryptocurrencies closely. Criminal cases for tax evasion stemming from cryptocurrency gains will likely arise in the near future. Just as the government "raise[d] the cost of being an FBAR scofflaw,"[216] the IRS hopes to increase the tax paid on virtual currency gains through summonses, penalties, prosecutions, and intimidation. This Note is not meant to unequivocally criticize the IRS's response to the problem of underreporting of virtual currency transactions. The agency has made great efforts to educate and warn taxpayers of their reporting obligations and has solicited and employed help and comment from industry experts in crafting its response—a difficult task, given the constantly evolving nature of blockchain and cryptocurrencies. Through all this, the IRS hopes to send a message, just as hedge fund manager and bitcoin investor Michael Novogratz implored young cryptocurrency users: "Pay your taxes!"[217]

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[214] *Id.* ("[A]s long as taxpayers are . . . taking a reasonable position, the IRS likely won't challenge it . . . ."); *see* I.R.C. § 6664(c)(1) (2018) ("No penalty shall be imposed . . . with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.").

[215] *Cf.* Curry, *supra* note 213, at 1027 (anticipating a lack of "pushback" from the IRS provided the taxpayer "take[s] 'reasonable positions'").

[216] SEC'Y OF THE TREASURY, *supra* note 96, at 11.

[217] Gary Shteyngart, *One Good Bet*, THE NEW YORKER, Apr. 16, 2018, at 47.

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