



United States Government Accountability Office

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Report to the Ranking Member,  
Committee on Ways and Means, House  
of Representatives

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# VIRTUAL CURRENCIES

## Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance

Accessible Version

February 2020

# GAO Highlights

Highlights of [GAO-20-188](#), a report to the Ranking Member, Committee on Ways and Means, House of Representatives

## Why GAO Did This Study

Virtual currencies, such as bitcoin, have grown in popularity in recent years. Individuals and businesses use virtual currencies as investments and to pay for goods and services. GAO was asked to review IRS's efforts to ensure compliance with tax obligations for virtual currencies.

This report examines (1) what is known about virtual currency tax compliance; (2) what IRS has done to address virtual currency tax compliance risks; (3) the extent to which IRS's virtual currency guidance meets taxpayer needs; and (4) whether additional information reporting on virtual currency income could assist IRS in ensuring compliance.

GAO reviewed IRS forms and guidance and interviewed officials at IRS, FinCEN, and other federal agencies, as well as tax and virtual currency stakeholders.

## What GAO Recommends

GAO is recommending that IRS clarify that part of the 2019 guidance is not authoritative and take steps to increase information reporting, and that FinCEN and IRS address how foreign asset reporting laws apply to virtual currency. IRS agreed with the recommendation on information reporting and disagreed with the other two, stating that a disclaimer statement is unnecessary and that it is premature to address virtual currency foreign reporting. GAO believes a disclaimer would increase transparency and that IRS can clarify foreign reporting without waiting for future developments in the industry. FinCEN agreed with View [GAO-20-188](#). For more information, contact James R. McTigue, Jr., at (202) 512-9110 or [mctiguej@gao.gov](mailto:mctiguej@gao.gov)

February 2020

## VIRTUAL CURRENCIES

### Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance

## What GAO Found

Taxpayers are required to report and pay taxes on income from virtual currency use, but the Internal Revenue Service (IRS) has limited data on tax compliance for virtual currencies. Tax forms, including the information returns filed by third parties such as financial institutions, generally do not require filers to indicate whether the income or transactions they report involved virtual currency.

IRS also has taken some steps to address virtual currency compliance risks, including launching a virtual currency compliance campaign in 2018 and working with other agencies on criminal investigations. In July 2019, IRS began sending out more than 10,000 letters to taxpayers with virtual currency activity informing them about their potential tax obligations.

IRS's virtual currency guidance, issued in 2014 and 2019, addresses some questions taxpayers and practitioners have raised. For example, it states that virtual currency is treated as property for tax purposes and that using virtual currency can produce taxable capital gains. However, part of the 2019 guidance is not authoritative because it was not published in the Internal Revenue Bulletin (IRB). IRS has stated that only guidance published in the IRB is IRS's authoritative interpretation of the law. IRS did not make clear to taxpayers that this part of the guidance is not authoritative and is subject to change.

#### Examples of Virtual Currency Transactions that Can Produce Taxable Capital Gains



Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

Information reporting by third parties, such as financial institutions, on virtual currency is limited, making it difficult for taxpayers to comply and for IRS to address tax compliance risks. Many virtual currency transactions likely go unreported to IRS on information returns, due in part to unclear requirements and reporting thresholds that limit the number of virtual currency users subject to third-party reporting. Taking steps to increase reporting could help IRS provide taxpayers useful information for completing tax returns and give IRS an additional tool to address noncompliance.

Further, IRS and the Financial Crimes Enforcement Network (FinCEN) have not clearly and publicly explained when, if at all, requirements for reporting financial assets held in foreign countries apply to virtual currencies. Clarifying and providing publicly available information about those requirements could improve the data available for tax enforcement and make it less likely that taxpayers will file reports that are not legally required.

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#### Abbreviations

CFTC	Commodity Futures Trading Commission
CI	Criminal Investigation division
FAQs	frequently asked questions
FATCA	Foreign Account Tax Compliance Act
FBAR	Report of Foreign Bank and Financial Accounts
FBI	Federal Bureau of Investigation
FinCEN	Financial Crimes Enforcement Network
IRB	Internal Revenue Bulletin
IRS	Internal Revenue Service
J5	Joint Chiefs of Global Tax Enforcement
LB&I	Large Business and International division
NRP	National Research Program
RAAS	Research, Applied Analytics, and Statistics
SAR	Suspicious Activity Report
SB/SE	Small Business/Self-Employed division
SEC	Securities and Exchange Commission
TIGTA	Treasury Inspector General for Tax Administration
Treasury	Department of the Treasury
VCIT	Virtual Currency Issue Team

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February 12, 2020

The Honorable Kevin Brady  
Ranking Member  
Committee on Ways and Means  
House of Representatives

Dear Mr. Brady:

Virtual currencies—digital representations of value that generally are not government issued—have grown in popularity since their introduction more than a decade ago. According to the Internal Revenue Service (IRS), there are currently more than 5,000 known virtual currencies. Individuals and businesses use virtual currencies as investments and to make or accept payments for goods and services, among other uses. These virtual currencies account for the equivalent of hundreds of millions of dollars or more in daily transactions. The growth of virtual currencies has raised questions about whether taxpayers who use them are fully meeting their tax obligations.

According to IRS guidance, virtual currencies are treated as property for tax purposes and income from virtual currency use is reportable on tax returns. If taxpayers who use virtual currencies do not comply with their tax obligations, they contribute to the tax gap, the difference between taxes that are owed and actually paid. In September 2019, IRS estimated an average annual gross tax gap of \$441 billion for tax years 2011 to 2013.

You asked us to review IRS's efforts related to virtual currency tax compliance, guidance, and information reporting, which involves third parties, such as financial institutions, reporting information on taxpayer income or transactions to IRS and taxpayers. This report (1) describes what is known about virtual currency tax compliance; (2) describes the steps IRS has taken to address virtual currency tax compliance risks; (3) evaluates the extent to which IRS's virtual currency guidance meets taxpayer needs; and (4) evaluates whether additional information reporting could assist IRS in ensuring compliance.

To describe what is known about virtual currency tax compliance and the steps IRS has taken to address virtual currency tax compliance risks, we reviewed IRS documentation on the agency's virtual currency tax

enforcement efforts, including information about the Large Business and International Division's virtual currency compliance campaign, which was launched in 2018 to address noncompliance related to the use of virtual currency through outreach and examinations. We interviewed IRS officials about any data the agency had on virtual currency tax compliance. For virtual currency tax compliance issues, we also interviewed a nongeneralizable selection of tax practitioners, tax attorneys, virtual currency industry advocates, and virtual currency exchange executives.<sup>1</sup> We selected these stakeholders to interview using a snowball sampling approach, and, in total, we interviewed five individual stakeholders and representatives of 10 entities. We also interviewed officials from the Financial Crimes Enforcement Network (FinCEN), Commodity Futures Trading Commission (CFTC), and Securities and Exchange Commission (SEC) about coordination efforts that have been made across agencies regulating virtual currencies.

To evaluate the extent to which IRS's virtual currency guidance meets taxpayer needs, we reviewed IRS's guidance specific to virtual currency, including Notice 2014-21, issued in March 2014, as well as Revenue Ruling 2019-24 and Frequently Asked Questions (FAQs) released in October 2019. We also reviewed and analyzed all of the public comments IRS had received on Notice 2014-21 as of August 19, 2019. To assess the reliability of these data, we requested information from IRS to identify the quality controls in place to help ensure all comments were processed. We determined that the data were sufficiently reliable for our purposes.

Prior to IRS issuing the Revenue Ruling and FAQs in October 2019, we interviewed the stakeholders mentioned above to determine any taxpayer concerns, any compliance challenges with virtual currency tax obligations, and the extent to which IRS's guidance was meeting taxpayer needs. After the new guidance was issued, we contacted these same stakeholders to gather their perspectives on the new guidance, and received responses from four of the five individuals and six of the 10 organizations we had contacted.

To evaluate whether additional information reporting could assist IRS in ensuring compliance, we reviewed IRS's requirements for information reporting for virtual currency transactions. We interviewed IRS officials about how IRS's third-party and taxpayer information reporting processes

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<sup>1</sup>Virtual currency exchanges provide a platform where users can transact in different types of virtual currencies or exchange them for government-issued currencies or other virtual currencies.

and forms assist in detecting noncompliance for virtual currencies. We reviewed the websites of a judgmental selection of nine major virtual currency exchanges based in the United States to identify any policies about tax information reporting. We also interviewed the stakeholders mentioned above to obtain their views on what virtual currency information is being reported to IRS; whether additional information reporting would help to ensure tax compliance; and, in interviews with executives from two virtual currency exchanges, what burden, if any, information reporting does or could impose on virtual currency exchanges and virtual currency users.

We conducted this performance audit from October 2018 to February 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### Types and Uses of Virtual Currency

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While there is no statutory definition for virtual currency, IRS guidance has described virtual currency as a digital representation of value that functions as a medium of exchange, a unit of account, or a store of value.<sup>2</sup> Some virtual currencies can be used to buy real goods and services and can be exchanged for U.S. dollars or other currencies.

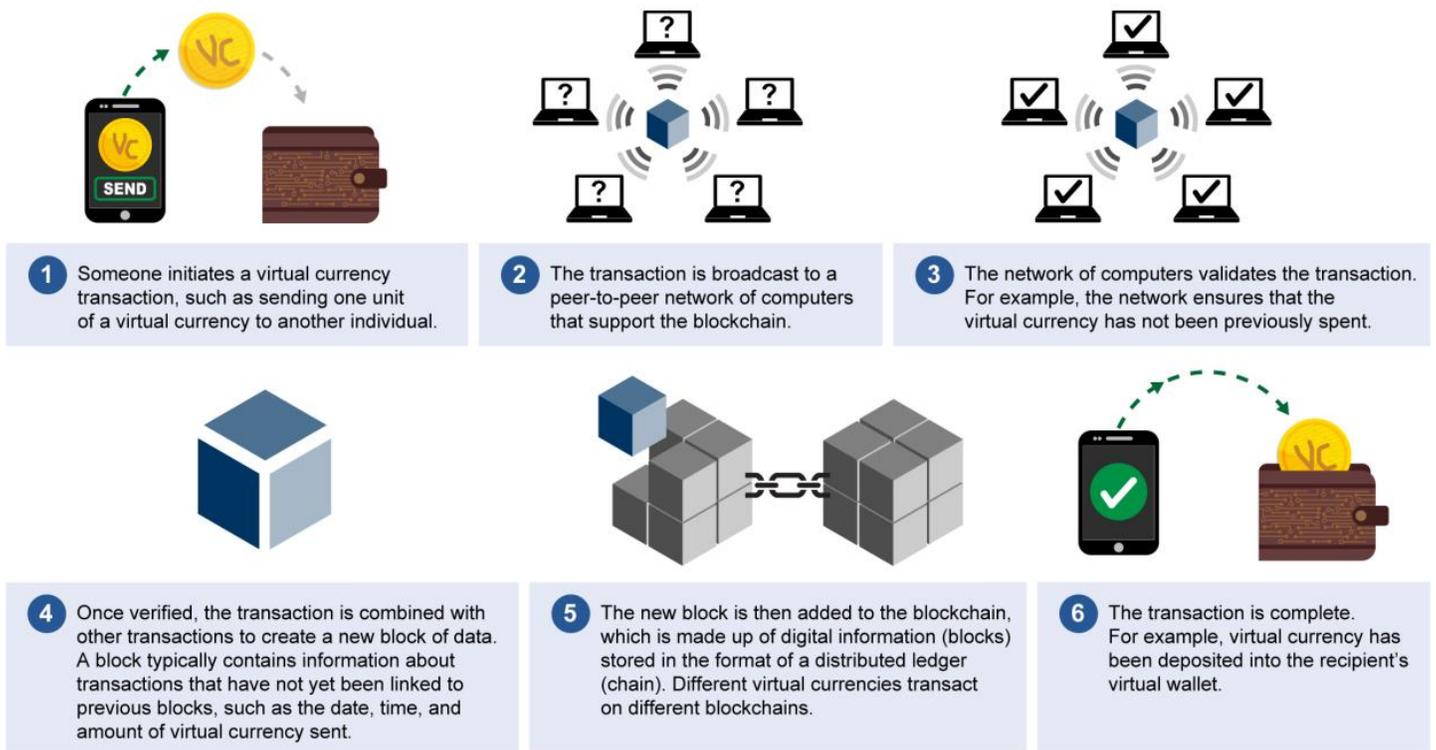
A cryptocurrency is a type of virtual currency that employs encryption technology and operates on distributed ledger technology, such as blockchain. Distributed ledger technology allows for users across a computer network to verify the validity of transactions potentially without a central authority. For example, a blockchain is made up of digital information (blocks) recorded in a public or private database in the format of a distributed ledger (chain). The ledger permanently records, in a chain of cryptographically secured blocks, the history of transactions that take

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<sup>2</sup>The term virtual currency is sometimes used interchangeably with other terms, such as digital asset or cryptocurrency. The term digital asset, as used by the Securities and Exchange Commission, refers to an asset that is issued and transferred using distributed ledger technology, including, but not limited to, virtual currencies.

place among the participants in the network. For the purposes of this report, we use the term virtual currency as a broad term that includes both cryptocurrencies, which use distributed ledger technology, and digital units of exchange that do not use that technology but still meet IRS’s definition of a convertible virtual currency, as defined in Notice 2014-21.<sup>3</sup> Figure 1 shows a simplified representation of how distributed ledger technology is used to circulate virtual currencies.

**Figure 1: Example of How a Virtual Currency Operates Using Blockchain, a Distributed Ledger Technology**



Source: GAO. | GAO-20-188

Note: This figure is a simplified depiction and does not portray how all blocked distributed ledger processes function.

Bitcoin, which emerged in 2009, is the first and most widely circulated blockchain-based cryptocurrency. Bitcoins are created through a process called mining. Bitcoin miners download software to solve complex equations to verify the validity of transactions taking place on the network,

<sup>3</sup>For more information, see GAO, *Science and Tech Spotlight: Blockchain & Distributed Ledger Technologies*, [GAO-19-704SP](#) (Washington, D.C.: Sept. 16, 2019).

and the first miner to solve a problem is awarded coins in return. Once a problem is solved, the transactions are added as a new block to the distributed ledger.

Users transact in virtual currencies electronically through a network, and may use virtual wallets to manage their virtual currency.<sup>4</sup> Some virtual currencies can be used as investments and to purchase goods and services in the real economy. For example, some retailers accept virtual currency as a form of payment. Virtual currency exchanges provide a platform where users can transact in different types of virtual currencies or exchange them for government-issued currencies or other virtual currencies.

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## Estimates of the Size of the Virtual Currency Market

The fair market value of some virtual currencies has changed dramatically over time. For example, according to one index, the average value of one bitcoin was just under \$20,000 in mid-December 2017.<sup>5</sup> By early February 2018, one bitcoin was valued at about \$7,000, before falling below \$4,000 in December 2018, and again rising to over \$9,000 in November 2019.

The size of the virtual currency market is unknown due to limitations in available data. For example, one recent analysis concluded that a widely cited source for data about bitcoin trading included exaggerated data that gave an inflated impression of the size of the actual market.<sup>6</sup>

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<sup>4</sup>Virtual wallets do not store money like traditional wallets, as there is no storage of digital coins following a transaction between users. Virtual wallets can store public keys, private keys, and addresses. Public keys are used to create addresses and verify signatures generated with private keys. Addresses function like account numbers used to send and receive virtual currencies. Private keys are used to sign transactions. For example, when one user sends virtual currency to another user, the sender signs off on the transfer of the virtual currency from the sender's address to the recipient's address. To be able to spend the virtual currency, the recipient must know the private key associated with the recipient's address. The transaction is signified by a transaction record on the blockchain and a change in balance of the users' addresses.

<sup>5</sup><https://coinmarketcap.com/currencies/bitcoin/historical-data/> (accessed December 4, 2019).

<sup>6</sup>Matthew Hougan, Hong Kim, and Micah Lerner, *Economic and Non-Economic Trading in Bitcoin: Exploring the Real Spot Market for the World's First Digital Commodity* (Bitwise Asset Management, May 2019).

Nonetheless, there are data that may provide some context for the size of this market:<sup>7</sup>

- As of April 2019, 10 major virtual currency exchanges collectively handled an average daily trading volume in bitcoin of more than \$500 million, according to Bitwise. For comparison, the Federal Reserve Banks' Automated Clearing House (a traditional payment processor) processed \$103 billion in payment transactions on average per day in 2018.
- According to one index, the total market capitalization of bitcoin, the most widely circulated virtual currency, is estimated to have ranged between \$60 billion and \$225 billion between December 2018 and October 2019.<sup>8</sup>
- As of November 2019, Coinbase, a large U.S.-based cryptocurrency exchange, reports a user base of more than 30 million.
- According to economists at the Federal Reserve Bank of New York, a 2018 survey they conducted found that 85 percent of respondents had heard of cryptocurrencies, 5 percent currently or previously owned cryptocurrency, and 15 percent reported that they were considering buying cryptocurrency.<sup>9</sup>

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## Regulation of Virtual Currency

Federal agencies, including CFTC, FinCEN, and SEC, have jurisdiction over various aspects of virtual currency markets and market participants. In May 2014, we reported on the federal financial regulatory and law enforcement agency responsibilities related to the use of virtual currencies and their associated challenges.<sup>10</sup> These challenges include money laundering, transfers of funds across borders, and consumer and

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<sup>7</sup>Given these limitations, we did not test the reliability of data. We provide some figures to provide context for the possible size of the virtual currency market.

<sup>8</sup><https://blockchain.info> (accessed November 5, 2019).

<sup>9</sup>Sean Hundtofte, Michael Lee, Antoine Martin, and Reed Orchinik, "Deciphering Americans' Views on Cryptocurrencies," Federal Reserve Bank of New York *Liberty Street Economics* (blog), accessed on April 23, 2019, <https://libertystreeteconomics.newyorkfed.org/2019/03/deciphering-americans-views-on-cryptocurrencies.html>.

<sup>10</sup>See GAO, *Virtual Currencies: Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges*, [GAO-14-496](#) (Washington, D.C.: May 29, 2014).

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investor protection issues. We also reported on the regulatory complexity for virtual currencies and the approaches that federal and state regulators have taken to their regulation and oversight.<sup>11</sup> For example, CFTC has taken the position that bitcoin and ether, another virtual currency, meet the definition of a commodity provided in the Commodity Exchange Act. SEC has determined that some virtual currencies may be designated as securities, based on the characteristics of how they are offered and sold.<sup>12</sup> FinCEN determined that certain virtual currency businesses would be money transmitters under the Bank Secrecy Act, subject to regulation as money services businesses.<sup>13</sup>

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## Tax Treatment of Virtual Currency

According to IRS guidance, convertible virtual currencies—which have an equivalent value in real currency or act as a substitute for real currency—are to be treated as property for tax purposes.<sup>14</sup> Among other things, this classification means that income, including gains, from virtual currency transactions is reportable on taxpayers' income tax returns. Therefore, a payment for goods or services made using virtual currency may be subject to tax to the same extent as any other payment made in property. Figure 2 illustrates examples of how virtual currency transactions can affect taxes.

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<sup>11</sup>See GAO, *Financial Technology: Information on Subsectors and Regulatory Oversight*, [GAO-17-361](#) (Washington, D.C.: Apr. 19, 2017).

<sup>12</sup>Securities and Exchange Commission, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207 (July 25, 2017).

<sup>13</sup>FinCEN, "Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies," FIN-2019-G001, May 9, 2019, <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.

<sup>14</sup>IRS Notice 2014-21.

**Figure 2: Examples of Virtual Currency Transactions That Can Affect Taxes**

**Transactions That Could Affect Taxable Income**



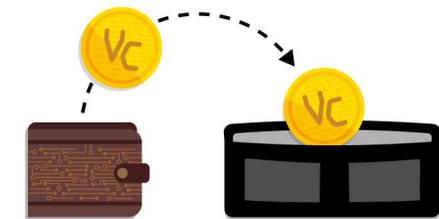
Selling virtual currency for U.S. dollars.



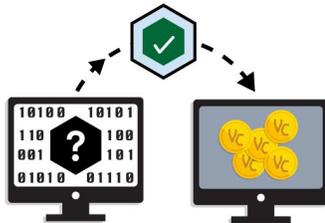
Exchanging one type of virtual currency for another.



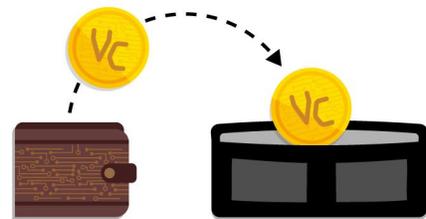
Buying virtual currency with dollars and holding on to it.



Receiving virtual currency for services.



Mining virtual currency.



Sending virtual currency to a different virtual wallet or account with the same owner.

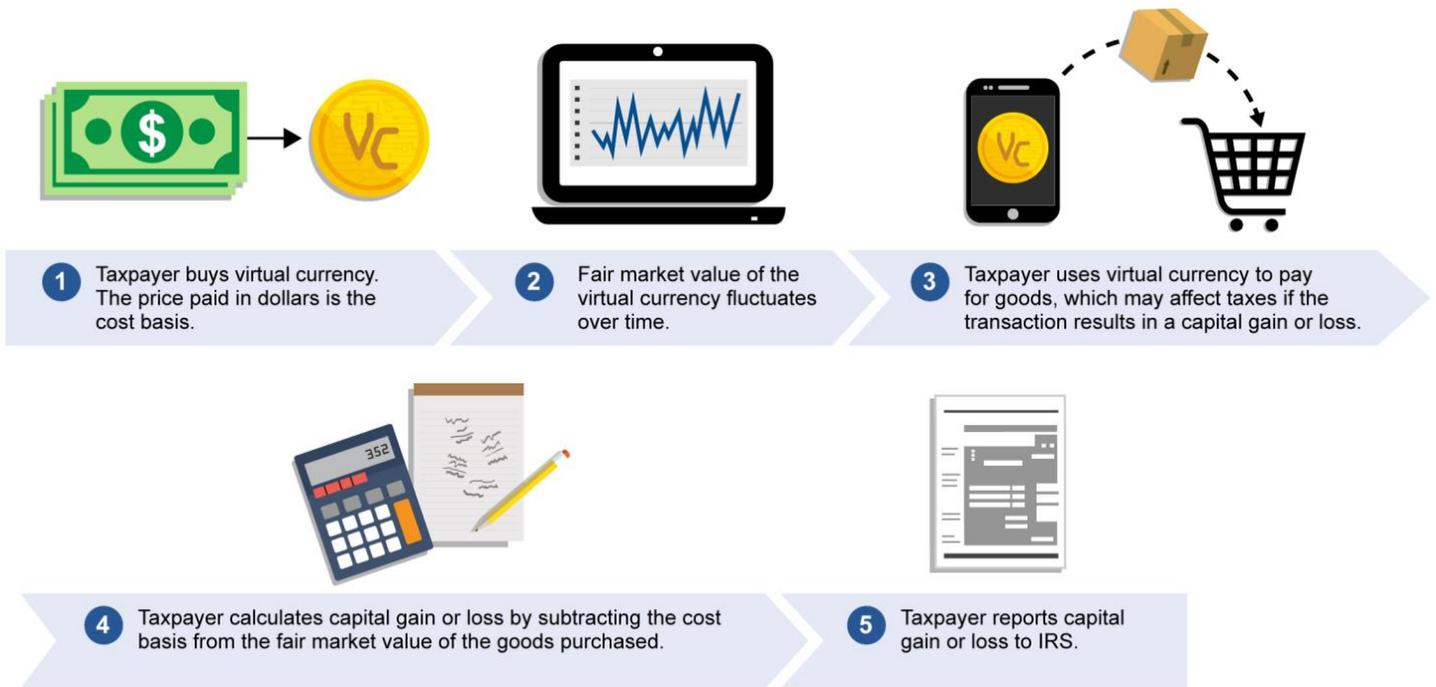
Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

Taxpayers using virtual currency must keep track of transaction-level information, such as the fair market value of the virtual currency at the time it was obtained, to determine tax basis and calculate gains or losses. The gain or loss from the sale or exchange of virtual currency is characterized as either a capital gain or loss or an ordinary gain or loss, depending on whether the virtual currency is held as a capital asset.<sup>15</sup> Taxpayers are required to report their gains or losses from virtual currency on their tax returns, including Form 1040, *U.S. Individual Income Tax Return*, and Form 8949, *Sales and Other Dispositions of Capital*

<sup>15</sup>According to IRS Notice 2014-21, a taxpayer generally realizes a capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. For example, stocks, bonds, and other investment property are generally capital assets. A taxpayer generally realizes ordinary gain or loss on the sale or exchange of virtual currency that is not a capital asset in the hands of the taxpayer. Inventory and other property held mainly for sale to customers in a trade or business are examples of property that is not a capital asset. Capital gains may be subject to lower tax rates than ordinary gains. Capital gains and losses are classified as long-term or short-term. Generally, if a taxpayer holds the asset for more than one year before disposing of it, the capital gain or loss is long-term. If a taxpayer holds it one year or less, the capital gain or loss is short-term. For more information, see IRS Publication 544, *Sales and Other Dispositions of Assets*.

Assets, for capital gains or losses. Figure 3 shows one example of how using virtual currencies could result in a capital gain or loss.

Figure 3: Tax Implications of Paying for Goods Using Virtual Currencies



Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

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## Data on Tax Compliance for Virtual Currencies Are Limited

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### Tax and Information Returns Do Not Specifically Capture Information on Virtual Currency Income and Transactions

IRS has limited data on tax compliance for virtual currency use, partly because the forms taxpayers use to report their taxable income do not require them to identify whether the source of their income is from virtual currency use. Likewise, information returns that third parties, such as employers, financial institutions, or other entities, file to report taxpayer income or transactions do not include space for, or direction to, indicate if the income or transactions reported involved a virtual currency.

In 2016, the Treasury Inspector General for Tax Administration (TIGTA) found that IRS had not developed a methodology for gathering data on virtual currency use in taxable transactions that would help to analyze the risk of noncompliance and to estimate its significance. TIGTA recommended that IRS revise third-party information returns to identify the amounts of virtual currency used in taxable transactions. IRS agreed with the recommendation, but stated that it faced other higher priority funding needs, and did not consider modifying information reporting forms to be a priority at the time. As of February 5, 2020, IRS has not implemented any changes to these information returns to include information about virtual currency use.

However, IRS added a question about virtual currency to Schedule 1, *Additional Income and Adjustments to Income*, of Form 1040 for tax year 2019. Individual taxpayers use Schedule 1 to report additional income, such as capital gains, unemployment compensation, prize or award money, and gambling winnings. IRS added a question asking if taxpayers received, sold, sent, exchanged, or otherwise acquired any financial interest in any virtual currency during the tax year. Only taxpayers who are otherwise required to file Schedule 1 or who would answer “yes” to the question need to file this schedule. According to IRS officials responsible for examining tax returns, IRS’s focus is on ensuring taxpayers are reporting all of their taxable income and it is not necessary to distinguish between virtual currency transactions and other property transactions being reported.

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## IRS Has Data on a Small Number of Taxpayers

Because IRS forms have not required taxpayers to explicitly identify income from virtual currency, IRS uses data from other sources to inform compliance decisions and research. These sources include:

- **Searches of tax return databases.** For tax years 2013 to 2015, IRS searched electronically filed Forms 8949 to identify how often taxpayers included language in the property description to indicate the transaction likely involved bitcoin, the most widely traded virtual currency at the time. For the 3 years, IRS identified fewer than 900 taxpayers who reported virtual currency activity each year. IRS officials said that due to the time and resources required to generate these data, IRS did not generate these filing statistics for tax years 2016 or later. By comparing these data to the size of the bitcoin market, IRS concluded that many taxpayers were likely not reporting income from virtual currency use.
- **Third party information reports.** To address tax noncompliance risks for virtual currencies, in December 2016, IRS served a John Doe summons to Coinbase, a U.S.-based cryptocurrency exchange.<sup>16</sup> After IRS later narrowed the scope of the summons, it requested identifying and transactional data for all Coinbase users with a U.S. address, U.S. telephone number, U.S. email domain, or U.S. bank account that transacted with Coinbase between January 1, 2013, and December 31, 2015 that had the equivalent of \$20,000 in any one transaction type (a buy, sell, send, or receive) in any year during that period. According to an announcement posted on Coinbase's website, on February 23, 2018, Coinbase notified approximately 13,000 customers that it expected to deliver information about their accounts to IRS within 21 days.<sup>17</sup> In addition, IRS officials stated that IRS had received information returns from a small number of virtual currency exchanges for tax year 2017.

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<sup>16</sup>A John Doe summons is a court-ordered summons that allows IRS to seek information about all taxpayers in a certain group, such as those with accounts at a certain financial institution, without knowing individual identities beforehand. The law authorizing a John Doe summons requires IRS to establish in a federal court proceeding that the summons relates to the investigation of a particular person or ascertainable group or class of persons; there is a reasonable basis to believe that the targeted person or group may fail or may have failed to comply with tax laws; and that the information is not readily available from other sources. 26 U.S.C. § 7609(f).

<sup>17</sup>"IRS Notification," Coinbase, accessed October 3, 2019, <https://support.coinbase.com/customer/portal/articles/2924446-irs-notification>. Due to taxpayer privacy protections, we are unable to report on whether IRS received these data or not.

- **Third-party reports of potential fraud.** IRS also has access to information on potential fraud reported to IRS and FinCEN by third parties. Financial institutions and money services businesses, which could include virtual currency exchanges, are to file a Suspicious Activity Report (SAR) if they observe or identify suspicious financial activity.<sup>18</sup> SAR reporting can help IRS in identifying potential income underreporting, money laundering, and other potential tax-related violations and crimes.<sup>19</sup> IRS may also receive information about tax noncompliance involving virtual currencies from whistleblowers and other referral programs.
- **Voluntary disclosures by taxpayers.** In March 2019, IRS updated Form 14457, *Voluntary Disclosure Practice Preclearance Request and Application*, to include a space specifically for taxpayers to disclose that they have unreported virtual currency income. IRS's Criminal Investigation division (CI) reviews the forms IRS receives to ensure they meet criteria of eligibility and timeliness, and that the disclosure does not apply to illegal sources of income. CI sends forms that meet the criteria to two of IRS's civil operating divisions—Large Business & International (LB&I) and Small Business/Self-Employed (SB/SE)—for review.<sup>20</sup> According to IRS officials, the addition of virtual currency to the form was made to assist IRS employees in routing the forms to the correct subject matter experts in the civil operating divisions.

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## IRS Included Virtual Currencies in Research Projects

According to officials with IRS's Research, Applied Analytics, and Statistics (RAAS) division, RAAS had begun some virtual currency research projects to better understand virtual currency tax compliance. One project, which RAAS completed, was to develop compliance profiles for taxpayers that LB&I had identified through its compliance efforts as having virtual currency activity. RAAS officials also said that they are enhancing their use of a range of third-party information reporting, including reporting of virtual currency activity, to improve IRS's ability to

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<sup>18</sup>31 U.S.C. § 5318(g) provides for the reporting of suspicious activities. FinCEN's regulations require money service businesses to file reports on any suspicious transaction relevant to a possible violation of law or regulation. 31 C.F.R. § 1022.320.

<sup>19</sup>Internal Revenue Manual Part 4, Chapter 26, Section 14.

<sup>20</sup>Criminal and civil matters are handled separately at IRS. IRS's civil divisions, which include LB&I and SB/SE, take administrative actions to enforce the tax code, including assessing tax and imposing civil penalties as appropriate. CI pursues criminal tax offenses that may lead to prosecution, criminal fines, and imprisonment.

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assess compliance risks. These efforts focus on use of data from multiple sources to better understand evolving risks and improve estimates of compliance risk. These projects support LB&I, SB/SE, CI, and IRS's broader research, analysis, and statistical reporting needs.

Virtual currency has not been included in past National Research Programs (NRP)—IRS's detailed study of voluntary tax compliance used as the basis for tax gap estimates. The most recent NRP study of individual tax returns was tax years 2011-2013, before virtual currencies became more widely used. RAAS officials said the time frame for the next NRP study of individual tax returns has not yet been determined, but virtual currency may be included in future NRP projects.

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## IRS Has Taken Some Steps to Address Virtual Currency Compliance Risks and Has Shared Information across Multiple Agencies

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### IRS Has Trained Staff on Virtual Currency and Begun Civil Enforcement Activities

In December 2013, IRS established the Virtual Currency Issue Team (VCIT) to study virtual currencies and related compliance issues. According to IRS officials, the VCIT aimed to learn about virtual currencies, educate examiners about them, and develop examination techniques to identify and address virtual currency tax compliance risks. In 2015, the VCIT provided two training lessons for examiners on the terminology, technology, and audit issues related to virtual currencies. The VCIT is made up of about 30 individuals and continues to meet periodically to discuss virtual currency issues.

In July 2018, IRS announced the launch of a virtual currency compliance campaign within LB&I to address noncompliance related to individual taxpayers' use of virtual currency through multiple education and enforcement actions, including outreach and examinations. The goals of the compliance campaign include identifying causes of noncompliance using feedback from examination results, using information to identify additional enforcement approaches to increase compliance and decrease taxpayer burden, and improving examiner knowledge and skills as related to virtual currency transactions. According to IRS officials, the compliance

campaign was initiated, in part, to analyze large amounts of data received from third-party sources.

As part of the campaign, IRS developed and delivered several online and in-person training classes on blockchain technology and virtual currencies to its examiners and other staff. The trainings included details on how to identify and understand blockchain transactions and provide examiners with information on how to seek additional information from taxpayers about possible virtual currency use. According to LB&I officials, as examiners provide feedback on what new issues they are seeing in cases involving virtual currency, they will schedule follow-up training sessions to address these new issues.

LB&I has also reached out to a number of external stakeholder groups to gather information and better understand the tax concerns within the virtual currency community. For example, LB&I and the IRS Office of Chief Counsel have spoken to tax practitioner groups, state tax authorities, IRS Nationwide Tax Forum participants, and tax preparation software companies.<sup>21</sup> According to IRS officials, the discussions they had with tax preparation software companies led to some adding questions to their programs asking taxpayers to enter virtual currency income when preparing their tax returns.

The compliance campaign also aims to assist in developing a comprehensive IRS virtual currency strategy. In addition to leading the compliance campaign, LB&I is also leading a working group focused on cryptocurrency that includes members from across IRS, including LB&I, SB/SE, CI, and the Office of Chief Counsel. This working group reports to the IRS Enforcement Committee, which includes the Deputy Commissioner for Services and Enforcement and the commissioners for each of the operating divisions and CI.

CI has been assisting in analyzing data received from third-party sources to look for potential investigative leads. According to CI officials, CI first reviews the data to identify any taxpayers who are already targets of CI investigations so that LB&I does not use the information in its civil

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<sup>21</sup>The Nationwide Tax Forum program is managed by IRS's Office of National Public Liaison. It provides information for tax professionals.

enforcement efforts.<sup>22</sup> The officials also said that they were reviewing information from large virtual currency users to identify any ties to criminal activity. However, according to IRS officials, since some of the data IRS has received predate a major uptick in virtual currency activity in 2017, the data that predate these developments are less valuable than more recent data would be, other than to understand the history of an individual's virtual currency usage.

IRS has also begun civil enforcement activities to address virtual currency noncompliance as part of the compliance campaign. In April 2019, LB&I was forwarding cases identified as likely involving virtual currency for examination classification, the process IRS uses to determine which returns to select to examine. Due to the time needed to complete examinations and to allow taxpayers time to exercise their rights, IRS officials said they do not have outcome data from these efforts yet.

In July 2019, IRS began sending out more than 10,000 letters to taxpayers with virtual currency transactions. These letters stated that IRS is aware that the taxpayer may have a virtual currency account. They instructed the taxpayer to ensure that virtual currency income, gains, and losses have been reported appropriately and to file or amend returns as necessary. The letters also provide taxpayers with information on where they can find resources to help them understand their reporting obligations.

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### IRS Shares Information across Multiple Agencies, Focusing on Criminal Enforcement Efforts That Can Involve Virtual Currencies

According to IRS officials, CI works with a number of federal partners, including FinCEN and the Federal Bureau of Investigation (FBI), among others, in the routine course of its work, which may involve virtual currency issues. According to CI officials, virtual currency does not constitute a new program area that would require a new specific set of

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<sup>22</sup>Internal Revenue Policy Statement 4-26 (formally P-4-84) requires balancing the civil and criminal aspects of investigations to maximize civil enforcement without imperiling criminal prosecution. This policy requires the support of all enforcement divisions/functions to maintain continuing cooperation and coordination. Pursuing both the criminal and the civil aspects of an investigation concurrently may jeopardize the successful completion of the criminal investigation.

policies and procedures. Instead, traditional crimes that CI might investigate may be intertwined with virtual currency use.

CI participates in virtual currency issue information sharing efforts through a number of groups. For example, CI is a monthly participant in the FBI's National Cyber Investigative Joint Task Force, which brings agencies together to share intelligence and work large-scale cases jointly. CI also has agents on site at the National Cyber-Forensics and Training Alliance, a public-private partnership, and at the European Union Agency for Law Enforcement Cooperation. Both entities work on a variety of issues, including virtual currency issues.

CI also participates in some multinational information sharing groups to address virtual currency issues as part of its broader criminal enforcement goals. For example, CI participates in the Joint Chiefs of Global Tax Enforcement (J5), a group of criminal intelligence and tax officials from Australia, Canada, the Netherlands, the United Kingdom, and the United States that launched in mid-2018 to focus on shared cross-national tax risks, including cybercrimes and virtual currency. Among the goals of the J5 are to lead the international community in developing a strategic understanding of offshore tax crimes and cybercrimes, and raise international awareness that the J5 are working together to address international and transnational tax crimes.

Within the Department of the Treasury (Treasury), IRS works with Treasury's Office of Tax Policy when developing any guidance or regulation, including for virtual currency. IRS also works with FinCEN with regard to IRS's delegated authority to administer parts of the Bank Secrecy Act, including *Report of Foreign Bank and Financial Accounts* (FBAR) filings.<sup>23</sup> For example, FinCEN provides training materials to SB/SE examination staff who may come across virtual currency issues in the performance of a Bank Secrecy Act examination. IRS and FinCEN officials also periodically discuss how to apply the Bank Secrecy Act and its implementing regulations to virtual currency transactions.

Given IRS's unique role in administering the federal tax system, it generally does not need to coordinate with other agencies outside of Treasury in developing or issuing virtual currency guidance or taking civil enforcement actions. According to IRS officials, the work of the virtual

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<sup>23</sup>The Bank Secrecy Act and related anti-money laundering authorities and requirements are tools for regulators and law enforcement to detect and deter the use of financial institutions for illicit finance activity.

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currency compliance campaign does not involve any other federal agencies.

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## IRS's Virtual Currency Guidance Meets Some Taxpayer Needs, but IRS Did Not Address Applicability of Frequently Asked Questions

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### IRS First Issued Virtual Currency Guidance in 2014 and Solicited Public Input to Identify Additional Guidance Needs

IRS first issued virtual currency guidance in 2014, in response to our recommendation.<sup>24</sup> In 2013, we found that IRS had not issued guidance specific to virtual currencies and that taxpayers may be unaware that income from transactions using virtual currencies could be taxable. We recommended that IRS provide taxpayers with information on the basic tax reporting requirements for transactions using virtual currencies. In response to this recommendation, IRS issued Notice 2014-21 in March 2014 and published it in the Internal Revenue Bulletin (IRB) in the form of answers to frequently asked questions (FAQs).<sup>25</sup>

IRS solicited public input on Notice 2014-21 through several means. Within the notice, IRS requested comments from the public regarding other aspects of virtual currency transactions that should be addressed in future guidance by providing a physical and email address to which comments could be submitted. IRS reviewed more than 200 public comments it received to identify topics that were in need of further guidance. Our analysis of the public comments found that the most common topics concerned tax forms and reporting (64 comments), realization of income (45 comments), cost basis (33 comments), and general tax liability (29 comments). Other topics included the tax implications of hard forks and airdrops, mining, and foreign reporting. Virtual currency stakeholders we spoke with, such as tax practitioners,

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<sup>24</sup>GAO, *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks*, [GAO-13-516](#) (Washington, D.C.: May 15, 2013).

<sup>25</sup>The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest.

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executives at virtual currency exchanges, advocacy groups, and industry representatives also identified these topics as in need of further guidance. Additionally, LB&I officials said they held several sessions to gather information from external stakeholders, such as tax practitioner groups and state tax authorities, to develop a better understanding of what was happening in taxpayer communities.

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### IRS's 2019 Virtual Currency Guidance Answers Some Taxpayer Concerns, but Presents Additional Challenges for Taxpayers

In October 2019, IRS issued two forms of additional virtual currency guidance, which answered some questions previously raised by the public comments and virtual currency stakeholders. According to IRS, these guidance documents were intended to supplement and expand upon Notice 2014-21.

- Revenue Ruling 2019-24 addresses the tax treatment of hard forks and airdrops following hard forks.<sup>26</sup> Specifically, the guidance discusses whether taxpayers have gross income as a result of (1) a hard fork, if they do not receive units of a new virtual currency; or (2) an airdrop of a new virtual currency following a hard fork if they receive units of new virtual currency.
- Additional FAQs provide further examples of how tax principles apply to virtual currency held as a capital asset. Topics addressed include what tax forms to use when reporting ordinary income and capital gains or losses from virtual currency; how to determine fair market value of virtual currencies; when virtual currency use results in taxable income; how to determine cost basis in several scenarios; and when a taxpayer may use the First-In-First-Out accounting method, known as FIFO, to calculate their gains.

However, some virtual currency and tax stakeholders with whom we spoke expressed concern that the 2019 revenue ruling and FAQs leave

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<sup>26</sup>A hard fork occurs when a blockchain splits into two incompatible versions. Such a split may result in the creation of a new type of virtual currency. An airdrop is a distribution of a virtual currency token or coin, usually for free, to virtual currency users, often as a way of promoting new types of virtual currency. For more information on blockchains and forks, see Dylan Yaga, Peter Mell, Nik Roby, and Karen Scarfone, *Blockchain Technology Overview*, National Institute of Standards and Technology Internal Report 8202 (Gaithersburg, MD: October 2018).

many questions unanswered and provide confusing responses to others. Their concerns include the following:

- **Clarity:** According to some stakeholders, Revenue Ruling 2019-24 is unclear, mostly due to confusion surrounding IRS's usage of technical virtual currency terminology and the situations meant to illustrate IRS's application of the law to hard forks and airdrops. Several tax and virtual currency stakeholders we spoke with said these examples do not accurately explain how virtual currency technology works and therefore may not be helpful to taxpayers looking for guidance on the tax implications of income received as a result of hard forks or airdrops. In public remarks on the new guidance in October 2019, IRS's Chief Counsel stated that terms are not used in a uniform way in the virtual currency industry, but IRS is interested in receiving comments on how virtual currency technology should be described.
- **Additional topics in need of guidance:** The revenue ruling and additional FAQs do not address several topics raised in the public comments and by stakeholders. For example, the guidance does not clarify foreign asset reporting requirements for virtual currency. The statutory provisions commonly known as the Foreign Account Tax Compliance Act (FATCA) require taxpayers and foreign financial institutions to report on certain financial assets held outside the United States.<sup>27</sup> Regulations implementing the Bank Secrecy Act separately require taxpayers to report certain foreign financial accounts to FinCEN on the FBAR form.<sup>28</sup> Some practitioners told us that it is unclear whether these requirements apply to virtual currency wallets and exchanges, as we discuss later in this report. Other topics not addressed in the 2019 guidance include mining, like-kind exchanges, and retirement accounts.

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<sup>27</sup>Subtitle A of Title V of the Hiring Incentives to Restore Employment Act is commonly referred to as FATCA. Pub. L. No. 111-147, §§ 501-541, 124 Stat. 71, 97-117 (2010).

<sup>28</sup>In prior work we found that reporting requirements for foreign financial assets under FATCA overlap with the FBAR reporting requirements. These overlapping requirements—implemented under two different statutes—have resulted in most taxpayers filing Forms 8938, *Statement of Specified Foreign Financial Assets*, also filing FBARs with FinCEN. We recommended that Congress consider amending the Internal Revenue Code, Bank Secrecy Act of 1970, and other statutes, as needed, to address overlap in foreign financial asset reporting requirements for the purposes of tax compliance and detection, and prevention of financial crimes, such as by aligning the types of assets to be reported and asset reporting thresholds, and ensuring appropriate access to the reported information. For more information, see GAO, *Foreign Asset Reporting: Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad*, [GAO-19-180](#) (Washington, D.C.: Apr. 1, 2019).

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According to an official from the IRS Office of Chief Counsel, IRS's focus when developing the 2019 guidance was to assist individual taxpayers. Therefore, the topics addressed by the revenue ruling and FAQs were limited to the most common issues that would be applicable to most individual taxpayers. The official told us that if IRS were to develop additional virtual currency guidance in the future, it may focus on a different audience, such as taxpayers involved in virtual currency businesses or exchanges that could be subject to third-party information reporting. Another official stated that issuing guidance on certain topics, including like-kind exchanges, would have taken additional time, and these topics were therefore left unaddressed.

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### IRS Did Not Include That the 2019 FAQs Are Not Legally Binding

IRS issues thousands of publications in a variety of different forms to help taxpayers and their advisors understand the law; however, IRS has stated that only guidance published in the IRB contains IRS's authoritative interpretation of the law.<sup>29</sup> Unlike with the virtual currency FAQs IRS issued in 2014 in the form of a notice, the 2019 FAQs were not published in the IRB. Therefore, the 2019 FAQs 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. For FAQs not published in the IRB, tax practitioners have noted that sometimes IRS has included a disclaimer noting that the FAQs do not constitute legal

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<sup>29</sup>Guidance published in the IRB goes through a multistep clearance process at both Treasury and IRS, involving review and approval by officials in a wide variety of Treasury and IRS offices. The weekly IRB is described as the "authoritative instrument" for publishing official IRS rulings and procedures and tax regulations. The five types of guidance published in the IRB are: regulations, revenue rulings, revenue procedures, notices, and announcements. Tax regulations are also published in the *Federal Register* and codified in the Code of Federal Regulations like other federal agency regulations. Other IRS publications and information are described in the Internal Revenue Manual as "a good source of general information." The form that information in this category can take varies widely, and includes IRS videos, online tools, forms and publications, and FAQs. For more information, see GAO, *Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance* [GAO-16-720](#), (Washington, D.C.: Sept. 6, 2016).

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authority and may not be relied upon.<sup>30</sup> The new virtual currency FAQs do not include such a disclaimer.

According to IRS officials, they did not include a disclaimer along with the new FAQs because the FAQs do not contain any substantial new interpretation of the law. IRS officials did not feel that a disclaimer about the limitations of the FAQs was necessary or that it would be helpful to taxpayers. However, the FAQs provide new information, such as a definition of the term “cryptocurrency” and an explanation of how taxpayers can track cost basis for virtual currency.

As we have previously reported, clarity about the authoritativeness of certain IRS publications could be improved by noting any limitations, especially when FAQs provide information to help taxpayers comply with tax law.<sup>31</sup> Additional explanatory language would help taxpayers understand what type of IRS information is considered authoritative and reliable as precedent for a taxpayer’s individual facts and circumstances.

The first article in IRS’s Taxpayer Bill of Rights—“The Right to Be Informed”—states that taxpayers have the right to know what they need to do to comply with tax laws. The article further states that taxpayers are entitled to clear explanations of the laws and IRS procedures in all forms, instructions, publications, notices, and correspondence. As we have previously reported, just as taxpayers have the right to clear explanations in IRS instructions and publications, taxpayers should be alerted to any limitations that could make some IRS information less authoritative than others.<sup>32</sup>

Failing to note any limitations associated with particular guidance could lead to misinterpretation of nonauthoritative information from IRS. If taxpayers make decisions based on guidance that is nonauthoritative, including FAQs, those taxpayers’ confidence in IRS and the tax system could be undermined if the content is later updated and IRS challenges taxpayers’ positions. As we have noted in prior reports, taxpayers’ perception that IRS is fairly and uniformly administering the tax system

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<sup>30</sup>See, for example, IRS, “U.S. Withholding Agent Frequently Asked Questions,” updated October 22, 2019, <https://www.irs.gov/businesses/international-businesses/us-withholding-agent-frequently-asked-question>, accessed December 16, 2019.

<sup>31</sup>GAO-16-720.

<sup>32</sup>GAO-16-720.

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helps further overall voluntary compliance and lowers IRS's administrative costs.<sup>33</sup>

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## Third-Party Information Reporting on Virtual Currency Is Limited, and Foreign Account Reporting Requirements Are Unclear

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### Limited Third-Party Information Reporting Makes It Difficult for IRS to Address Compliance Risks

IRS does not receive information returns on some potentially taxable transactions involving virtual currency, which limits its ability to detect noncompliance. Some virtual currency exchanges send information returns to IRS and to customers that provide information about customers' trading activity, but others do not.

Financial institutions and other third parties are to report interest payments, property sales, and other transactions to both taxpayers and IRS using forms known as information returns.

- **Form 1099-K, Payment Card and Third Party Network Transactions.** Third parties that contract with a substantial number of unrelated merchants to settle payments between the merchants and their customers are required to issue a Form 1099-K for each merchant that meets the threshold of having more than 200 transactions totaling more than \$20,000 in a year.<sup>34</sup>
- **Form 1099-B, Proceeds from Broker and Barter Exchange Transactions.** Brokers use Form 1099-B to report transactions such as sales or redemptions of securities, regulated futures contracts, and

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<sup>33</sup>See, for example, GAO, *IRS Return Selection: Wage and Investment Division Should Define Audit Objectives and Refine Other Internal Controls*, [GAO-16-102](#) (Washington, D.C.: Dec. 17, 2015); and *IRS Return Selection: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, [GAO-16-103](#) (Washington, D.C.: Dec. 16, 2015).

<sup>34</sup>26 U.S.C. § 6050W; 26 C.F.R. §§ 1.6050W-1, 1.6050W-2.

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commodities.<sup>35</sup> For certain types of property, brokers must also report cost basis information on Form 1099-B if the information is required.

- **Form 1099-MISC, *Miscellaneous Income*.** Certain payments made in the course of a trade or business—including rents, prizes, and various other types of income—must be reported by the payer on Form 1099-MISC. For most types of income subject to reporting on Form 1099-MISC, payers must file the form only if they made payments totaling at least \$600.<sup>36</sup>

According to our review of websites for nine major U.S.-based virtual currency exchanges, as of November 2019, two exchanges have policies posted online stating that they report information for some of their customers' virtual currency transactions to IRS on Form 1099-K. One exchange states that it reports customers' transactions on Form 1099-B, a more detailed information return that provides a breakdown of individual virtual currency transactions. Another exchange's website states that it provides Forms 1099, but does not identify the form more specifically. Three exchanges' websites have policies stating that the exchanges do not report customers' transactions on tax forms. The remaining two exchanges do not state on their websites whether or not they file information returns or provide customers with tax forms.

When transactions handled by third parties, such as virtual currency exchanges, go unreported on information returns, it is difficult for IRS to identify and address compliance risks. According to IRS officials and tax practitioners we interviewed, it is difficult for IRS to find out when taxable transactions involving virtual currency are occurring. As discussed earlier in this report, IRS's virtual currency compliance campaign has identified more than 10,000 taxpayers who may not have properly reported virtual currency transactions on tax returns. However, the campaign likely has not identified all taxpayers with underreported virtual currency income. In addition, according to IRS officials, examining tax returns is more

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<sup>35</sup>26 U.S.C. § 6045; 26 C.F.R. § 1.6045-1.

<sup>36</sup>26 U.S.C. § 6041; 26 C.F.R. §§ 1.6041-1 to 1.6041-10.

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resource intensive than the automated processes IRS uses to match tax returns against information returns.<sup>37</sup>

For taxpayers, limited information reporting by third parties can make it difficult to complete tax returns. Tax practitioners told us that recordkeeping is a challenge for taxpayers who buy and sell virtual currencies. To report virtual currency income accurately under IRS guidance, taxpayers need to report information about each transaction, including cost basis and fair market value at the time virtual currency is disposed of, such as by selling it for cash or another virtual currency on an exchange.

Some taxpayers may not keep their own records of virtual currency transactions, and as a result may lack easy access to the information that would be provided in third-party information returns. When taxpayers do keep these records, they may not know how to report virtual currency transactions on tax forms. As discussed earlier in this report, 64 of the public comments IRS received on Notice 2014-21 were about forms and reporting. For example, some of these 64 comments expressed uncertainty about how to calculate the fair market value of virtual currency at the time of sale; others requested assistance in determining which tax forms to use to report income from virtual currency transactions.

Some virtual currency transactions are not subject to third-party reporting requirements. For example, unless owned by a U.S. payor (including a controlled foreign corporation), virtual currency exchanges operating outside the United States are not required to file information returns such as Forms 1099-K or 1099-B unless the customer or transaction has certain connections to the United States. Some transactions, such as transferring virtual currency directly to a merchant in exchange for goods, generally create no obligation to file any information returns.

Other virtual currency transactions, such as sales of virtual currency for cash through virtual currency exchanges, may be subject to third-party reporting requirements. However, those requirements are not entirely

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<sup>37</sup>The automated underreporter program, through which IRS matches amounts reported on tax returns with amounts reported on information returns submitted by third parties, is one such process. This computer matching program allows IRS to identify discrepancies between tax returns and information returns, and propose automatic changes to taxpayers. Sometimes, if the discrepancy exceeds a certain tax threshold, an automated underreporter reviewer will contact a taxpayer asking for an explanation of the discrepancy or payment if additional taxes are assessed.

clear, and people have interpreted them differently. Tax practitioners we spoke with generally stated that it is not clear whether current regulations require virtual currency exchanges to report customers' trading activity on Forms 1099-K or 1099-B. According to IRS officials, virtual currency exchanges may be subject to the 1099-K reporting requirement if they fall into the legal category of "third party settlement organizations."<sup>38</sup> Exchanges are subject to the 1099-B requirement only if they are brokers or barter exchanges. IRS does not have an official position on whether virtual currency exchanges are required to report customers' trading activity on Form 1099-B. There may also be ambiguity regarding when, if at all, reporting on virtual currency sales is required on Form 1099-MISC.

Furthermore, even if exchanges are subject to the 1099-K, 1099-B, or 1099-MISC reporting requirements, these requirements do not cover all taxable transactions. Third-party settlement organizations are required to file Form 1099-K only for customers who make more than 200 transactions in a year that total more than \$20,000. Taxable transactions below that threshold may not be reported. Separately, some transactions carried out by brokers do not need to be reported on Form 1099-B unless they involve cash. For example, taxpayers must report trades between different virtual currencies on tax returns, but brokers may not be required to report such trades on Form 1099-B.<sup>39</sup> According to IRS, a virtual currency exchange would be required to file Form 1099-MISC if it has sufficient information, such as the recipient's basis in the virtual currency, to determine whether a payment made to a recipient in exchange for virtual currency gives rise to income for that recipient.

In addition, Forms 1099-K, 1099-B, and 1099-MISC do not always contain all the information that taxpayers need to file accurate tax returns or that IRS needs to monitor compliance. Form 1099-K provides information on the number and gross amount of payments made to the recipient, but does not provide information about individual transactions.<sup>40</sup> Some tax practitioners we interviewed stated that taxpayers who receive

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<sup>38</sup>The term third party settlement organization refers to the central organization that has the contractual obligation to make payment to participating payees of third party network transactions. 26 U.S.C. § 6050W(b)(3), (e).

<sup>39</sup>26 C.F.R. § 1.6045-1(a)(9) (defining "sale" in terms of a disposition for cash). However, barter exchanges may be required to report trades between different virtual currencies that do not involve cash. 26 C.F.R. § 1.6045-1(f). IRS has not taken an official position on how the rules for barter exchanges apply to virtual currency exchanges.

<sup>40</sup>The content of Form 1099-K follows the requirements set out in the Internal Revenue Code for information reporting by payment settlement entities. 26 U.S.C. § 6050W.

Form 1099-K for virtual currency transactions may find the form unhelpful or confusing. Because the form does not identify specific transactions, it may be difficult to match the aggregate amounts reported on the form with taxpayers' own records of virtual currency transactions. Form 1099-B does provide information about individual transactions, but does not always include or require cost basis information. According to IRS, a Form 1099-MISC that reports a payee's gain does not provide information about that payee's gross proceeds and basis.

Some stakeholders we interviewed mentioned challenges that could make it difficult to implement information reporting at the individual transaction level. For example, it could be difficult to distinguish between taxable dispositions of virtual currency—such as the sale of virtual currency for U.S. dollars—and nontaxable events such as the transfer of virtual currency from a taxpayer's account on an exchange to a personal wallet controlled directly by the same taxpayer. These stakeholders also told us that if exchanges were required to report cost basis information, additional challenges could include tracking the cost basis of virtual currency transferred between exchanges. However, as we have previously reported, cost basis reporting can be particularly valuable for tax compliance.<sup>41</sup> IRS officials told us that they are studying the issue of third-party information reporting, and it is included in IRS's priority guidance plan as of October 2019.<sup>42</sup>

We have reported that, in general, the extent to which taxpayers accurately report their income is closely aligned with the amount of income that third parties report to them and to IRS.<sup>43</sup> For example, according to IRS data for tax years 2011-2013, taxpayers misreported more than half of their income for types of income subject to little or no third-party information reporting (see figure 4). Taxpayers misreported a much lower percentage of their income for types of income subject to at least some information reporting.

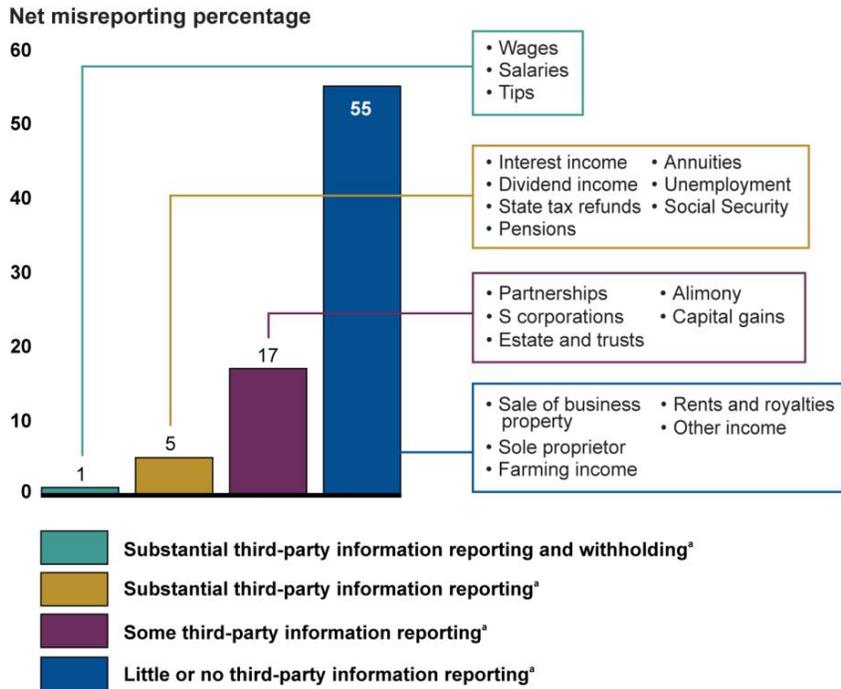
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<sup>41</sup>GAO, *Tax Gap: Sources of Noncompliance and Strategies to Reduce It*, [GAO-12-651T](#) (Washington, D.C.: Apr. 19, 2012).

<sup>42</sup>Previously, IRS officials told us that clarifying existing information reporting requirements or adding new requirements specific to virtual currency may require statutory changes to the Internal Revenue Code.

<sup>43</sup>GAO, *Tax Gap: Multiple Strategies Are Needed to Reduce Noncompliance*, [GAO-19-558T](#) (Washington, D.C.: May 9, 2019); IRS, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013*, Publication 1415 (Washington, D.C.: September 2019), available at <https://www.irs.gov/pub/irs-pdf/p1415.pdf>.

**Figure 4: Effect of Third-Party Information Reporting on Individual Income Tax Compliance, Tax Years 2011-2013**



Source: GAO analysis of Internal Revenue Service (IRS) information. | GAO-20-188

Note: Net misreporting percentage is the net misreported amount divided by the absolute values of the amounts that should have been reported, expressed as a percentage.

<sup>a</sup>IRS receives information from third parties that it uses to verify income or deduction amounts that taxpayers report on their tax returns. IRS categorized various line items on the individual income tax return into four different groupings of third-party reporting in IRS Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013* (Washington, D.C.: September 2019). However, IRS did not provide a scale to define the differences between substantial, some, and little or no third-party information reporting.

Information returns that include details about individual transactions can assist taxpayers by providing information about how to report virtual currency income correctly. For example, in addition to providing transaction details, Form 1099-B instructs recipients where to report transactions on Form 8949 or Schedule D, which are forms used to report capital gains. By contrast, Form 1099-K does not include similar instructions.

One of IRS’s strategic goals is to protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax

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code.<sup>44</sup> This goal includes identifying and planning for compliance risks proactively, including risks associated with the increasing complexity of the tax base. Further, internal control standards state that management should use quality information to achieve the entity's objectives.<sup>45</sup> Using quality information requires identifying information requirements and obtaining relevant data from reliable sources.

As discussed above, IRS does not have quality information on many potentially taxable transactions involving virtual currency, in part because information reporting requirements for virtual currency exchanges are unclear, and in part because some information reporting does not include detailed information about specific transactions. As a result, some taxpayers may not be reporting virtual currency transactions properly on their tax returns or paying the full amount of tax owed on those transactions, contributing to the tax gap.

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## IRS and FinCEN Have Not Clarified Whether Foreign Account Reporting Requirements Apply to Virtual Currency

As previously discussed, two overlapping reporting requirements apply to taxpayers who have foreign financial assets. These two requirements are the *Report of Foreign Bank and Financial Accounts* (FBAR) filings required under the Bank Secrecy Act and the separate reports required by the statutory provisions commonly known as the Foreign Account Tax Compliance Act (FATCA). The federal agencies that administer these requirements have not clarified how taxpayers who hold virtual currency should interpret them.

### FATCA Requirements

Under FATCA, taxpayers have an obligation to report certain foreign financial accounts and other assets on IRS Form 8938, *Statement of Specified Foreign Financial Assets*, if the value of those assets exceeds a certain amount. FATCA was enacted in 2010 to reduce offshore tax

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<sup>44</sup>IRS, *Strategic Plan: FY2018—2022*, Publication 3744 (April 2018).

<sup>45</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014), 59.

evasion, and it also requires foreign financial institutions to report detailed information to IRS about their U.S. customers.

Tax practitioners we interviewed told us that there is no generally accepted view about whether FATCA filing requirements apply to virtual currency holdings, and IRS has not publicly stated a position on how, if at all, FATCA requirements apply to virtual currency holdings for either taxpayers or institutions. Some practitioners stated that in the absence of guidance or information from IRS specifically addressing virtual currency and FATCA, some of their clients report foreign virtual currency accounts because the potential penalties for failing to report, if deemed to be required, are high.<sup>46</sup> Additionally, several public comments on IRS Notice 2014-21 requested clarification from IRS about whether virtual currency holdings must be reported under FATCA.

The FATCA filing requirements can be difficult for individual taxpayers to interpret, in part because FATCA was enacted before the use of virtual currency became more widespread, and it was not designed to cover nontraditional assets such as virtual currencies. For example, under FATCA, taxpayers must report accounts at foreign financial institutions. A taxpayer who holds virtual currency with an exchange based outside the United States may not know whether the exchange counts as a foreign financial institution under FATCA because this determination involves applying legal criteria to specific facts about how the exchange operates.<sup>47</sup>

Taxpayers must also report foreign nonaccount assets held for investment (as opposed to held for use in a trade or business), such as foreign stock and securities, foreign financial instruments, contracts with non-U.S. persons, and interests in foreign entities.<sup>48</sup> IRS officials told us that in some situations, virtual currencies could be foreign nonaccount

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<sup>46</sup>Nonfiling penalties for individuals can be up to \$10,000 for failure to disclose and an additional \$10,000 for each 30 days of nonfiling after IRS notice of a failure to disclose, for a potential maximum penalty of \$50,000. 26 U.S.C. § 6038D(d); 26 C.F.R. § 1.6038D-8.

<sup>47</sup>A foreign financial institution is defined as a foreign entity that either (1) accepts deposits in the ordinary course of a banking or similar business; (2) as a substantial portion of its business, holds financial assets for the account of others; or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities. 26 U.S.C. § 6038D(b)(1); 26 U.S.C. § 1471(d)(4),(5).

<sup>48</sup>26 U.S.C. § 6038D(b)(2).

assets, depending on specific facts about how an individual taxpayer holds the virtual currency. However, a taxpayer holding virtual currency may not know whether the virtual currency is considered a specified foreign financial asset because this determination involves applying legal criteria to specific facts such as whether the virtual currency has a foreign issuer, which the taxpayer may not have sufficient information to determine.

According to IRS officials, they have not issued guidance about virtual currency and FATCA because the instructions for Form 8938 clearly explain how taxpayers are to interpret FATCA requirements. However, those instructions do not mention virtual currency and do not provide information needed to determine whether virtual currency holdings must be reported. For example, the instructions state that a financial account is any depository or custodial account maintained by a foreign financial institution, but do not explain under what circumstances, if any, an account that holds virtual currency could be considered a depository or custodial account.<sup>49</sup>

IRS's Taxpayer Bill of Rights states that taxpayers are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. Furthermore, one of IRS's strategic goals is to empower taxpayers by making it easier for them to understand and meet their filing, reporting, and payment obligations.<sup>50</sup>

Without information about how to interpret and apply FATCA requirements to situations involving virtual currency, taxpayers will not know whether they are required to report virtual currency held outside the United States. As a result, they may be underreporting, depriving IRS of data needed to address offshore tax evasion, or overreporting by filing forms that are not required. As we have previously reported, such

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<sup>49</sup>The instructions refer to the Treasury regulations for the definitions of the terms "depository account" and "custodial account." For example, a custodial account is defined as "an arrangement for holding a financial instrument, contract, or investment (including, but not limited to, a share of stock in a corporation, a note, bond, debenture, or other evidence of indebtedness, a currency or commodity transaction, a credit default swap, a swap based upon a nonfinancial index, a notional principal contract as defined in § 1.446-3(c), an insurance or annuity contract, and any option or other derivative instrument) for the benefit of another person." This section of the regulations does not define the terms "financial instrument" or "investment." 26 C.F.R. § 1.1471-5.

<sup>50</sup>IRS, *Strategic Plan: FY2018—2022*, Publication 3744 (April 2018).

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overreporting creates unnecessary burdens, including financial costs, for taxpayers.<sup>51</sup>

### FBAR Requirement

Separate from the requirement to file Form 8938 under FATCA, regulations implementing the Bank Secrecy Act require reporting of financial accounts maintained with financial institutions located outside the United States on the FBAR form.<sup>52</sup> FinCEN's FBAR regulations predate the widespread use of virtual currency and do not specifically mention virtual currency. Consequently, tax practitioners have raised questions about whether taxpayers are required to include virtual currency holdings in FBAR filings.

In correspondence and interviews, FinCEN officials have stated that, based on their understanding of the regulations, virtual currency does not need to be reported on the FBAR. For example, FinCEN officials told us that FinCEN provides a standard response when members of the public ask FinCEN's Resource Center about reporting virtual currency on the FBAR. The response states, in part, "as of right now, reporting [virtual currency exchange accounts] on the FBAR is not required." Likewise, in March 2019, FinCEN responded in writing to a question from the American Institute of Certified Public Accountants by stating that the FBAR regulations do not define virtual currency held in an offshore account as a type of reportable account.

While FinCEN has provided responses to direct questions, it has not made information about whether foreign virtual currency accounts are subject to the FBAR requirement readily available, such as by posting this information on its website. FinCEN officials stated that FinCEN and IRS had issued a statement on IRS's website in 2014 informing the public that virtual currencies did not need to be reported on the FBAR.<sup>53</sup> However, the officials noted that the statement was no longer available on the website, but they did not say when it may have been removed or why.

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<sup>51</sup>[GAO-19-180](#).

<sup>52</sup>31 C.F.R. § 1010.350.

<sup>53</sup>Under a Memorandum of Agreement signed in 2003, IRS and FinCEN each have responsibilities for certain aspects of the FBAR requirement, and the two agencies work together to interpret and enforce the requirement.

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Neither IRS's FBAR Reference Guide nor FinCEN's instructions for filing the FBAR mention virtual currencies.

Internal control standards state that management should externally communicate the necessary quality information to achieve the entity's objectives.<sup>54</sup> As part of this standard, management should communicate information that allows external parties, including the general public, to assist the entity in achieving its objectives.

In the absence of a readily available official statement from FinCEN that virtual currencies are not reportable on the FBAR, users of virtual currency may be filing reports that are not legally required. According to some tax practitioners we interviewed, some individuals may report foreign virtual currency accounts on the FBAR even if they believe it is unlikely that they are required to report, because of the high penalties for failing to file required FBARs.<sup>55</sup> Such filings can create financial costs and unnecessary recordkeeping and other burdens for these individuals.

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## Conclusions

Virtual currencies can present challenges for enforcement of tax laws, both because they can be circulated without a central authority and because complying with current tax requirements can be confusing and burdensome. IRS has taken important steps to address these challenges, including issuing multiple sets of guidance to clarify how virtual currencies would be treated for tax purposes and carrying out a range of enforcement activities to address noncompliance.

Although IRS's 2019 virtual currency guidance addressed some issues left unresolved by its 2014 guidance, it did not address others, and it has also prompted new concerns among virtual currency stakeholders. Additionally, including information that the 2019 FAQs are not legally

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<sup>54</sup>GAO-14-704G, 62.

<sup>55</sup>Penalties for failing to file a required FBAR can be up to \$10,000 per violation, if nonwillful, and the greater of \$100,000 or 50 percent of account balances, if willful, for civil penalty assessment prior to August 2, 2016. For penalties assessed after August 1, 2016, whose associated violations occurred after November 2, 2015, the maximum penalties for negligent, nonwillful, and willful violations are adjusted for inflation. 31 C.F.R. § 1010.821. Criminal penalties may also apply for certain willful violations of either FATCA or FBAR requirements.

binding would enhance taxpayer understanding and could ultimately help enhance taxpayers' confidence in IRS and the tax system.

Currently, much trading activity in virtual currency goes unreported on information returns. In part, this lack of reporting may be because third parties are unclear about whether they are required to report. Limitations in what information returns report related to virtual currencies also constrain the utility of reported information. In general, information reporting is associated with high levels of compliance.

Additionally, the rules for foreign asset reporting—specifically, the FBARs required by the Bank Secrecy Act and the separate reports required by FATCA—do not clearly address virtual currency, and tax professionals have raised questions about the applicability of these requirements to virtual currency. Clarifying the FATCA requirements and making a statement about the FBAR requirements readily available to the public would help reduce uncertainty about these rules and may result in reduced burden for some taxpayers who may be filing reports that are not required.

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## Recommendations for Executive Action

We are making a total of four recommendations, including three to IRS and one to FinCEN. Specifically,

The Commissioner of Internal Revenue should update the FAQs issued in 2019 to include a statement that the FAQs may serve as a source of general information but cannot be relied upon by taxpayers as authoritative since they are not binding on IRS. (Recommendation 1)

The Commissioner of Internal Revenue should take steps to increase third-party reporting on taxable transactions involving virtual currency, which could include clarifying IRS's interpretation of existing third-party reporting requirements under the Internal Revenue Code and Treasury Regulations, or pursuing statutory or regulatory changes. (Recommendation 2)

The Commissioner of Internal Revenue should clarify the application of reporting requirements under FATCA to virtual currency. (Recommendation 3)

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The Director of FinCEN, in coordination with IRS as appropriate, should make a statement about the application of foreign account reporting requirements under the Bank Secrecy Act to virtual currency readily available to the public. (Recommendation 4)

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## Agency Comments and Our Evaluation

We provided a draft of this report to IRS, FinCEN, Treasury, SEC, and CFTC for review and comment. In its written comments, which are summarized below and reproduced in appendix II, IRS agreed with one and disagreed with two of the recommendations directed to it. In its written comments, which are summarized below and reproduced in appendix III, FinCEN agreed with the recommendation directed to it. IRS, Treasury, SEC, and CFTC provided technical comments, which we incorporated as appropriate.

IRS agreed with the recommendation to take steps to increase third-party reporting on taxable transactions involving virtual currency (recommendation 2). IRS stated that it is working with Treasury to develop guidance on third-party reporting under section 6045 of the Internal Revenue Code for certain taxable transactions involving virtual currency. Such guidance, if it aims to increase third-party reporting, would address the intent of the recommendation.

IRS disagreed with the recommendation to add a statement to the 2019 FAQs on virtual currency informing taxpayers that the FAQs provide general information but are not binding on IRS (recommendation 1). IRS stated that the FAQs are illustrative of how longstanding tax principles apply to property transactions. IRS also stated that IRS does not take positions contrary to public FAQs. We continue to believe that including such a statement would provide more transparency and help taxpayers understand the nature of the information provided in the FAQs.

As we state earlier in this report, IRS has included disclaimer statements in other informal FAQs posted on its website. IRS could include a similar statement in the virtual currency FAQs at minimal cost. Alternatively, if IRS intends to be bound by the positions it takes in the current version of the virtual currency FAQs, as the response to this recommendation suggests, it could publish the FAQs in the Internal Revenue Bulletin. Doing so would render a disclaimer statement unnecessary and would satisfy the intent of the recommendation.

IRS disagreed with the recommendation to clarify the application of FATCA reporting requirements to virtual currency (recommendation 3). IRS stated that U.S. exchanges and other U.S. businesses play a significant role in virtual currency transactions carried out by U.S. taxpayers, and therefore it is appropriate for IRS to focus on developing guidance for third-party reporting under section 6045, as discussed above. IRS also stated that guidance on FATCA may be appropriate in the future when the workings of foreign virtual currency exchanges become more transparent.

We believe that, given the widespread uncertainty about the FATCA requirements among virtual currency stakeholders, it would benefit taxpayers for IRS to clarify these requirements to the extent possible with the information currently available. It may be appropriate to wait for future developments in the foreign virtual currency exchange industry before issuing detailed, thorough guidance on this issue. However, IRS could address the uncertainty about the FATCA requirements by clarifying in general terms how it believes they should be interpreted in situations involving virtual currency.

In its comments, FinCEN agreed with the recommendation to make a public statement about whether virtual currency must be reported on the FBAR (recommendation 4). FinCEN confirmed in its letter that as of January 2020, its regulations do not require virtual currency held in an offshore account to be reported on the FBAR. Additionally, FinCEN stated that it will coordinate with IRS to determine the best approach to provide clarity to the public regarding the FBAR requirement.

We are sending copies of this report to the appropriate congressional committees, the Secretary of the Department of the Treasury, the Commissioner of Internal Revenue, the Director of the Financial Crimes Enforcement Network, the Chairman of the Securities and Exchange Commission, the Chairman of the Commodity Futures Trading Commission, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or [mctiguej@gao.gov](mailto:mctiguej@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

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Letter

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James R. McTigue, Jr.  
Director, Tax Issues  
Strategic Issues

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# Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) describe what is known about virtual currency tax compliance; (2) describe the steps the Internal Revenue Service (IRS) has taken to address virtual currency tax compliance risks; (3) evaluate the extent to which IRS's virtual currency guidance meets taxpayer needs; and (4) evaluate whether additional information reporting could assist IRS in ensuring compliance.

To describe what is known about virtual currency tax compliance and the steps IRS has taken to address virtual currency tax compliance risks, we reviewed IRS documentation on the agency's virtual currency tax enforcement efforts, including information about the legal summons IRS issued to Coinbase and the Large Business and International (LB&I) division's virtual currency compliance campaign. We interviewed IRS officials in the Small Business/Self Employed (SB/SE) and LB&I operating divisions, as well as the Research, Applied Analytics, and Statistics division about any data the agency had on virtual currency tax compliance, challenges in collecting such data, and plans for data analyses. We also reviewed IRS forms that taxpayers may use to report virtual currency use.

We interviewed officials from the Financial Crimes Enforcement Network, Commodity Futures Trading Commission, and Securities and Exchange Commission about coordination efforts that have been made across agencies regulating virtual currencies. We also interviewed tax practitioners, tax attorneys, virtual currency industry advocates, and virtual currency exchange executives about virtual currency tax compliance issues. We took a snowball sampling approach to identify the outside stakeholders we interviewed, which involved asking stakeholders we interviewed for recommendations of others we should contact to gain additional insight into virtual currency tax compliance, and we assessed their qualifications and independence. In total, we interviewed five individual stakeholders in addition to representatives of 10 entities with expertise in tax issues related to virtual currency. Although results from these interviews are not generalizable, they provide insight into what is known about tax compliance and the steps IRS has taken to address virtual currency tax compliance risks.

To evaluate the extent to which IRS's virtual currency guidance meets taxpayer needs, we identified and analyzed all of the guidance and statements IRS has published about tax compliance for virtual currencies. To identify these documents, we searched IRS's website and interviewed IRS officials. According to IRS officials, Notice 2014-21, issued in March 2014, and Revenue Ruling 2019-24 and Frequently Asked Questions (FAQs), issued in October 2019, are the only IRS guidance specific to virtual currencies.

We also reviewed and analyzed all of the public comments IRS had received on Notice 2014-21 as of August 19, 2019, to determine the concerns raised about virtual currency tax compliance. IRS sent us 229 public comments. We identified 25 of the comments as not applicable because they were not related to Notice 2014-21, were duplicate comments, or were otherwise not relevant. Two reviewers coded the content of the 204 applicable public comments and grouped them into 13 different thematic categories. We developed these categories based on the topics or issues that commenters identified. We assigned each separate issue raised by a comment to an existing category unless it did not relate to any of the existing categories, in which case we created a new category. We also recorded the date the comment was submitted and the occupation of the commenter, if specified in the comment.

To assess the reliability of these data, we reviewed relevant documentation and consulted knowledgeable IRS officials. Specifically, we requested information from IRS's Office of Chief Counsel to identify the quality controls in place to help ensure all comments are processed. We determined that the data were sufficiently reliable for our purposes. The information we obtained from these comments may not be representative of the viewpoints of the entire U.S. public.

In addition, we interviewed the stakeholders mentioned above before IRS released new guidance in October 2019 to identify any taxpayer concerns, any compliance challenges with virtual currency tax obligations, and the extent to which the guidance provided in IRS's Notice 2014-21 was meeting taxpayer needs. We reached out to these same stakeholders in October 2019, after IRS issued a new set of FAQs and Revenue Ruling 2019-24, to determine how these new guidance documents addressed taxpayers' concerns. Of the five individuals and 10 groups we initially interviewed, we received responses regarding the new IRS guidance from four individuals and six groups. The information we obtained from these practitioners and exchanges is not generalizable to all practitioners and exchanges because we took a snowball sampling

approach, but the information provides insight into the extent to which IRS's virtual currency guidance is meeting the needs of taxpayers.

To evaluate whether additional information reporting could assist IRS in ensuring compliance, we reviewed IRS's requirements for information reporting for virtual currency transactions, including the laws and regulations for foreign asset reporting. We interviewed IRS officials in the SB/SE and LB&I operating divisions about how IRS's third-party and taxpayer information reporting processes and current forms assist in IRS's work to detect noncompliance for virtual currencies. We reviewed the websites of a judgmental selection of nine virtual currency exchanges for policies or statements about tax reporting, including whether the exchanges file Forms 1099-B or 1099-K. For the website review, we selected virtual currency exchanges that were based in the United States and that were likely, because of their size or public profile within the virtual currency industry, to have established policies regarding information reporting. For each exchange, we identified and categorized any statements on the exchange's website regarding tax or information reporting, such as a statement that the exchange does not provide any tax forms to customers or a statement that the exchange provides information on a specific form to customers and IRS.

We also interviewed the stakeholders mentioned above to determine what information is being reported to IRS and whether additional information reporting would help IRS and taxpayers with ensuring tax compliance. We interviewed executives from two exchanges to determine what burden, if any, information reporting does or could impose on exchanges and virtual currency users. We attempted to contact four additional exchanges but did not receive a response. Because we used a snowball sampling approach, the information we obtained from these virtual currency industry participants is not generalizable to all virtual currency industry participants.

We conducted this performance audit from October 2018 to February 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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# Appendix II: Comments from the Internal Revenue Service

**Appendix II: Comments from the Internal Revenue Service**



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

January 23, 2020

James R. McTigue  
Director, Tax Issues  
Strategic Issues Team  
U.S. Government Accountability Office  
441 G Street N.W.  
Washington, DC 20548

Dear Mr. McTigue:

Thank you for the opportunity to review and comment on the draft report, *Virtual Currencies: Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance (GAO-20-188)*.

As reflected in your report, the IRS has undertaken several measures to address virtual currency tax compliance risks. We continue to engage a broad spectrum of external stakeholders for feedback on how the IRS might balance taxpayer service with proper regulatory enforcement of digital assets, including virtual currency. The wide variety of currency exchanges and digital assets pose a challenge to issuing guidance on specific circumstances, but the guidance issued by the IRS to date illustrates how longstanding tax principles associated with the sale, exchange or disposition of property can apply to virtual currency. We agree that additional information reporting will improve tax compliance and we will continue to engage stakeholders on how this might best be accomplished.

For the 2020 filing season, the IRS has added a new virtual currency question to Schedule 1 of the Form 1040, U.S. Individual Income Tax Return, that will capture sales, receipt, exchanges, or other acquisitions of virtual currency during the tax year. Requiring the reporting of virtual currency events on a tax return is beneficial to both taxpayers (ensures timely and proper treatment of virtual currency transactions) and tax administration (reporting has been shown to increase compliance and minimizes the need to reach out to taxpayers). This effort, coupled with the ongoing enforcement activities through our virtual currency campaign, will enhance voluntary compliance with respect to virtual currencies.

We appreciate GAO's review of this issue. The IRS will remain actively engaged in addressing non-compliance related to virtual currency transactions through a variety of efforts, ranging from taxpayer education to audits to criminal investigations. Virtual currency is an ongoing focus area for IRS Criminal Investigation (IRS-CI). Successful

**Appendix II: Comments from the Internal Revenue Service**

2

prosecutions of dark web marketplaces, such as 'Welcome To Video' and 'xDedic', as well as other illicit companies like 'OneCoin', continue to deter criminal enterprises from utilizing virtual currency as their primary means of facilitation. Additionally, IRS-CI remains vigilant in the pursuit of stripping nefarious actors of their ill-gotten gains, including virtual currency.

Attached please find our response to the recommendations that are directed to the IRS. If you have any questions, please contact me, or a member of your staff may contact John V. Cardone, Assistant Deputy Commissioner Compliance Integration, Large Business and International Division, at (202) 317-8830.

Sincerely,



Sunita Lough  
Deputy Commissioner for  
Services and Enforcement

Enclosure

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**Appendix II: Comments from the Internal Revenue Service**

Enclosure

IRS Responses to GAO's Recommendations in the Draft Report on Virtual Currencies: Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance (GAO-20-188).

**Recommendation 1:**

The Commissioner of Internal Revenue should update the FAQs issued in 2019 to include a statement that the FAQs may serve as a source of general information but cannot be relied upon by taxpayers as authoritative since they are not binding on IRS.

**Comment:**

We disagree with this recommendation. The FAQs are illustrative of how longstanding tax principles apply to property transactions. Further, the IRS does not take positions contrary to public FAQs.

**Recommendation 2:**

The Commissioner of Internal Revenue should take steps to increase third-party reporting on taxable transactions involving virtual currency, which could include clarifying IRS's interpretation of existing third-party reporting requirements under the Internal Revenue Code and Treasury Regulations, or pursuing statutory or regulatory changes.

**Comment:**

We agree with this recommendation. One of the items on the Department of the Treasury 2019-2020 Priority Guidance Plan is "Guidance regarding information reporting on virtual currency under §6045." IRS Office of Chief Counsel and the Department of Treasury are working on guidance that will address third-party reporting under section 6045 on certain taxable transactions involving virtual currency. It is anticipated that the guidance will also propose rules to avoid duplicate reporting under other information reporting regimes that may apply to transactions involving virtual currency.

**Recommendation 3:**

The Commissioner of Internal Revenue should clarify the application of reporting requirements under the Foreign Account Tax Compliance Act to virtual currency.

**Comment:**

We disagree with this recommendation. It is appropriate at this time to focus guidance on information reporting on transactions subject to section 6045, in light of the significant role that U.S. exchanges and other U.S. businesses play in virtual currency transactions carried out by U.S. taxpayers. As the workings of foreign virtual currency exchanges become more transparent over time, additional FATCA guidance may be appropriate in the future.

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# Appendix III: Comments from the Financial Crimes Enforcement Network

**Appendix III: Comments from the Financial  
Crimes Enforcement Network**



Financial Crimes Enforcement Network  
U.S. Department of the Treasury

Office of the Director

Washington, D.C. 20220

January 22, 2020

James R. McTigue, Jr.  
Director, Tax Issues  
Strategic Issues  
United States Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. McTigue:

Thank you for providing the Financial Crimes Enforcement Network (FinCEN) the opportunity to review the Government Accountability Office (GAO) report, "Virtual Currencies, Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance (GAO-20-188)." FinCEN supports your objective to determine if additional information reporting and guidance can improve tax compliance as it relates to virtual currencies. FinCEN concurs with Recommendation Four set out in the report and which states that "[t]he Director of FinCEN, in coordination with IRS as appropriate, should make a statement about the application of foreign account reporting requirements under the Bank Secrecy Act to virtual currency readily available to the public."

FinCEN will coordinate with the IRS to determine the best approach to provide clarity to the public regarding the application of the Report of Foreign Bank and Financial Accounts (FBAR) to virtual currency. Currently, the FBAR regulations do not define virtual currency held in an offshore account as a type of reportable account. (See 31 CFR 1010.350(c)). For that reason, at this time, virtual currency held in an offshore account is not reportable on the FBAR. FinCEN, however, in consultation with the IRS, continues to evaluate the value of incorporating virtual currency held offshore into the FBAR regulatory reporting requirements.

We appreciate the role of the GAO in providing oversight of our programs and look forward to working with GAO in the future.

Sincerely,

/s/

Kenneth A. Blanco  
Director

[www.fincen.gov](http://www.fincen.gov)

# Appendix IV: GAO Contact and Staff Acknowledgments

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## GAO Contact:

James R. McTigue, Jr. (202) 512-9110, [mctiguej@gao.gov](mailto:mctiguej@gao.gov)

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## Staff Acknowledgments

In addition to the contact named above, Jeff Arkin (Assistant Director), Danielle Novak (Analyst-in-Charge), Theodore Alexander, Michael Bechetti, David Blanding, Jacqueline Chapin, Ed Nannenhorn, Bruna Oliveira, Kayla Robinson, and Andrew J. Stephens made key contributions to this report.

# Appendix V: Accessible Data

## Data Tables

### Accessible Data for Examples of Virtual Currency Transactions that Can Produce Taxable Capital Gains

#### Examples of Virtual Currency Transactions that Can Produce Taxable Capital Gains

- Selling virtual currency for U.S. dollars
- Buying goods with virtual currency
- Trading one virtual currency for another

Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

### Accessible Data for Figure 1: Example of How a Virtual Currency Operates Using Blockchain, a Distributed Ledger Technology

#### Step Step description

1. Someone initiates a virtual currency transaction, such as sending one unit of a virtual currency to another individual.
2. The transaction is broadcast to a peer-to-peer network of computers that support the blockchain.
3. The network of computers validates the transaction. For example, the network ensures that the virtual currency has not been previously spent.
4. Once verified, the transaction is combined with other transactions to create a new block of data. A block typically contains information about transactions that have not yet been linked to previous blocks, such as the date, time, and amount of virtual currency sent.
5. The new block is then added to the blockchain, which is made up of digital information (blocks) stored in the format of a distributed ledger (chain). Different virtual currencies transact on different blockchains.
6. The transaction is complete. For example, virtual currency has been deposited into the recipient's virtual wallet.

Source: GAO. | GAO-20-188

### Accessible Data for Figure 2: Examples of Virtual Currency Transactions That Can Affect Taxes

#### Transactions that Could Affect Taxable Income

#### Transaction number Transaction description

1. Selling virtual currency for U.S. dollars.

Appendix V: Accessible Data

Transaction number	Transaction description
2.	Exchanging one type of virtual currency for another.
3.	Receiving virtual currency for services.
4.	Mining virtual currency.

**Transactions that Do Not Affect Taxable Income**

Transaction number	Transaction description
1.	Buying virtual currency with dollars and holding on to it.
2.	Sending virtual currency to a different virtual wallet or account with the same owner.

Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

**Accessible Data for Figure 3: Tax Implications of Paying for Goods Using Virtual Currencies**

Step	Step description
1.	Taxpayer buys virtual currency. The price paid in dollars is the cost basis.
2.	Fair market value of the virtual currency fluctuates over time.
3.	Taxpayer uses virtual currency to pay for goods, which may affect taxes if the transaction results in a capital gain or loss.
4.	Taxpayer calculates capital gain or loss by subtracting the cost basis from the fair market value of the goods purchased.
5.	Taxpayer reports capital gain or loss to IRS.

Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

**Accessible Data for Figure 4: Effect of Third-Party Information Reporting on Individual Income Tax Compliance, Tax Years 2011-2013**

Category	Net misreporting percentage
Substantial information reporting and withholding <ul style="list-style-type: none"> <li>• Wages</li> <li>• Salaries</li> <li>• Tips</li> </ul>	1
Substantial information reporting <ul style="list-style-type: none"> <li>• Interest income</li> <li>• Dividend income</li> <li>• State tax refunds</li> <li>• Pensions</li> <li>• Annuities</li> <li>• Unemployment</li> <li>• Social Security</li> </ul>	5

Category	Net misreporting percentage
Some information reporting	17
<ul style="list-style-type: none"><li>Partnerships</li><li>S corporations</li><li>Estate and trusts</li><li>Alimony</li><li>Capital gains</li></ul>	
Little or no information reporting	55
<ul style="list-style-type: none"><li>Sale of business property</li><li>Sole proprietor</li><li>Farming income</li><li>Rents and royalties</li><li>Other income</li></ul>	

Source: GAO analysis of Internal Revenue Service (IRS) information. | GAO-20-188

## Agency Comment Letters

### Accessible Text for Appendix II Comments from the Internal Revenue Service

#### Page 1

January 23, 2020

James R. McTigue

Director, Tax Issues

Strategic Issues Team

U.S. Government Accountability Office

441 G Street N.W.

Washington, DC 20548

Dear Mr. McTigue:

Thank you for the opportunity to review and comment on the draft report, *Virtual Currencies: Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance (GAO-20-188)*.

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For the 2020 filing season, the IRS has added a new virtual currency question to Schedule 1 of the Form 1040, U.S. Individual Income Tax Return, that will capture sales, receipt, exchanges, or other acquisitions of virtual currency during the tax year. Requiring the reporting of virtual currency events on a tax return is beneficial to both taxpayers (ensures timely and proper treatment of virtual currency transactions) and tax administration (reporting has been shown to increase compliance and minimizes the need to reach out to taxpayers). This effort, coupled with the ongoing enforcement activities through our virtual currency campaign, will enhance voluntary compliance with respect to virtual currencies.

We appreciate GAO's review of this issue. The IRS will remain actively engaged in addressing non-compliance related to virtual currency transactions through a variety of efforts, ranging from taxpayer education to audits to criminal investigations. Virtual currency is an ongoing focus area for IRS Criminal Investigation (IRS-CI). Successful

## Page 2

prosecutions of dark web marketplaces, such as 'Welcome To Video' and 'xDedic', as well as other illicit companies like 'OneCoin', continue to deter criminal enterprises from utilizing virtual currency as their primary means of facilitation. Additionally, IRS-CI remains vigilant in the pursuit of stripping nefarious actors of their ill-gotten gains, including virtual currency.

Attached please find our response to the recommendations that are directed to the IRS. If you have any questions, please contact me, or a member of your staff may contact John V. Cardone, Assistant Deputy

Commissioner Compliance Integration, Large Business and International Division, at (202) 317-8830.

Sincerely,

Sunita Lough

Deputy Commissioner for Services and Enforcement

Enclosure

Page 3

IRS Responses to GAO's Recommendations in the Draft Report on Virtual Currencies: Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance (GAO-20-188).

Recommendation 1:

The Commissioner of Internal Revenue should update the FAQs issued in 2019 to include a statement that the FAQs may serve as a source of general information but cannot be relied upon by taxpayers as authoritative since they are not binding on IRS.

Comment:

We disagree with this recommendation. The FAQs are illustrative of how longstanding tax principles apply to property transactions. Further, the IRS does not take positions contrary to public FAQs.

Recommendation 2:

The Commissioner of Internal Revenue should take steps to increase third-party reporting on taxable transactions involving virtual currency, which could include clarifying IRS's interpretation of existing third-party reporting requirements under the Internal Revenue Code and Treasury Regulations, or pursuing statutory or regulatory changes.

Comment:

We agree with this recommendation. One of the items on the Department of the Treasury 2019-2020 Priority Guidance Plan is "Guidance regarding information reporting on virtual currency under §6045." IRS Office of Chief

Counsel and the Department of Treasury are working on guidance that will address third-party reporting under section 6045 on certain taxable transactions involving virtual currency. It is anticipated that the guidance will also propose rules to avoid duplicate reporting under other information reporting regimes that may apply to transactions involving virtual currency.

Recommendation 3:

The Commissioner of Internal Revenue should clarify the application of reporting requirements under the Foreign Account Tax Compliance Act to virtual currency.

Comment:

We disagree with this recommendation. It is appropriate at this time to focus guidance on information reporting on transactions subject to section 6045, in light of the significant role that U.S. exchanges and other U.S. businesses play in virtual currency transactions carried out by U.S. taxpayers. As the workings of foreign virtual currency exchanges become more transparent over time, additional FATCA guidance may be appropriate in the future.

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### Accessible Text for Appendix III Comments from the Financial Crimes Enforcement Network

January 22, 2020

James R. McTigue, Jr.

Director, Tax Issues

Strategic Issues

United States Government Accountability Office

441 G Street, NW

Washington, DC 20548

Dear Mr. McTigue:

Thank you for providing the Financial Crimes Enforcement Network (FinCEN) the opportunity to review the Government Accountability Office (GAO) report, "Virtual Currencies, Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance (GAO-20-188)." FinCEN supports your objective to determine if additional information reporting and guidance can improve tax compliance as it relates to virtual currencies. FinCEN concurs with Recommendation Four set out in the report and which states that "[t]he Director of FinCEN, in coordination with IRS as appropriate, should make a statement about the application of foreign account reporting requirements under the Bank Secrecy Act to virtual currency readily available to the public."

FinCEN will coordinate with the IRS to determine the best approach to provide clarity to the public regarding the application of the Report of Foreign Bank and Financial Accounts (FBAR) to virtual currency. Currently, the FBAR regulations do not define virtual currency held in an offshore account as a type of reportable account. (See 31 CFR 1010.350(c)). For that reason, at this time, virtual currency held in an offshore account is not reportable on the FBAR. FinCEN, however, in consultation with the IRS, continues to evaluate the value of incorporating virtual currency held offshore into the FBAR regulatory reporting requirements.

We appreciate the role of the GAO in providing oversight of our programs and look forward to working with GAO in the future.

Sincerely,

/s/

Kenneth A. Blanco

Director

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