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# 3 Ways To Disclose Cryptocurrency Transactions To The IRS

By **Amy Lee Rosen**

*Law360 (October 25, 2019, 6:28 PM EDT)* -- The Internal Revenue Service has made cryptocurrency tax compliance one of its top priorities and has recommended that virtual currency users come clean to the agency if they haven't disclosed transactions in the past.

This summer, the IRS sent more than 10,000 letters to cryptocurrency users who may have failed to report transactions or pay taxes on them, warning of the consequences of noncompliance. Earlier this month, in the wake of guidance released by the agency on the treatment of cryptocurrency, IRS Chief Counsel Michael Desmond said users might want to consult with their advisers if they hadn't been properly disclosing their cryptocurrency transactions.

Here, Law360 examines three disclosure avenues for cryptocurrency users who may not have properly reported the assets.

**File Delinquent Returns**

If a holder of cryptocurrency simply did not file tax returns at all, then following delinquent return procedures would be one way of becoming compliant, according to Dale Werts, a partner at Lathrop Gage LLP who has experience in cryptocurrency-related issues. However, one must examine records, he said. Record-keeping is crucial since someone cannot accurately report loss or gain on a cryptocurrency sale, purchase or exchange without knowing the basis of the cryptocurrency and its value after the transaction, Werts said.

For example, if the IRS does not have information about a cryptocurrency user's basis, it unfavorably assumes the basis is zero, Werts said. Several software packages and vendors provide tools for tracking cryptocurrency transactions, he said.

“The burden is on the taxpayer to comply with the law, to accurately report income and to accurately file returns,” Werts said. “This requires good record-keeping of all cryptocurrency transactions.”

The enforcement period for delinquent returns is no more than six years, but the agency can choose to enforce beyond that time period depending on the facts and circumstances. The enforcement period may be longer or shorter depending on the prior history of noncompliance, whether the income comes from illegal sources, the effect of voluntary compliance, anticipated revenue that's related to the time and effort required to determine the tax due and any special circumstances.

There is a 5% penalty for failing to file by the tax return due date, plus another 5% for each month the return is late, up to 25%. If taxes are due, there is a failure-to-pay penalty of 0.5% per month, according to Section 6651 of the Internal Revenue Code.

**File Amended Returns**

If someone previously filed tax returns but made mistakes by not reporting cryptocurrency transactions or not reporting them correctly, then filing an amended return is another option for cryptocurrency holders.

While filing an amended return along with paying all tax and interest due is generally recognized as a way to correct noncompliance, there are disadvantages, such as being exposed to criminal or fraud penalties, according to Michel Stein, principal at Hochman Salkin Toscher Perez PC.

“The downside of the amended returns is that they can serve as admissions that can assist the IRS in an ongoing investigation or with the assertion of fraud penalties,” Stein told Law360. “The amended returns could be subject to a protracted examination, depending on the facts presented in a case.”

Many people may not even realize that they need to report the transactions to the IRS or that they owe taxes on previous “hard forks,” or splits in the blockchain database for the cryptocurrency, according to Omri Marian, a law professor and academic director of the graduate tax program at the University of California at Irvine.

For example, Marian said, he personally owns bitcoin because he purchased half a bitcoin several years ago for research purposes. When there was a hard fork, he said, he received additional cryptocurrency but didn't even realize it at first. Under the guidance released by the IRS this month, taxable income is generated by “airdrops” that deliver new cryptocurrency after a hard fork.

Marian said he didn't report the cryptocurrency he received at first because he didn't know he had an obligation, but now that he knows more about the requirements he plans to file an amended return.

“I assume that most taxpayers never reported these hard forks,” Marian said. “I don't know what most taxpayers will do [because] most are not even aware.”

**Initiate a Voluntary Disclosure**

If a cryptocurrency user is concerned about possible criminal charges, a voluntary disclosure may be appropriate. Under the IRS' voluntary disclosure procedures, a taxpayer can come forward about tax noncompliance in exchange for avoiding criminal charges. Initiating a voluntary disclosure may be advantageous because it can provide a certain level of penalty certainty, Stein told Law360.

“In my opinion, the formalized voluntary disclosure is reserved for those with real criminal potential and/or those in need of more certainty and closure on exposure for tax liabilities and civil penalties,” he said. “The cost of this procedure is generally six years of corrected income taxes and a civil fraud penalty for the highest income tax year.”

Last November, the IRS updated its procedures for voluntary disclosures to assist those who wanted to come clean on international or domestic noncompliance. To initiate a voluntary disclosure, a client must first request preclearance from the IRS Criminal Investigation division and promptly submit all documents using a Form 14457 preliminary clearance request. The form requests information about the noncompliance in a narrative that lays out the facts, circumstances, entities, related parties and any professional advisers involved.

The first part of the form makes the request. The IRS will check to see if the taxpayer can receive clearance, and then the person can submit the second part of the form within 45 days, according to Kevin Johnson, a tax controversy partner at BakerHostetler. Following submission of the second part, the IRS will determine eligibility for the program and, once accepted, the case is assigned to an IRS revenue agent for a civil audit, he said.

When deciding between filing amended returns and initiating a voluntary disclosure, one must consider whether the misreporting was due to sloppiness or the client's frame of mind, whether the client relied on a tax adviser and the amount of unreported income and unreported tax, according to Edward Froelich, of counsel with Morrison & Foerster LLP.

“The IRS' general voluntary disclosure program is suited to taxpayers who intentionally filed a return knowing it to be false and who are exposed to criminal penalties,” he said.

--Editing by Robert Rudinger and Neil Cohen.