

# Cryptocurrency Crackdown:

## What You Need to Know about Enhanced IRS/Government Scrutiny of Cryptocurrency Transactions

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# SEC and CFTC Regulations



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# The Regulators – SEC and CFTC

- What is the current regulatory landscape for cryptocurrency and digital token offerings (“ICOs”) in the U.S.?
  - The SEC has asserted jurisdiction over most if not all digital tokens and ICOs (presumably except Bitcoin (BTC))
    - and is reviewing “virtual currencies”?
  - CFTC has asserted jurisdiction over Bitcoin (BTC)
    - and is reviewing other “virtual currencies”



## **Cryptocurrency and token offerings (“ICOs”) in the U.S. – not much is settled between the SEC and CFTC . . . .**

- Apart from BTC, both the SEC and the CFTC have stated that many other virtual currencies and ICOs have characteristics of a virtual currency and/or a security.
  - May 14<sup>th</sup> – WSJ reports the CFTC is pushing the SEC to make up its mind on Ethereum or ETH.



## Definitions?

- “Virtual currency” a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value, but does not have legal tender status in any jurisdiction.”
  - Generally consistent across the CFTC, SEC and the IRS.
- “Crypto currency” a type of virtual currency that uses various cryptography to provide additional functionality, including additional security, verification of transactions and in many cases anonymity.
- “Digital Token” something that represents a digital asset, whether a crypto currency or a block-chain based smart contract.
  - “Utility Token” a Digital Token that is not a security subject to the SEC’s jurisdiction or a virtual currency subject to the CFTC’s jurisdiction (e.g. “a token that represents an interest in a book-of-the-month club” – SEC Chairman Clayton December 11, 2017).



# The Securities Exchange Commission (SEC)

- **The SEC has asserted jurisdiction over most Initial Coin Offerings (and virtual currencies?).**
  - The DAO Report – July 2017 (discussed below).
  - SEC Chairman Jay Clayton – Statement on Cryptocurrencies and Initial Coin Offerings December 11, 2017.
    - “...the structures of initial coin offerings that I have seen promoted involve the offer and sale of securities.”
    - “merely calling a token a ‘utility’ token or structuring it to provide some utility does not prevent the token from being a security”...
    - “while there are cryptocurrencies that do not appear to be securities, simply calling something a “currency” or a currency-based product does not mean that it is not a security.”



# How did we get here with the SEC?

- **Early Cases/Enforcement Proceedings – Most are Ponzi Schemes and Unregistered Offerings of Shares (not ICOs) for Bitcoin (BTC).**
  - Bitcoin was launched in 2009.
  - SEC vs. T. Shavers and Bitcoin Savings and Trust (July 23, 2013). SEC files a complaint alleging that defendant offered investments in return for bitcoin, promised outsized returns and was essentially operating a Ponzi scheme.
  - **SEC Investor Alert:** Bitcoin and Other Virtual Currency-Related Investments (May 7, 2014).
  - In the Matter of BTC Trading Corp. and Ethan Burnside (December 8, 2014). The SEC orders respondent to cease and desist operating LTC-Global Virtual Stock Exchange and BTC Virtual Stock Exchange as unregistered, securities exchanges and brokers dealers. Other violations of securities laws are asserted.
  - In the matter of Erik T. Voorhees (June 3, 2014). The SEC orders respondent to cease and desist from offering shares of FeedZeBirds and SatoshiDICE in exchange for BTC without registering the shares or relying on an exemption from registration.





## How did we get here? (Cont'd)

- SEC vs. Garza, GAW Miners LLC and ZenCloud (December 1, 2015). SEC alleged that defendants violated the securities laws by offering “hashlets” without registering the hashlets or relying on an exemption from registration, as well as committing securities fraud.
- In the Matter of Sand Hill Exchange (June 17, 2015). SEC orders respondents to cease and desist from offering security-backed swaps that were bought and sold using linked to the valuation of startups, based on “smart contracts”. Some users bought products using BTC. The security-based swaps were sold in violation of the Dodd Frank Act and the “smart contracts” did not exist.
- **SEC Investor Alert:** Beware of Fantasy Stock Trading Websites Offering Real Returns June 17, 2015.



## How did we get here? (Cont'd)

- *In the Matter of Bitcoin Investment Trust and SecondMarket Inc.* (July 11, 2016). SEC orders respondents to cease violating Regulation M. Bitcoin Investment Trust's only assets were BTC and it sold shares in a private placement in exchange for BTC. BIT, via its affiliate, SecondMarket, a registered broker dealer, began a shareholder redemption program which violated Rules 101 and 102 of Regulation M.
- *SEC vs. Haddow, Bar Works, 7th Avenue and Bitcoin Store* (June 30, 2017). Defendant Haddow allegedly operated an unregistered broker dealer to sell securities in a few companies, one of which was Bitcoin Store, a platform for customers to hold and trade BTC. Among a number of alleged violations of law, the offering materials misrepresented material facts about the companies in violations of the Securities laws.



# The DAO Report – July 2017

- Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (the “DAO Report”).
  - The SEC analyzes an ICO for the industry – a warning . . .
- In the DAO Report, the token holders exchanged Ether for Virtual DAO Tokens to fund projects in which the investors would share in anticipated earnings.



## The DAO Report – July 2017 (cont'd)

- The SEC analyzed the DAO tokens under the 1946 case, *SEC vs. Howey* which “generally” has 4 elements:
  - 1) Is there an investment of money?
    - Yes, Ether for DAO Tokens
  - 2) In a common enterprise?
    - Yes, the DAO organization
  - 3) With a reasonable expectation of profit?
    - Yes, token holders expected a *return on investment*.
  - 4) Derived from the entrepreneurial or management efforts of others.
    - *DAO curators reviewed proposals, and the token holders had limited voting rights and were relying on management.*



## SEC – Next Steps

- The SEC left the door open at that time to analyze each token to determine whether the facts and circumstances (Howey factors) are met.
  - SEC Investor Bulletin July 25, 2017 – “Depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities.”
- September 25, 2017, the SEC launches a new Cyber Unit that focuses on violations involving ICOs.
- **SEC Investor Alert:** Celebrity Endorsements (November 1, 2017).



## SEC – Next Steps (cont'd)

- *In the Matter of Munchee Inc.* (December 11, 2017)
  - Munchee creates an iPhone app for people to review restaurants. Munchee alleges that it has conducted a “Howey” analysis and found that MUNs were not securities (i.e. utility tokens). The SEC finds that MUN Tokens offered by Munchee to raise capital to improve the app and recruit users is a security. The SEC also focuses on Munchee’s marketing efforts.
  - The SEC contacts Munchee, no tokens had been delivered yet and Munchee returns all proceeds.
- Late 2017/Early 2018 – Chairman Clayton speaks (see previous slide).
  - Since then, more enforcement actions and cease and desist orders: *SEC v. Arisebank* (Jan 25, 2018); *SEC vs. Bitfunder* (February 21, 2018); *Centra Tech, Inc.* (April 2, 2018; amended April 20, 2018) and *SEC v Longfin Corp* (April 6, 2018).



# Takeaway

- In the current regulatory environment, digital tokens most likely will be viewed as securities by the SEC until proven otherwise and ICOs must comply with the securities laws .
  - Register tokens as securities under the Securities Act (but not certain the SEC will approve given the retail nature of a registered offering).
  - Rely upon a private placement exemption from registration.



# Digital exchanges - regulatory and legal challenges

- On March 7, 2018, the Division of Enforcement and Trading and Markets of the SEC stated that if a trading platform offers trading of digital assets that are securities (including ICOs which the SEC views as securities) and operates as an exchange, then the platform must register with the SEC as a national securities exchange or be exempt from registration as an “ATS” or Alternative Trading System.
  - An SEC registered exchange is the equivalent of the NYSE; a self regulatory organization (or SRO) with robust policies and procedures.
  - An ATS is registered with the SEC as a broker dealer and becomes a member of and SRO.





# The Commodity Futures Trading Commission (CFTC)

- **CFTC has asserted jurisdiction over Bitcoin (BTC) and other “virtual currencies.”**
  - The CFTC generally has jurisdiction over commodities .
  - The CFTC has jurisdiction over and regulates commodity futures, options and other derivatives that are within the definition of a “swap.”
  - The CFTC does not directly regulate commodity “spot” markets *but has the authority to bring anti-fraud and anti-manipulation cases* in respect thereof.
  - In 2015, the CFTC first asserted its interpretation that virtual currencies were within the definition of “commodity.” [\*In the Matter of Coinflip, Inc.\*](#), CFTC Docket 15-29 (Sept. 17, 2015).
  - The United States District Court for the Eastern District of New York agreed with the CFTC’s interpretation in granting a preliminary injunction order against defendants in an enforcement case. [\*CFTC v. Patrick K. McDonnell and Cabbagetech, Corp. d/b/a Coin Drop Markets\*](#), No. 18-CV-361 (E.D.N.Y. March 6, 2018).



## CFTC (cont'd)

- **Currently Offered Bitcoin-related Products** – The CFTC has allowed certain of its registrants to launch Bitcoin-related products for trading.
  - Options and Swaps (LedgerX).
  - Binary Options (Cantor Exchange; announced but not yet available).
  - Forwards (TeraExchange).
  - Futures (CME; CBOE Futures Exchange).
- **LabCFTC**
  - Last year LabCFTC, an initiative by the CFTC to promote FinTech innovations, released a “Primer on Virtual Currencies.”



# Other Issues to Consider and Recent Observations

- Investment Advisers Act of 1940.
  - Any person in the business of providing advice about an investment in an ICO or virtual currency that is considered a security could be acting as an investment adviser.
    - Investment advisers generally must be registered with the SEC (over \$100M in assets under management) or the state in which they have their principal place of business and possibly states in which their clients reside.
- Class action lawsuits started being filed in 2017 . . .
- Pay your taxes!

# IRS Regulations



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# Tax Terms

- **Capital asset:** Basically anything you own, from a house to furniture to stocks and bonds – property.
- **Basis:** The amount you paid to buy property (including any fees you paid).
- **Realized capital gain or loss:** The profit or loss you made when you sold property (i.e. the price you sold it for minus your basis).
- **Unrealized gain or loss:** The profit or loss you have on paper but have not actually cashed in on.
- **Short-term gain:** Realized gain on property or any other investment held for one year or less before selling it.
- **Long-term gain:** Realized gain on property or any other investment held for longer than one year before selling it.
- **Virtual Currency/Cryptocurrency:** Defined by the IRS as a digital representation of value that functions as a medium of exchange, or a unit of account, and/or a store of value, i.e. cryptocurrency such as bitcoin.



# Cryptocurrencies: A Tax Perspective

The IRS fears cryptocurrencies.

- The core technology underlying cryptocurrencies – blockchain – is premised on anonymity.
- Transactions involving virtual currencies can be difficult to trace.
- IRS believes there is significant noncompliance in reporting cryptocurrency transactions.
- Unreported cryptocurrency transactions have damaged government finances through lost tax revenue.
- Steven Mnuchin, U.S. Treasury Secretary, recently said that cryptocurrency could become “the next Swiss bank account.”



# Cryptocurrency

## Currency or Property?

- U.S. income taxation of financial instruments is generally based on a particular financial instrument's tax classification.
- A part of the Internal Revenue Code (Subpart J of Part III of subchapter N) provides a set of tax rules that applies to transactions concerning currencies.
- Certain issues related to the tax treatment of cryptocurrency were addressed by Notice 2014-21.
- The Notice refers to cryptocurrency as “convertible virtual currency.”





## IRS Notice 2014-21

- In March 2014 the IRS released guidance in Notice 2014-21 (2014-16 IRB 938).
- In general, the sale or exchange of virtual currency, or the use of virtual currency to pay for goods or services has tax consequences that may result in a tax liability.
- For federal tax purposes virtual currency is treated as “property.” Virtual currency transactions are taxable by law just like transactions in any other property.
- Thus, taxpayers can have a gain or loss on the sale or exchange of a virtual currency.



# IRS Notice 2014-21

- Despite the guidance, the Notice does not address the kind of property that virtual currency should be regarded as for tax purposes.
  - Is it a commodity?
  - Is it a security?
  - Is it a marketable security?
- It is not clear whether the same characterization should apply to all virtual currencies given the differences in economic and other rights.
- The Notice also did not address the valuation issues surrounding virtual currencies.
- No additional guidance from the IRS.



# IRS Notice 2014-21

- These open issues lead to a variety of questions that need to be addressed. For example,
  - Can you make a Section 475 mark-to-market election for trading in cryptocurrency?
  - Is trading cryptocurrency eligible for the securities trading safe harbor, or can it be ECI?
  - Can cryptocurrency issued by a foreign issuer represent shares of a CFC or PFIC?
- Notice 2014-21 was just the first step in necessary guidance.



# IRS Notice 2014-21

Under general tax principles applicable to property transactions, virtual currency transactions are reportable to the IRS in the following situations:

## **WAGES AND SERVICES**

- Wage, salary, or other income paid to an employee with virtual currency is reportable by the employee as ordinary income, subject to federal income tax withholding, FICA, FUTA and must be reported on Form W-2.
- Virtual currency received by a self-employed individual in exchange for services is ordinary income subject to self-employment tax.
- Virtual currency received in exchange for goods or services by a business is reportable as ordinary income.
- The basis of virtual currency is the fair market value of the virtual currency in U.S. dollars as of the date of receipt.



# IRS Notice 2014-21

## INVESTMENT

- Gain on the sale of property held as a capital asset in exchange for virtual currency is reportable as a capital gain or loss.
- Gain on the exchange of virtual currency for other property is generally reported as a capital gain if held as a capital asset and as ordinary income if it is property held for sale to customers in a trade or business.
- Payments made in virtual currency are subject to information reporting requirements to the same extent as payments made in real currency or instruments denominated in real currency.



# IRS Notice 2014-21

## MINING

- A taxpayer who successfully “mines” virtual currency, the fair market value of the virtual currency as of the date of receipt is includable in gross income.
- If “mining” constitutes a trade or business, (and the miner is not an employee) the earnings (net of allowable business expense deductions) are self-employment income and subject to self-employment tax.
- The Notice does not address other issues relating to mining of virtual currencies, including treatment of mining costs and whether the tokens are inventory of a miner.



# IRS Notice 2014-21

## INFORMATION REPORTING

- A payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property.
- A payment of \$600 or more in the course of a trade or business is required to be reported to the IRS and to the payee. (Form 1099-Misc. or W-2).
- Examples include: salaries, wages, rent, premiums, annuities and compensation to an independent contractor.



# IRS Notice 2014-21

## BACKUP WITHHOLDING

- A payment made in connection with a trade or business using virtual currency is subject to backup withholding to the same extent as other payments made in property.
- Therefore, payees must give the payor their taxpayer identification number (TIN) and related information.
- The payer must withhold tax from the payment if a TIN is not obtained prior to payment (backup withholding).





# Tax Basis

- Notice 2014-21 provides that the cost basis of a unit of virtual currency received as a payment for goods or services is equal to the FMV of that unit in U.S. dollars on the date received.
- When do gains become taxable?
  - Sale of cryptocurrency.
  - Exchange for Other Property or Service.



# Amount Realized

## Sale

In the case of a sale, the amount realized is equal to the sales price, less any selling costs you incur in the transaction (like commissions or wire transfer fees). Your gain is realized the moment you sell the cryptocurrency. It is irrelevant whether the proceeds from the sale are kept in a bank account or your exchange account.

## Exchange

Realization of a gain may occur when you exchange the cryptocurrency for any type of other property or service. Essentially, any transaction involving a cryptocurrency is a realization event that triggers taxable gain.

For example, if you purchased a laptop on May 1 with bitcoins, your amount realized would be equal to the Fair Market Value of the laptop on that date. The easiest way to determine Fair Market Value is by reference to the sales price, although an alternative method can be used if it yields a more accurate value.

The only way to avoid realization is to hold your cryptocurrency without selling or exchanging it.



# Character of Gain

- Notice 2014-21 provides that the character of gain on the disposition or exchange of virtual currency depends on the nature of the holdings in the hands of the taxpayer.
- For investors, the gain on the sale or exchange will likely be capital gain. The capital gains can be either long term (assets held for at least one year) or short term (held for less than a year).
- In other instances, the gain on sale or exchange will be ordinary, including as a result of treating the virtual currency as inventory or another trade or business asset, for example.



# Losses

The IRS notice provides that the deductibility of a loss depends on multiple factors. In general, losses from the exchange or disposition of assets held for personal purposes are not deductible.

- A person who uses virtual currency exclusively for consumption will be required to recognize gains, but would be denied deductions for any losses because the transaction was not entered into for profit.

Losses from sale of cryptocurrency held as an investment are subject to general loss rules under the Code.

- Offset gains with losses.
- Carryover losses.
- New restriction on trade or business losses.



# What about Cryptocurrency Forks?

- In 2017, the bitcoin blockchain “hard forked” for the first time.
  - In August 2017, the bitcoin blockchain was split into bitcoin and bitcoin cash.
  - In practice, all holders of bitcoin as of the date of the hard fork received the right to an equal number of bitcoin cash units.
  - In November 2017, another hard fork of bitcoin occurred when bitcoin gold was created.
  - Bitcoin cash and bitcoin gold were received as a result of holding bitcoin.



# What about Cryptocurrency Forks?

- There are open questions on when a fork should be included in income.
- The character of income resulting from a fork is likewise unclear.
- If treated as a property division, it would be necessary to divide basis each time a cryptocurrency forked.
- If treated as a realization event, then the recipient of the new coin would recognize ordinary income and take a fair market value basis in the new coin.



# How Will IRS Know of Your Gain?

1. Your cryptocurrency exchange or payment processor may report your transaction to the IRS. Form 1099 statement.
2. A bank or exchange may file a Suspicious Activity Report (“SAR”). U.S. banks and exchanges are required to file SARs for wire transfers that are “suspicious” and larger than \$5,000 (\$2,000 in the case of bitcoin exchanges).
  - The larger and/or more frequent your SAR filings, the more likely they will become a legitimate red flag and trigger an investigation
3. Someone may become a Whistleblower/Reward.
4. You voluntarily and accurately report your gains on your tax return.



# Record Requirements

- You are required to maintain records sufficient for determining the amount of your gain or loss, as well as the holding period of your virtual currency.
- The IRS can generally go back and audit your tax returns for a period of 3 years. That period is extended to 6 years if your tax return omitted more than 25% of your income.
- There is no time limit if the civil fraud penalty applies or you never file your tax returns.





# Coinbase – IRS Summons Enforcement Action

- Coinbase is the largest bitcoin trading platform in the United States and registered with FinCEN as a Money Transmitter.
  - Over 5.9 million customers.
  - Over 6 billion bitcoin transactions.
- In November 2016, the IRS filed an ex parte Petition in federal court seeking permission to serve a “John Doe” summons on Coinbase in accordance with Section 7609(f).



# John Doe Summons

- A John Doe Summons is one "which does not identify the person with respect to whose liability the summons is issued."
- The John Doe Summons allows the IRS to get the names and request information and documents concerning all taxpayers in a certain group.
- The government must file a petition in the court of the federal district in which the summoned party resides or can be found. The procedure is ex parte and based "solely on the petition and supporting affidavits" submitted by the government.



# John Doe Summons

- The court will issue the John Doe Summons only if:
  1. The summons relates to the investigation of a particular person or ascertainable group or class of persons;
  2. There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law;
  3. The information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.
- The reason for requiring a court to approve the issuance of a John Doe Summons is to provide some restraint on the IRS.



# John Doe Summons

## Challenging a John Doe Summons

The party who receives the John Doe summons or the subject of the summons cannot intervene in the Section 7609(f) proceeding. Congress intended "that the question whether a John Doe summons could be served should not become embroiled in an adversary proceeding." These parties, however, can challenge the summons in an enforcement proceeding on the ground that the IRS failed to comply with the requirements of *United States v. Powell* (379 U.S. 48) or that it acted with bad faith or abuse of process.

*Powell* identifies the limitations on the IRS's general summons authority. Before a court will enforce a summons, the IRS must make a *prima facie* showing that:

1. its investigation is being conducted for a legitimate purpose;
2. the inquiry may be relevant to that purpose;
3. the government doesn't already have the information; and
4. the IRS has complied with the administrative requirements of the code.



# Coinbase Summons

- The John Doe summons issued to Coinbase requested information "regarding United States persons, who, at any time between January 1, 2013 through December 31, 2015, conducted transactions in a virtual currency as defined in Notice 2014-21."
- Coinbase and some John Does attempted to quash the summons, and the government brought a summons enforcement action against Coinbase.
- The IRS agreed to narrow its initial request to users with at least \$20,000 in any one transaction (buy, sell, send, or receive) in any one year during 2013-2015 for which Coinbase had not filed a Form 1099. (The narrowed summons excluded users who only bought and held Bitcoin during the 2013-2015 period.)
- The IRS alleged that in 2015 only 800 taxpayers reported bitcoin transactions on Form 1040 Schedule D (Capital Gain/Loss Form).



# Coinbase Summons

- The federal district court held that the IRS had satisfied the Powell factors but concluded that some categories of records (like KYCs) were irrelevant to the purpose.
- The district court ordered Coinbase to produce the following customer information:
  - The taxpayer ID number.
  - Name.
  - Birth date.
  - Address.
  - Records of account activity.
  - All periodic statements of account invoices (or the equivalent).
- This information was limited to customers with at least \$20,000 in any one Bitcoin transaction in any one year from 2013-2019.
- Coinbase was required to produce information on 14,355 customers, potentially covering 8.9 million transactions.



# Voluntary Disclosure

- Taxpayers who have not disclosed cryptocurrency transactions should consider filing a voluntary disclosure because it enables taxpayers to become compliant, avoid substantial penalties and generally eliminates the risk of criminal prosecution.
- Service of a John Doe Summons itself will not cause a taxpayer to be ineligible for voluntary disclosure.
  - Domestic.
  - Foreign.
    - OVDP expires on September 28, 2018.
- Acceptance into a voluntary disclosure arrangement depends on the individual facts and circumstances involved.
- Once the government obtains information on a particular taxpayer from the John Doe summons, the taxpayer may no longer be eligible for voluntary disclosure.



# Qualified Amended Return

- IRS permits a taxpayer to file an amended tax return (QAR procedure) before the IRS contacts the taxpayer, avoiding the substantial understatement penalty.
- However, the QAR procedure may not be used:
  1. Once the IRS has issued a John Doe summons to any person, group or class to which the taxpayer belongs, or
  2. After the IRS first contacts a promoter ( section 6700) with respect to a transaction which the taxpayer claimed a tax benefit.
- Coinbase customers covered by the John Doe summons cannot benefit from QAR, but taxpayers who used another virtual currency exchange may be eligible.





# FBARs

- In June 2014, an IRS analyst stated that cryptocurrency was not reportable on an FBAR for tax years ended 2014. However, no guidance was provided in regard to future tax years.
- In November 2018, a Treasury official said that “a virtual currency wallet would not fall under the definition of an account” for FBAR reporting purposes.
- In United States v. Ham, No. C-13-3721-WHA (N.D. Cal. 2014) concluded that online gambling accounts can be foreign financial accounts subject to FBAR reporting.
- The safest approach given this lack of guidance is to report cryptocurrency investments on FBARs to avoid penalties.



# Penalties for Non-Compliance

## Civil

- Fraud penalties imposed under IRC §§ 6651(f) or 6663. Where an underpayment of tax, or a failure to file a tax return, is due to fraud, the taxpayer is liable for penalties that essentially amount to 75 percent of the unpaid tax.
- An accuracy-related penalty on underpayments imposed under IRC § 6662. Depending upon which component of the accuracy-related penalty is applicable, a taxpayer may be liable for a 20 percent or 40 percent penalty.
- Failure to timely or correctly report virtual currency transaction when required to do so may be subject to information reporting penalties under Section 6721 and 6722.



# Penalties for Non-Compliance

## Civil

If cryptocurrency held in a foreign account, additional civil penalties could apply:

- Penalty for failure to file FBAR. The civil penalty for willfully failing to file an FBAR can be as high as the greater of \$100,000 or 50 percent of the total balance of the foreign financial account.
- Penalty for failing to file Form 8938 reporting taxpayer's interest in certain foreign financial assets. The civil penalty for failing to file each one of these informational returns is \$10,000 increasing by \$10,000 for each month the failure continues beginning 90 days after the taxpayer is notified, up to a maximum of \$50,000 per return.



# Penalties for Non-Compliance

## Criminal

- Possible criminal charges:
  - Tax evasion (IRC § 7206).
  - Filing a false return (IRC § 7203).
  - Conspiracy to defraud the government (18 USC § 286).
  - Conspiracy to commit offense (18 USC § 371).
- A person convicted of tax evasion is subject to a prison term of up to 5 years and a fine of up to \$250,000.
- Filing a false return subjects a person to a prison term of up to three years and a fine of up to \$250,000.



# State Tax Implications

- In addition to federal tax liability, virtual currency transactions may trigger state tax obligations.

## Wyoming

- In March 2018, Wyoming adopted a law to promote the growth and development of block chain and cryptocurrency within the state.
- The Crypto Property Tax Exemption law provides that virtual currency is not subject to taxation as “property” in Wyoming.



# Lessons from The Swiss Bank Program

- IRS will contact Coinbase customers within the next few months and open field audits.
- CI may become involved depending on particular facts.
- Indictments of some taxpayers may follow .
- IRS could extend OVDP beyond sunset date of September 28, 2018.
- Abatement of civil penalties unlikely.
- Additional John Does summonses to other exchanges will likely follow – the investigation will expand.
- IRS may issue additional guidance.



# NY AG Opens Investigation

- On April 17 New York Attorney General Eric Schneiderman launched the Virtual Markets Integrity Initiative.
- Described as a “fact-finding” inquiry into the policies and practices of virtual currency exchanges used by consumers to trade crypto currencies.
- Letters were sent to 13 major virtual currency trading platforms requesting key information on their operations, internal controls and safeguards to protect customer assets.
- Appears to be in response to recent reports of theft of vast sums of virtual currency from customer accounts (i.e. Coincheck), market manipulation and sudden unexplained trading outages.
- The exchanges had only two weeks (to May 1) to provide written responses.



# NY AG Opens Investigation

- The questionnaire covered ownership and control, operations and fee structure, internal controls, trading policies, outages, measures to safeguard customer accounts, privacy and money laundering.
- Crypto exchange Kraken responded to the NYAG inquiry, calling the initiative a “publicity stunt,” and referring to Japan’s virtual currencies act as a “good example” of “relatively” reasonable regulation.
- Kraken further objected to the two-week deadline as too short.
- Unclear how the NYAG’s resignation will affect status of the investigation.



# Questions



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Basil Godellas concentrates his practice on representing companies in the asset management industry with respect to regulatory and transactional matters.

He regularly counsels clients in connection with structuring and forming private investment funds, including hedge funds, private equity funds, commodity pools, commingled funds, group trusts and collective investment trusts, new product development, securities offerings and related filing obligations, investment management compliance matters, acquisitions, divestitures, and domestic and cross-border reorganizations.

Basil has structured and documented numerous onshore and offshore funds, including "master feeder" funds, multi-class funds, series funds, and segregated portfolio companies. He has represented an international investment bank in connection with its acquisition of a futures commission merchant, a large investment manager in connection with its reorganization and the spin-off of its alternative investments business division, and the private banking division of a European bank in connection with its acquisition of a registered U.S. investment adviser.

Basil also advises a number of clients with respect to crypto currencies, internet coin offerings, and block chain technology. This includes developing and offering ICOs, in addition to organizing and operating alternative trading systems in compliance with US securities laws and the latest guidance from the SEC and the CFTC. He is the Co-Chair of the firm's Disruptive Technology Taskforce, where he applies his expertise in all aspects of the crypto currency industry and disruptive technologies.



## Lawrence M. Hill

Partner, New York  
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### Services

Federal Tax Controversy  
Tax  
White Collar, Regulatory  
Defense & Investigations  
Banking Litigation

### Education

George Washington University  
JD, 1984

### Bar Admissions

New York

Lawrence M. Hill is a tax partner in the firm's New York office. Prior to joining Winston, he served as a senior partner and global head of tax controversy and litigation at several major international law firms. Earlier in his career, Larry was a trial attorney and National Tax Shelter Project Attorney with the Office of Chief Counsel of the Internal Revenue Service and a Special Assistant United States Attorney with the United States Attorney's Office in Washington, DC. The IRS honored him twice with Special Achievement Awards for his work as a top trial attorney in the country. Larry also previously served as Assistant General Counsel to a "Big Four" accounting firm.

*The New York Times* recognizes Larry as "a leading member of the American tax bar." According to *The Legal 500*, Larry "stands out as one of the country's preeminent advisors in tax controversy, procedure and administration." Additionally, *Chambers USA* credits him with "winning acclaim from all corners." Larry has been recognized as one of *The Best Lawyers in America*, a preeminent attorney by *Martindale-Hubbell*, a New York Super Lawyer, a leader in tax controversy by the *International Tax Review* and a featured lawyer in *Who's Who Legal: Corporate Tax*.

Larry is valued for his judgment, common sense and depth of experience as well as his trial, negotiation, procedural and tactical skills in resolving complicated tax disputes. He is appreciated for his thorough and prudent evaluation of sophisticated tax structures and the pragmatic risk management guidance he provides to clients.



## Rachel Ingwer

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### Services

Federal Tax Planning  
Financial Services  
Mergers & Acquisitions  
Private Equity Transactions  
Private Investment Funds  
Tax

### Education

Columbia University  
JD 2008

### Bar Admissions

New York

Rachel advises clients on various domestic and cross-border tax issues, including both M&A and fund-related tax matters. In addition, she has significant experience with addressing tax issues for high net worth individuals.

Rachel Ingwer concentrates her practice on transactional matters. She advises clients on a wide variety of private equity and other transactional issues (both domestic and cross-border), including business formations, taxable and tax-free mergers and acquisitions, divestitures, financings and restructurings and recapitalizations. Rachel also advises clients on debt and equity offerings, tax disclosures issues, and fund formation issues, including structuring and partnership matters.

In addition, she advises high net worth individuals on individual and private foundation tax matters, as well as tax matters relating to their business interests.



## Beth R. Kramer

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### Services

Corporate & Finance  
Financial Services  
Financial Services Regulatory /  
Compliance  
Investment Management  
Latin America Private Equity  
Mergers & Acquisitions  
Permanent Capital Solutions  
Privacy & Data Security  
Private Equity Transactions  
Private Investment Funds

### Education

American University  
JD 1986

### Bar Admissions

New York

Beth focuses her practice on the representation of U.S. and non-U.S. asset managers in connection with the formation of funds and ongoing management of their businesses. She also advises clients on regulatory and compliance matters.

Beth Kramer has extensive experience in advising investment advisers on the formation and ongoing management of funds and on the regulatory and compliance aspects of their businesses. She counsels investment companies, private funds and separately managed accounts on structuring, organization, distribution, and SEC regulatory and compliance issues, including responses to SEC examinations.

Beth's experience includes the creation of new advisory businesses, along with registration and formation with appropriate regulatory authorities, development of compliance policies and procedures, performing compliance reviews, and counseling clients on compliance with the Dodd-Frank Act, Investment Advisers Act of 1940, and the Investment Company Act of 1940. She also regularly advises on the creation of disclosure documents for private funds, drafting of investment management products, and evaluating fund documents for institutional investors and family offices seeking alternative investments.

Additionally, Beth counsels clients on transactions involving cryptocurrency, blockchain, and token offerings. She also advises clients on applicable securities laws and regulatory matters. She serves on the firm's Disruptive Technology Taskforce advising on all aspects of the industry.





## Michael L. Loesch

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### Services

Corporate & Finance  
Corporate Governance  
Derivatives & Structured  
Products  
Electric Power Transactions  
Energy & Environmental  
Energy Industry Investigations  
& Litigation  
Litigation  
Securities Litigation  
White Collar, Regulatory  
Defense & Investigations

### Education

University of San Diego  
JD 1993

### Bar Admissions

Pennsylvania  
District of Columbia

Michael focuses his practice on advising corporations and individuals on matters related to commodities and securities litigation and enforcement, corporate internal investigations, and regulatory compliance.

Michael Loesch counsels clients with respect to CFTC and SEC enforcement investigations and compliance matters, including those involving energy trading and derivatives market activity. He has extensive enforcement and compliance experience that stems from his private practice and more than 14 years of federal regulatory and legislative service. He previously served in senior leadership positions at the CFTC and the SEC, including:

- **Chief of Staff and Chief Operating Officer, US Commodity Futures Trading Commission:** As Chief of Staff under CFTC Acting Chairman Walter Lukken, Michael provided counsel regarding the full range of legal, regulatory and policy matters before the CFTC, including energy market oversight, enforcement investigations, futures market surveillance, derivatives clearing, and litigation. In that role, Michael also served as the primary CFTC staff representative to the President's Working Group on Financial Markets.
- **Counsel to the Chairman, US Securities and Exchange Commission:** Michael served for seven years at the SEC in various roles, including Counsel to the Chairman for enforcement matters. He provided legal advice to the SEC Chairman regarding many of the highest profile SEC enforcement proceedings at the time.
- **Branch Chief, US Securities and Exchange Commission:** As a supervisor in the SEC's Enforcement Division, Michael supervised investigations of federal securities law violations including matters involving market manipulation, insider trading, accounting fraud and broker dealer conduct.
- **Extensive Investigation Experience:** Michael obtained extensive investigation experience as a Senior Counsel in the SEC's Enforcement Division, where he handled several complex investigations that resulted in SEC enforcement actions involving broker dealer fraud and accounting fraud.

Before joining the SEC, Michael served in various roles as a staffer in the US Senate, including as Counsel, US Senate's Committee on Governmental Affairs, Subcommittee on International Security, Proliferation and Federal Services. In that capacity, Michael worked on the Committee's year-long investigation of campaign finance abuse and foreign influence in the 1996 federal elections. He also staffed US Senator Thad Cochran of Mississippi during hearings and investigations conducted by the Senate's Permanent Subcommittee on Investigations.



## Richard Nessler

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### Services

Banking Litigation  
Federal Tax Controversy

### Education

St John's University  
JD 1991

### Bar Admissions

New York

Richard is a seasoned litigator with 20 years of experience representing corporations and individuals in complex federal tax controversy matters and internal and governmental investigations.

Richard Nessler is Of Counsel in the firm's New York office. He is an experienced litigator who concentrates his practice on representing clients in tax litigation and IRS controversy matters. His practice also includes the representation of clients in New York State tax controversy matters, as well as in government and internal investigations and related tax and appellate matters. He is a frequent writer on tax controversy and litigation issues, and is a contributing editor for Winston & Strawn's bi-monthly tax controversy newsletter.

# Thank You



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