

Cryptocurrency Soft Letters Yield Big Bang for the Buck

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The IRS is getting more information from its cryptocurrency exchange John Doe summonses, which it will use to fuel another round of soft letters to account holders, according to an agency official.

The IRS used the information it got from its John Doe summons to [Coinbase Inc.](#) to send taxpayers [10,000 letters](#) reminding them to report their taxable gains from dealing in virtual currencies.

Those letters induced approximately 600 calls to an IRS hotline, 577 taxpayer amended returns, and an additional \$15 million in assessed tax liabilities, according to Steve Dyson of the IRS Office of Fraud Enforcement (OFE).

The IRS determined that in 123 of the responses, the taxpayers were already fully compliant, often because they proved that their basis in the transactions covered the gross receipts from those transactions, Dyson said December 10 at a conference in Las Vegas hosted by the American Bar Association Section of Taxation.

The letters were great tools for improving the IRS's efficiency because those results came without any audits, Dyson said. For example, the IRS's Large Business and International Division has 329 open audits linked to the Coinbase John Doe summonses, and approximately 100 cases closed to date have yielded only about \$1 million in tax collections, he said.

"We get the best bang for the buck here," Dyson said. Because the agency has gotten that level of compliance response, the soft letters [will probably reappear](#) in response to the John Doe summonses the IRS served on cryptocurrency exchanges [Circle](#) and [Kraken](#), he said.

Roger M. Brown of Chainalysis Inc. noted that only about 1 percent of the taxpayers disclosed by the Coinbase summons had already been compliant. He attributed much of the controversy in the area to what he called the "broken" Form 1099 process for cryptocurrency.

Cryptocurrency third-party reporting, [at least to date](#), hasn't been comparable to other investment reporting for a variety of reasons, he said.

New Releases

The IRS received information about [approximately 14,000 users](#) with transactions over \$20,000

in response to the Coinbase summons.

Dyson said the agency has gotten 85,000 results from its latest two John Doe summonses. That data will be added to the IRS's databases and fuel both audits and criminal referrals in addition to serving as the basis for another round of soft letters, he said.

Lawrence A. Sannicandro of McCarter & English LLP noted the sevenfold increase in results between the Coinbase and later cryptocurrency exchange summonses.

Michel R. Stein of Hochman Salkin Toscher Perez PC noted that the Coinbase summons used older tax years but the same dollar threshold for determining which accounts the exchanges had to disclose to the IRS. The substantial increase in virtual currency values could explain a large portion of the increased number of responses, he said.

New Additions

The IRS will continue to employ John Doe summonses as investigative tools, and the OFE's [emerging threat mitigation team](#) is looking for future targets, Dyson, the leader of that team, said.

The emerging threat mitigation team has nine members but is looking to add more, according to Dyson. So far, it has several experienced revenue agents who used to be part of the special enforcement program and a couple of seasoned revenue officers, he said, adding that further staffing should include some statisticians and information technology folks.

Dyson said his team has been working on the OFE's [Operation Hidden Treasure](#), an umbrella program for the office's interest in cryptocurrency tax compliance. Those efforts include work on an analytic tool for incorporating taxpayer lifestyle data into the various analyses the office performs when looking for tax fraud, he said. The lifestyle tool is expected to go live toward the end of 2022, he added.

The OFE and its emerging threat mitigation team are also interested in suspicious activity reports that banks file with the Financial Crimes Enforcement Network under the Bank Secrecy Act, according to Dyson. Those reports are helpful records often used as part of making referrals to the IRS's Criminal Investigation division, he said.

Because hand review of thousands of those reports can be cumbersome, a process is underway to automate that task, Dyson said. After computers analyze the data, IRS analysts will be able to examine it and look for noncompliance trends and individual noncompliant taxpayers, he said.