

Thousands of Virtual Currency Owners May Be Subject to Back Taxes, Penalties, and Interest

Tax & Benefits Alert

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The IRS has begun sending “educational” letters to more than 10,000 taxpayers who have engaged in virtual currency transactions, but possibly failed to report and pay tax on those transactions. According to the IRS, these letters are intended to “help taxpayers fully understand and meet their obligations.” This alert discusses the types of letters the IRS is issuing, why the IRS may have sent the letter to the taxpayer, and what to do if such a letter is received.

Types of Letters

The IRS is sending three variations of the letter, depending on the information the IRS has about the recipient:

- Letter 6173 addresses taxpayers who the IRS (a) knows have or had one or more virtual currency accounts and (b) believes may have been required to file a tax return, form, or schedule reporting virtual currency transactions for the 2013 through 2017 tax years, but did not. The letter requests a response from the taxpayer, potentially including a declaration made under penalties of perjury, irrespective of whether the taxpayer believes that he or she properly reported all items.
- Letter 6174 addresses taxpayers who the IRS (a) knows have or had one or more virtual currency accounts, and (b) believes the taxpayer may not know the requirements for reporting virtual currency. The letter provides information about the reporting requirements and tax treatment of virtual currency. It also invites the taxpayer to take corrective action if he or she identifies potential tax-related issues, including filing an amended return with “Letter 6174” written at the top of the first page.
- Letter 6174-A addresses taxpayers who the IRS (a) believes may have or had one or more virtual currency accounts and (b) believes may not have properly reported such transactions. The letter provides information about the reporting requirements and tax treatment of virtual currency, and the letter invites the taxpayer to take corrective action if he or she identifies potential tax-related issues.

These letters relate to both cryptocurrency and non-cryptocurrency virtual currencies.

Related People:

Geoffrey N. Rosamond
Lawrence A. Sannicandro
Michael A. Guariglia

Why Am I Receiving this Letter?

The “educational” letters, which the IRS has said will reach all recipients by the end of August 2019, are one of the IRS’s broadest crackdowns on tax avoidance with cryptocurrency transactions. Recipients of these letters were most likely identified through information received in response to the John Doe summons served on Coinbase, Inc., in late 2016; the IRS’s Virtual Currency Compliance campaign; the information reporting conducted by various crypto exchanges; the IRS’s recent initiatives toward data analytics; whistleblowers; and potentially related criminal investigations and audits.

We have written about many of these enforcement initiatives and the proper tax treatment of cryptocurrency transactions [here](#). The IRS and the U.S. Department of Justice previously made public that their lawyers and agents are and have been closely reviewing this information, so the IRS’s outreach is not surprising.

What Do I Do if I Receive an “Educational” Letter?

The IRS Commissioner publicly invited noncompliant taxpayers to amend prior years’ tax returns and pay back taxes, penalties, and interest. We urge taxpayers to take these notices very seriously, but not to blindly submit amended tax returns without the advice of counsel. Amended tax returns can subject certain taxpayers to unnecessary penalties and, arguably, be used against the taxpayer in a civil or criminal proceeding.

Taxpayers have various other options to comply voluntarily with the internal revenue laws without the threat of criminal prosecution or accuracy-related penalties. The options potentially available include a so-called “qualified amended return,” a voluntary disclosure using the IRS’s updated voluntary disclosure practice, or one of three IRS administrative procedures. The availability of these options depends on numerous factors, including, but not limited to, the reasons the taxpayer did not report the cryptocurrency, the exchange on which the crypto was traded, whether that exchange was located within or outside of the United States, and the location of the wallet or server on which the crypto was “held.”

The attorneys at McCarter have been advising taxpayers on a broad range of civil and criminal tax issues related to unreported or misreported cryptocurrency transactions. You can learn about our approach in our [articles](#), free [webinars](#), or in-person when we speak this month at the [IRS Nationwide Tax Forum](#) about cryptocurrency and related enforcement.