

Should Your Cannabis or Bitcoin Client Consider Taking the Fifth?

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Overview

- Excellent presentation last year discussing California's Cannabis Industry. We will not duplicate.
- Goldman Sachs is considering a trading desk specifically for bitcoin. WSJ 10/2/17
- Over 100,000 merchants accept bitcoin payments. CryptoCoinsNews
- Merchants include Overstock.com, Home Depot, DirectTV, Dell, Microsoft, Amazon and Expedia. Time.com

Overview

(continued)

- Brief discussion of virtual currency
 - What is “virtual currency”
- IRS Guidance
 - Notice 2014-21
- Civil Exam Considerations
 - LB&I “John Doe” Summons
- Case Studies

What is Cybercurrency?

- Cryptocurrency is any of the many digital currencies exchanged by means of encrypted software and held in digital wallets.
- Several hundred cryptocurrencies exist, with bitcoin the best known.

What is Cybercurrency?

(continued)

- People who hold cryptocurrency that's part of the same network can trade coins or make purchases where the currency is accepted.
- Unlike fiat currency - like U.S. dollars, euros and yen – cryptocurrency is not regulated or controlled by any government agency.

What is Bitcoin?

- A digital cryptocurrency using peer-to-peer technology for nearly instant payments.
- Bitcoin was invented by an unidentified programmer or group of programmers, under the pseudonym Satoshi Nakamoto.

What is a Blockchain?

- The entire history of bitcoin transactions is recorded in a digital ledger called the blockchain.
- Because the blockchain is public anyone can access it. Data is stored across a network.

What is a Blockchain?

(continued)

- Each record or series of records on the blockchain is known as a block.
- A block is sent to the network and added to the blockchain after it's accepted by the network as a valid transfer.

Key Terms

- Bitcoin Address
 - Called a Key, which is a string of alphanumeric characters used to receive bitcoin.
- Bitcoin Exchange
 - An online website or platform that allows users to buy and sell bitcoin for other currencies.

Key Terms

(continued)

- Digital Wallet
 - Sometimes called an e-wallet, an electronic system or app that securely stores personal information, payment details and passwords so that a consumer can make digital payments online or at retail stores that accept cryptocurrencies.

IRS Guidance and Direction

- GAO Report 13-516 – Virtual Economies And Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks
- MSP #24 – Taxpayer Advocate 2013 Report to Congress – The IRS should issue guidance to assist users of digital currency

IRS Guidance and Direction

(continued)

- IRS Notice 2014 – 21 – How existing general tax principles apply to transactions using virtual currency
- TIGTA Report #2016-30-083 – As the use of virtual currencies in taxable transactions becomes more common, additional actions are needed to ensure taxpayer compliance

IRS Notice 2014 – 21

- Virtual currency is treated as property, not currency.
- Income received in the form of virtual currency equals its fair market value in U.S. dollars, as of the date that the virtual currency was received.
- The basis of virtual currency equals its fair market value in U.S. dollars, as of the date that the virtual currency was received.

IRS Notice 2014 – 21

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- Sales or exchanges of virtual currency may create a taxable gain or loss.
- A payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property.

Civil Exam Considerations

- Large Portion of Tax Gap Due to Unreported Income
- IRS Enforcement Staffing and Examinations Continue to Fall
- Increased Emphasis on Income Probes during Examinations
- Lack of Information Reporting on Virtual Currency Transactions

IRS Coinbase, Inc “John Doe” Summons

- Coinbase is a virtual currency “exchanger”, offers buy/sell trading functionality in 32 countries, maintains over 4.9 million wallets, and \$2.5 billion exchanged in bitcoin.
- Senior IRS Revenue Agent Utzke identified and interviewed three taxpayers who had used virtual currencies as a means of evading taxes.

“John Doe” Summons

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- “To further its investigation into the identities of U.S. taxpayers who have failed to disclose tax information relating to their participation in virtual currency transactions” ... “to identify U.S. persons who have not properly reported income arising from their use of virtual currency”
- Very Broad Documents Requested

“John Doe” Summons

(continued)

- Following Motions to Intervene and Quash IRS Narrowed documents summonsed to Coinbase users with:
 - A minimum equivalent of \$20,000 in one transaction
 - With no 1099-K filed by Coinbase, or
 - A Coinbase user whose Identity is known by the IRS.

Hypothetical #1

- Taxpayer, a dual U.S./Chinese citizen, owns a foreign account at UBS Switzerland. TP opened the account several years ago with his Chinese passport and has never reported it to the IRS. UBS has no idea TP is also a U.S. person. TP would like to repatriate the funds from his foreign account to get into the marijuana business in California.
- TP transfers the funds from his UBS account to another Swiss bank which works with a virtual currency exchanger to convert his funds into bitcoin.
- TP begins his marijuana business purchasing marijuana and paying rent with bitcoin, while paying his employees in a combination of bitcoin and cash.
- Eventually TP repatriates all of the funds from Switzerland to the U.S. by selling the marijuana in exchange for cash.
- TP comes to you and asks you to prepare his tax return.

Hypothetical #2

- TP is now under examination.
- IRS Agent asks to interview your client.
- During the interview the Agent asks TP if he deals with bitcoin. TP takes the fifth.
- Gov't obtains a warrant to search TP's home and uncovers a cell phone. The phone contains TP's private key to his bitcoin wallet.
- Gov't asks TP the password to his phone. Does he have to provide it?
- Can the IRS force eye retina and/or fingerprint to unlock?

Questions

