

December 23, 2016

U.S. Department of Justice Obtains Court Order Authorizing IRS to Investigate Bitcoin Users

Using the same procedure it used to crack the secrecy of Swiss Banks, on November 30, 2016, the U.S. Department of Justice obtained a court order allowing the IRS to issue a “John Doe” summons to Coinbase Inc., the largest exchanger of bitcoin into dollars in the United States as of last year. *See United States v. Doe*, No. 3:16-cv-6658 (N.D. Cal., filed Nov. 17, 2016). The summons approved by the court allows the IRS to seek the names of U.S. taxpayers, as identified by their U.S. address, telephone number, e-mail domain, or bank account, who conducted transactions in bitcoin or other convertible virtual currencies from 2013 through 2015, as well as detailed profile information, transaction history, statements, correspondence and other items regarding their Coinbase accounts. The IRS has stated that it needs this information to determine the correct federal income tax liabilities of these Coinbase customers. However, one Coinbase customer has already challenged the validity of the summons, moving to quash it in the same court proceeding. His motion is scheduled to be heard in January.

The Justice Department’s action comes two years after the IRS issued guidance on virtual currencies after being criticized by the Government Accountability Office (“GAO”) for failing to do so and thus “missing an opportunity to address virtual currency tax compliance risks.” U.S. Gen. Accounting Office, GAO-13-516, *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks* (2013). That guidance, found at IRS Notice 2014-21, advises that virtual currency transactions generate taxable income in various circumstances, such as when a taxpayer receives virtual currency as payment for goods or services or exchanges virtual currency for other assets, goods or services exceeding the taxpayer’s basis in the virtual currency. The Notice provides that, when a taxpayer receives virtual currency in lieu of either wages or non-employee compensation, that income is subject to withholding and employment tax or self-employment tax, respectively, and that the payor must comply with all relevant informational reporting requirements as if the payments had been made in cash.

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