

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Virtual Currency Tax Compliance Enforcement Can Be Improved

July 10, 2024

Report Number: 2024-300-030

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

TIGTACommunications@tigta.treas.gov | www.tigta.gov

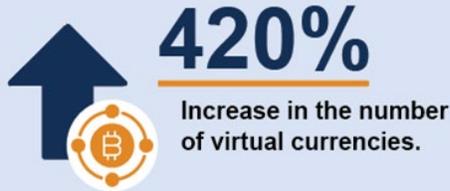
HIGHLIGHTS: Virtual Currency Tax Compliance Enforcement Can Be Improved

Final Audit Report issued on July 10, 2024

Report Number 2024-300-030

Why TIGTA Did This Audit

This audit was initiated because the use of virtual currency has grown exponentially in recent years. In addition, the number of types of virtual currency has grown significantly since April 2020, from 5,000 to over 26,000 as of July 2023.



The anonymity of virtual currency, complicates the IRS's enforcement efforts. The tax enforcement of virtual currency transactions is a challenge for the IRS because it does not have a clear window into taxpayers' virtual currency investments or transactions because their names generally are not directly attached. Further, the IRS does not consistently get reports from trading platforms on virtual currency transactions.

Impact on Tax Administration

The number of taxpayers using virtual currency as a payment method is growing. Because the IRS regards virtual currency as property, each time a taxpayer uses virtual currency as a medium of exchange it potentially creates taxable consequences. Making payments with virtual currency has emboldened taxpayers to move money offshore, purchase illegal goods and services, and carry out other nefarious activities. Users may feel there is the possibility of avoiding tax reporting obligations.

What TIGTA Found

IRS Criminal Investigation has taken advantage of analytics tools to address virtual currency noncompliance. During Fiscal Years 2018 to 2023, Criminal Investigation investigated 390 cases involving virtual currency (hereafter referred to as digital assets). In that period, 224 cases were completed with a recommendation for prosecution.

The IRS civil examination enforcement efforts focused on digital assets are mostly indirect and negligible. For instance, the IRS business units do not use taxpayers' responses to the Form 1040, *U.S. Individual Income Tax Return*, digital assets question to

[REDACTED] The IRS stated that it uses the information [REDACTED]

The IRS established "Operation Hidden Treasure," describing it as a partnership between the criminal and civil functions to identify taxpayers who omit digital assets from their tax returns. However, its primary purpose has been limited to the acquisition of tools and training, rather than pursuing taxpayers.

Passage of the Infrastructure Investment and Jobs Act in November 2021, requires brokers to file an information return for digital assets transactions in a calendar year. In response, the IRS created a new information form to report the information needed to calculate gains (or losses) on transactions. While the Infrastructure Investment and Jobs Act was effective for transactions after January 1, 2023, the proposed regulations are effective for transactions after January 1, 2025, for gross proceeds reporting and January 1, 2026, for basis reporting. The proposed two-year implementation delay will hinder efforts to regulate the digital asset industry and may result in lost revenue and taxpayer burden.

What TIGTA Recommended

TIGTA recommended that the Deputy Commissioner ensure that other pertinent divisions and functions: 1) analyze [REDACTED] of digital assets; 2) leverage data pertaining [REDACTED] compliance activity; and 3) develop a compliance plan that includes the use of Form 1099-DA (Digital Assets) data, case identification, and case selection of digital asset cases.

IRS management agreed with all three TIGTA recommendations. For example, IRS management agreed that [REDACTED] with digital asset transactions and plans to use case data and tax return data in the development of an IRS-wide Compliance Strategic Plan.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20024

July 10, 2024

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

A handwritten signature in cursive script that reads "Danny Verneuille".

FROM: Danny R. Verneuille
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Virtual Currency Tax Compliance Enforcement Can Be Improved (Audit No.: 202330015)

This report presents the results of our review to determine how effectively the Internal Revenue Service identifies income earned from virtual currency transactions. This review is part of our Fiscal Year 2024 Annual Audit Plan and addresses the major management and performance challenge of *Tax Compliance and Enforcement*.

Management's complete response to the draft report is included as Appendix III. If you have any questions, please contact me or Frank J. O'Connor, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).

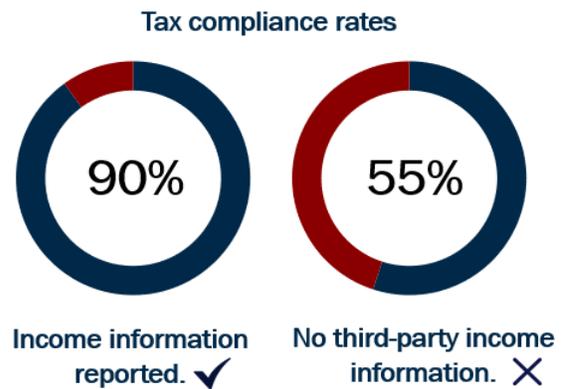
Table of Contents

<u>Background</u>	Page 1
<u>Results of Review</u>	Page 8
<u>IRS Enforcement on Criminal Activity Involving Digital Assets Is Increasing, While Civil Enforcement Efforts Can Be Improved</u>	Page 9
<u>Recommendations 1 through 3</u>	Page 19
Appendices	
<u>Appendix I – Detailed Objective, Scope, and Methodology</u>	Page 20
<u>Appendix II – Selected Legal Provisions and Guidance for Reporting Digital Asset Transactions</u>	Page 22
<u>Appendix III – Management’s Response to the Draft Report</u>	Page 24
<u>Appendix IV – Glossary of Terms</u>	Page 27
<u>Appendix V – Abbreviations</u>	Page 30

Background

Virtual currency is a digital representation of value that functions as a unit of account, medium of exchange and a store of value, and its use throughout the economy has grown exponentially in recent years.¹ In the last 15 years, virtual currency has grown into a trillion-dollar industry. Since its emergence, virtual currency has proven challenging for the Internal Revenue Service (IRS) from both a guidance and an enforcement perspective. Despite the label as a “currency,” the IRS regards virtual currency as property that when sold can generate taxable gain or loss for taxpayers, creating taxable consequences each time the virtual currency is used as a medium of exchange.²

Due to the anonymity of virtual currency transactions, the IRS does not always have a clear window into taxpayers’ transactions, and the trading platforms do not generally provide information reporting documents to the IRS. Without information reporting documents, the IRS has been unable to use some of its enforcement tools to match reported virtual currency-related income to taxpayers’ tax returns to ensure that taxpayers are accurately reporting their income generated from virtual currencies. When there is income information reporting from third parties, tax compliance exceeds 90 percent; however, when there is no third-party income information tax compliance is 55 percent.³



For some taxpayers, the anonymity has been part of virtual currency’s appeal, and the anonymity of virtual currencies complicates the IRS’s enforcement efforts. For other taxpayers that purchased virtual currency on various platforms and moved among different digital wallets, determining taxable gains may be problematic, even when the taxpayers want to be tax compliant.⁴

While all cryptocurrencies are virtual currencies, not all virtual currencies are cryptocurrencies. Both virtual currency and cryptocurrencies fall under the umbrella of digital assets, and both use cryptographic protocols to secure transactions recorded on publicly or privately available decentralized ledgers, called blockchains. The virtual currency Bitcoin has been described as a pure peer-to-peer version of electronic cash involving digital signatures that allows online payments to be sent directly from one party to another without going through a financial institution.⁵

¹ See Appendix IV for a glossary of terms.

² IRS Notice 2014-21 – *IRS Virtual Currency Guidance*.

³ IRS, Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016* p. 3 (Rev. 10-2022).

⁴ Digital wallets allow payment for goods or services electronically without using physical cards or cash (e.g., Apple Pay, Venmo, and PayPal).

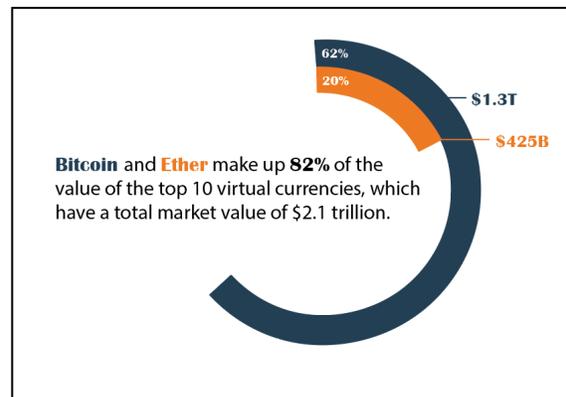
⁵ Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (Oct. 31, 2008), <https://www.bitcoin.com/satoshi-archive/whitepaper/>.

The number of virtual currencies has grown significantly since April 2020, from 5,000 to over 26,000 (420 percent) as of July 2023. The following graphic shows that the two most dominant virtual currencies had a total market value of over \$1.7 trillion as of June 11, 2024. Bitcoin represented nearly 62 percent of the market capitalization at over \$1.3 trillion, while Bitcoin and Ether together account for over 82 percent market capitalization among the 10 largest virtual currencies.

Obtaining and using virtual currency

Virtual currency can be obtained in various ways including mining; trading for goods and services; purchases through brokers; and exchanges using dollars and/or other virtual currencies.⁶ Virtual currency exchanges are online platforms that allow users to buy, sell, or trade virtual currencies. The Securities and Exchange Commission recently approved the listing and trading of Exchange Traded Product shares allowing investors to have the ability to invest in digital assets without directly owning those assets.⁷

Virtual currency wallets are reflected as a string of letters and numbers and store private keys.⁸ These private keys allow access to the virtual currency and are used to send and receive digital assets and monitor balances. Virtual currencies are sent and received for trading between users, purchasing, or exchanging into U.S. dollars, euros, other fiat currencies, and/or virtual currencies through a direct peer-to-peer system. Virtual currency can be used for direct purchases, gift cards, and/or investments.



The number of taxpayers using virtual currency as a payment method is growing. Making payments with virtual currency instead of a fiat currency has emboldened users to move money offshore, purchase illegal goods and services, and carry out other nefarious activities. Also, users may feel there is the possibility of avoiding tax reporting obligations.

History of reporting guidance and tax consequences of virtual currency transactions

In March 2014, the IRS issued Notice 2014-21, on the tax treatment of virtual currency transactions for individuals and businesses. For Federal tax purposes, virtual currency is treated as property.⁹ This notice provided that the sale or exchange of virtual currencies, the use of

⁶ A person or entity engaged in the business of exchanging virtual currency for fiat currency, fiat for virtual currency, or exchanging other types of virtual currency. Exchanges can be either centralized or decentralized.

⁷ Statement on the Approval of Spot Bitcoin Exchange-Traded Products, Securities and Exchange Commission Chairman, (January 10, 2024).

⁸ Keys are used to send and receive digital assets and monitor balances.

⁹ See Appendix II for legal provisions and guidance related to virtual currency.

virtual currencies to pay for goods or services, and buying and selling them as an investment generally have tax consequences that could result in a tax liability.¹⁰ For example:

- Payments using virtual currency made to independent contractors and other service providers are taxable, and self-employment tax rules generally apply. Payors are subject to the same information reporting requirements as any other payor. For example, a Form 1099-MISC, *Miscellaneous Information*, must be issued to an independent contractor if Bitcoin payments exceed \$600 per year.¹¹
- Wages paid to employees using virtual currency are taxable to the employee, must be reported by an employer on a Form W-2, *Wage and Tax Statement*, and are subject to Federal income tax withholding and payroll taxes.
- When a taxpayer sells or exchanges virtual currency or an asset with similar characteristics that is held as a capital asset, the resulting gain or loss is treated as a capital gain or loss for Federal income tax purposes. Additionally, if a taxpayer uses virtual currency that is held as a capital asset to pay for a service, it is similar to exchanging a capital asset for that service and a capital gain or loss will be incurred on the transaction.

The IRS has expanded upon the examples provided in Notice 2014-21 by providing a series of frequently asked questions on IRS.gov to assist taxpayers in reporting of virtual currency tax matters. Figure 1 provides examples of virtual currency transactions that affect income reporting and others that do not.

¹⁰ Holding virtual currency as an investment has tax consequences generally when the taxpayer sells or transfers the virtual currency.

¹¹ Although not used by independent contractors before Notice 2014-12 was issued, they currently use Form 1099-NEC, *Nonemployee Compensation* for payment purposes.

Figure 1: Taxable and Nontaxable Virtual Currency Transactions

	SALES	AIRDROP	MINING	STAKING
Taxable	If virtual currency is sold for cash, traded for currency, or used to buy something, the transaction is taxable.	An airdrop is a random distribution of coins during a marketing effort. The IRS considers marketing giveaways to be ordinary income.	This action creates ordinary income. For example, if one joins a mining pool and spends \$8,000 on electricity and is rewarded with a Bitcoin worth \$9,800. Even if one doesn't sell the coin, the \$1,800 profit must be reported.	Some blockchains reward participants for putting up their virtual currency as collateral and then certify the transactions. The reward coins are treated like bank interest, as ordinary income.
Nontaxable	Transfers of virtual currency from a wallet, address, or account belonging to themselves to another wallet, address, or account that also belongs to themselves, the transfer is a nontaxable event.	If one receives virtual currency as a bona fide gift, the gift is nontaxable.	Donation of virtual currency to a charitable organization described in Internal Revenue Code (I.R.C.) Section 170(c), one will not report income, gain, or loss from the donation.	When a distributed ledger undergoes a protocol change that does not result in the creation of a new cryptocurrency. Soft forks do not result in any income.
	SELF TRANSACTIONS	BONA FIDE GIFTS	CHARITABLE CONTRIBUTIONS	SOFT FORKS

Source: Treasury Inspector General for Tax Administration's (TIGTA) review of the IRS's guidance related to virtual currency and digital assets.

An airdrop is an unsolicited distribution of a cryptocurrency token or coin, usually for free, to numerous wallet addresses. A hard fork occurs when a cryptocurrency undergoes a protocol change and the cryptocurrency splits into two and may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the original distributed ledger.

In October 2019, the IRS issued Revenue Ruling 2019-24, which offered guidance on the income tax consequences of airdrops following hard forks. Revenue Ruling 2019-24 addressed gross income context of airdrops that follow hard forks. Yet, the guidance did not address the general tax treatment of airdrops. Under this Revenue Ruling, if the distributed ledger (such as a blockchain) of a cryptocurrency undergoes a hard fork, creating new cryptocurrency, and a holder of the original cryptocurrency receives units of this new cryptocurrency by means of an "air drop," then the holder has ordinary income as a result.

The Infrastructure Investment and Jobs Act (IIJA), amended Internal Revenue Code (I.R.C.) § 6045 to provide information reporting requirements for brokers with respect to digital assets.¹² The law clarifies the definition of broker to include "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."¹³ IIJA changes to I.R.C. § 6045 also add digital assets acquired on or after January 1, 2023, to the list of covered securities subject to cost-basis reporting. Hereafter and where appropriate, we will use the term digital assets when referring to virtual currency and

¹² Public Law No. 117-58, Provision 80603 (Nov. 15, 2021).

¹³ Public Law No. 117-58, Provision 80603(a)(3) (Nov. 15, 2021).

cryptocurrency.¹⁴ The term digital asset is defined as a digital representation of value that is recorded on a cryptographically secured distributed ledger (or similar technology).

On January 9, 2023, the IRS released Announcement 2023-2, which provided transitional guidance stating that brokers are not required to report additional information with respect to dispositions of digital assets, issue additional statements, or report to the IRS on transfers of digital assets until final regulations under I.R.C. §§ 6045 and 6045A are issued.

In July of 2023, the IRS issued Revenue Ruling 2023-14 addressing whether a cash-method taxpayer that receives additional units of digital assets from staking must include the fair market value of those rewards in gross income. Staking is when the taxpayer locks up the coins in the blockchain to help support the operation of a blockchain and maintain its security. In exchange for staking, taxpayers earn rewards calculated in percentage yields, earning more digital assets.¹⁵

The IRS's frequently asked questions advises taxpayers to report most digital asset sales and on how to calculate any capital gain or loss in accordance with IRS forms and instructions, including on Form 8949, *Sales and Other Dispositions of Capital Assets*, and then summarize capital gains and deductible capital losses on Form 1040, *U.S. Individual Income Tax Return*, Schedule D, *Capital Gains and Losses*. The frequently asked questions also advise taxpayers with ordinary income from digital assets to report on Form 1040, Schedule 1, *Additional Income and Adjustments to Income*, as applicable.

Digital assets voluntary reporting efforts

It has been difficult for the IRS to identify taxpayers with digital asset transactions in part because of the lack of third-party information reporting and guidance regarding those requirements. To give the IRS more insight with respect to digital asset ownership, the IRS created a question on Schedule 1 of Form 1040 in Tax Year (TY) 2019 asking taxpayers if they received, sold, sent, exchanged, or acquired an interest in virtual currency. For TY 2020, the IRS moved this question to Page 1 of Form 1040, where it remains. In addition to the new more prominent location, since TY 2022, the IRS changed the question to reflect digital assets. In addition, the TY 2022 Form 1040 Instructions were revised to present examples of when to select "Yes" and instructions on how to report digital asset transactions. For TY 2023 the IRS also added the digital assets question to other tax forms for 2023 returns filed in 2024. Figure 2 exhibits the revised question as shown on Page 1 of TY 2023, Form 1040.

¹⁴ With passage of the IIJA, the IRS updated its terminology and instead of using the term "virtual currencies," it now refers to them as "digital assets." Digital asset is a broader term and would cover nonfungible tokens.

¹⁵ Staking offers digital asset holders a way of earning passive income without selling their digital assets.

Figure 2: Form 1040 Digital Assets Question for TY 2023

Form 1040 Department of the Treasury—Internal Revenue Service		2023	OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.
For the year Jan. 1–Dec. 31, 2023, or other tax year beginning _____, 2023, ending _____, 20____				See separate instructions.
Your first name and middle initial _____		Last name _____		Your social security number _____
If joint return, spouse's first name and middle initial _____		Last name _____		Spouse's social security number _____
Home address (number and street). If you have a P.O. box, see instructions. _____			Apt. no. _____	Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse
City, town, or post office. If you have a foreign address, also complete spaces below. _____		State _____	ZIP code _____	
Foreign country name _____		Foreign province/state/county _____	Foreign postal code _____	
Filing Status <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly (even if only one had income) <input type="checkbox"/> Head of household (HOH)				
Check only one box. <input type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Qualifying surviving spouse (QSS)				
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent: _____				
Digital Assets At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) <input type="checkbox"/> Yes <input type="checkbox"/> No				

Source: TY 2023 Form 1040.

Taxpayers answering “Yes” to this question provides the IRS with information about potential taxable events pertaining to digital assets. Although the question does not require taxpayers to provide the nature and extent of such transactions, taxpayers are required to report digital assets gains and losses on IRS Form 8949. Taxpayers who do not properly report the income tax consequences of digital assets transactions may be liable for tax, penalties, interest and in some cases, subject to criminal prosecution.

On January 22, 2024, an IRS Newswire (IR-2024-18) was released reminding taxpayers that they must again answer a digital assets question and report all digital asset related income when they file their TY 2023 Federal income tax return, as they did for their TY 2022 Federal tax returns. This newswire also defined digital assets and provided limited instruction on how to report digital asset income.

IIJA guidance and new Form 1099-Digital Assets Proceeds from Broker Transactions

Prior to passage of the IIJA, most of the statutory provisions requiring third-party information reporting predated the emergence of digital assets and none expressly addressed its treatment.¹⁶ I.R.C. § 6045 generally requires that each person doing business as a broker, file and furnish information returns (Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*) to report information about each customer, gross proceeds, cost-basis reporting and other details as required by regulations.

The IIJA clarifies and expands transfers of covered securities to include digital assets and requires a broker to file an information return with the IRS for a calendar year with respect to any transfer. These changes are effective for information returns required to be filed and statements required to be furnished after December 31, 2023, (effective for transactions after January 1, 2023). In response to Provision 80603 of the IIJA, the IRS created a new information

¹⁶ Public Law No. 117–58, November 15, 2021.

return form, Form 1099-DA.¹⁷ The form is designed to include proceeds from digital assets transactions and to be used by brokers once the regulations under 6045 are amended to include digital assets. The use of Form 1099-DA is contingent on these regulations being finalized. On April 19, 2024, the IRS posted on its website a draft version of Form 1099-DA.¹⁸

The Form 1099-DA will report some of the information necessary so that taxpayers can calculate gains (or losses) from digital asset transactions. Among other information, the form is proposed to capture information including name, address, account number, Tax Identification Number of filer and recipient, broker type, gain or loss, date and time acquired, date and time sold, and cost or another basis.¹⁹

For those digital asset exchanges that were reporting transactions on Form 1099-B, Form 1099-DA is set to replace some of the Forms 1099 currently used by digital assets exchanges to provide their customers' tax information.²⁰ Prior to the effective date of the proposed regulations, the reporting requirements for brokers regarding digital assets were unclear. However, taxable transactions resulting from digital asset activity must be reported by taxpayers on their tax return.

A notice of proposed rulemaking along with proposed Treasury Regulations were issued on August 29, 2023. Treasury and the IRS extended the comment period to November 13, 2023, and postponed the hearing to the same date.²¹ With proposed applicability date for digital transactions taking place on or after January 1, 2025, for gross proceeds reporting and January 1, 2026, for basis reporting, the proposed regulations would:²²

- Define "broker" to include digital asset trading platforms, payment processors, certain hosted wallet providers, and persons who regularly offer to redeem digital assets created or issued by that person.
- Extend the information reporting rules to brokers acting as agents, principals, or digital asset middlemen to effect sales or exchanges of digital assets for cash, broker services, or property subject to reporting of digital assets payments associated with payment card and third-party network transactions subject to reporting under I.R.C. § 6050W.
- Require reporting on real estate purchasers who use digital assets to acquire real estate in a reportable real estate transaction and extend current real estate reporting on sellers

¹⁷ The proposed regulations did not specifically reference the new "Form 1099-DA," however, the press release associated with the publishing of the proposed regulations in the Federal Register specifically references mentions "Form 1099-DA." Brokers will use Form 1099-DA to report proceeds from (and in some cases, basis for) transactions to them and the IRS.

¹⁸ The draft Form 1099-DA is for information purposes and brokers and taxpayers are instructed not to file the draft form.

¹⁹ Basis reporting will not be required on all Forms 1099-DA. The proposed rule is limited to dispositions of a digital asset from the same account in which it was acquired after January 1, 2023.

²⁰ Those using Form 1099-MISC or Form 1099-NEC to report payments like rewards, which are not broker transactions will not be replaced.

²¹ The Administrative Procedure Act requires agencies when drafting regulations to publish a general notice of proposed rulemaking allowing the public to comment on the proposed regulations. 5 U.S.C. § 553(b).

²² Publishing the proposed regulations in the Federal Register provides the public official notice of their existence and allows for the public to provide comments on the proposed regulations.

under I.R.C. § 6045 to include the fair market value of digital assets received by sellers in exchange for real estate.

- Provide specific rules for determining the amount realized in a sale, exchange, or other disposition of digital assets and calculating the basis of digital assets.

While the IJA was enacted in November 2021, the regulations are proposed to take effect January 1, 2025, and the adjusted basis and character of gain or loss for sales of digital assets that are affected on or after January 1, 2026.²³ This proposed two-year implementation delay for broker reporting rules for digital assets will hinder the Government's efforts to regulate the digital asset industry and may result in lost revenue and taxpayer burden. Brokers will not be required to complete and submit Form 1099-DA until January 2026. Form 1099-DA will assist brokers with complying with the proposed reporting requirements and assist the IRS in ensuring taxpayer compliance with income reporting requirements.

The Digital Asset Initiative Project Office

During Calendar Year 2022, the IRS took several actions to centralize its approach to addressing the significant impact that digital assets will continue to have on tax administration.

- In February 2022, the IRS recognized that a Service-wide approach was needed to address digital assets and created the Digital Asset Advisory Committee. The Digital Asset Advisory Committee was established to provide Service-wide collaboration, planning, and information sharing.
- In June 2022, the IRS developed its Digital Asset Initiative which outlines the IRS's Service-wide digital asset priorities. The digital asset initiatives identified during this workshop tie into the IRS's Inflation Reduction Act Strategic Operating Plan by providing an additional set of objectives to further voluntary compliance and educate taxpayers about tax obligations related to digital assets.²⁴
- In October 2022, the IRS formed its Digital Asset Initiative Project Office to continue to provide a Service-wide perspective for digital assets.

To date, the Digital Asset Initiative Project Office continues to coordinate digital asset Service-wide efforts, which includes developing forms, instructions, and guidance; ensuring information systems will receive, store, and access the new digital asset information required by Congress; and conducting other outreach activities.

Results of Review

Consistent with findings from its Tax Gap analyses, IRS research shows that compliance is higher when amounts are subject to information reporting and even higher when also subject to withholding. The IRS refers to the extent of coverage by information reporting and/or withholding as "visibility" because incomes that are reported to the IRS are more "visible" to

²³ On June 28, 2024, while this TIGTA report was in the draft report stage, the final regulations were released ([2024-14004.pdf \(federalregister.gov\)](#)). These regulations were published on July 9, 2024.

²⁴ Publication 3744, Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY [Fiscal Year] 2023 – 2031, pp 40, 62-64, 76-77, 86-87, and 98-99 (April 2023).

both the IRS and taxpayers. Since the popularity of digital assets began to grow, the “line of sight” into digital asset transactions for the IRS and taxpayers has been limited due to the lack of third-party reporting. While publicly available digital asset information identifies transactions, it does not identify the person(s) conducting the transactions.

The IRS’s focus on addressing digital asset tax enforcement issues on the civil side has mainly been on a function-by-function basis, and for some important functions, such as the Examination function, increased line-of-sight into digital asset ownership and transactions has been limited. IRS compliance functions generally have existing processes and procedures to manage their operational workload. For its part, the Large Business and International (LB&I) Division has used John Doe Summons related information in a campaign to address noncompliance related to the use of digital assets through multiple treatment streams including outreach and examinations.²⁵

Criminal Investigation has had greater success with identifying cryptocurrency transactions. It uses specific tools that allow special agents to identify taxpayers linked to suspicious transactions involving digital assets. For instance, special agents can identify the taxpayers associated with digital asset transactions by serving subpoenas on virtual currency exchanges or using software tools and open-source intelligence to analyze blockchain data.

Given the volatile nature of digital asset values, taxpayers owning digital assets must closely monitor and maintain records of all their transactions to correctly report their tax liability at the end of the year. Accordingly, the pending guidance for the changes to I.R.C. §§ 6045 and 6045A, as well as the required use of Form 1099-DA, should assist taxpayers and dramatically increase tax compliance in this area.

IRS Enforcement on Criminal Activity Involving Digital Assets Is Increasing, While Civil Enforcement Efforts Can Be Improved

Criminal Investigation has taken advantage of analytics tools to address digital assets noncompliance. Criminal Investigation has acquired tools and successfully worked with blockchain analytics firms to identify individuals who may be evading taxes by using digital assets to hide their income. However, we found that the civil examination enforcement efforts are mostly indirect and negligible when it comes to identifying digital asset transactions.

Criminal Investigation uses proactive compliance efforts

Although not widely distributed to other IRS business units, Criminal Investigation has used data analytic tools since 2014 to identify potential fraud cases involving digital assets such as money laundering and investment fraud.²⁶ According to the Director of Cybercrimes, Criminal Investigation, during Fiscal Years (FY) 2018 and 2019 the use of digital assets has exploded in activity and value.²⁷ Criminal Investigation special agents use these tools to obtain both private sector and public blockchain data to identify digital assets transactions that are potentially being

²⁵ A John Doe Summons is an IRS summons authorized by I.R.C. § 7609(f). It does not identify the person with respect to whose liability the summons is issued. Internal Revenue Manual 25.5.7.1.1 (June 4, 2020).

²⁶ Criminal Investigation uses investigation software that connects cryptocurrency transactions to real-world entities.

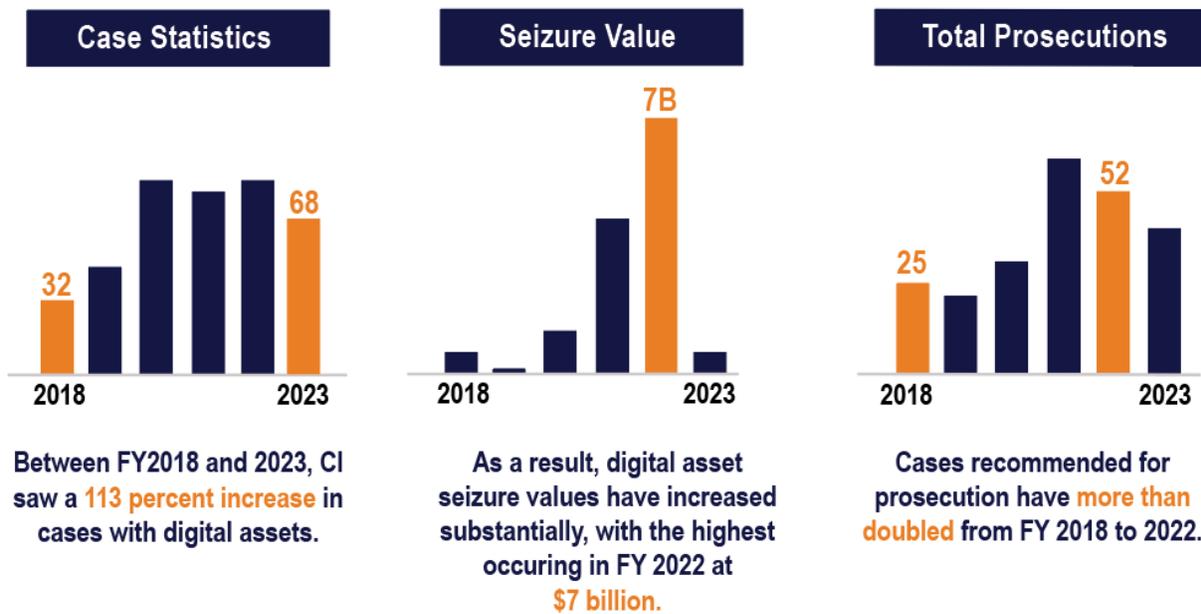
²⁷ Criminal Investigation is involved in cyber-related criminal investigations and provides tools, resources, and training to assist special agents with cyber investigations such as tracking digital assets.

used to fund criminal activity. For example, one such software tool analyzes the blockchain public ledger data, which is primarily used to track digital assets. With this data and other open-source information, Criminal Investigation uses available IRS tax information to enhance its investigative efforts to identify potentially fraudulent blockchain activity.

Special agents take additional steps, such as serving subpoenas, obtaining tax records, performing financial tracing to identify the individuals associated with criminal acts, and using their standard criminal procedures to build their cases.²⁸ While special agents have enforcement tools that are not used on the civil side of the IRS, such as subpoena power, they still face challenges. For instance, the Director of Cybercrimes, Criminal Investigation, stated that for digital asset cases, special agents typically identify the potential criminal transactions before identifying the perpetrator (taxpayer).

These efforts have resulted in the prosecution of significant cases since 2018 involving digital assets. Criminal Investigation officials stated that because of the prevalence of digital assets, the dollar value of seizures ballooned. During FYs 2018 through 2022, the value of seizures increased from approximately \$1.5 million to about \$7 billion. Figure 3 exhibits the number of open criminal cases, seizure value, and total prosecutions involving digital assets for FYs 2018 to 2023.

Figure 3: Criminal Investigation’s Case Statistics Involving Digital Assets



Source: TIGTA’s review of IRS provided data on Criminal Investigation case statistics for FYs 2018 to 2023.

During FYs 2018 to 2023, Criminal Investigation investigated 390 cases involving digital assets, with a 113 percent increase in the number of cases with digital assets from FY 2018 to FY 2023. In that period, 224 cases were completed with a recommendation for prosecution.

²⁸ Special agents are authorized to serve subpoenas issued under authority of the United States.

- This person’s business facilitated the laundering of approximately \$311 million worldwide through the use of virtual currencies. [REDACTED]
- [REDACTED]
- [REDACTED] Consequently, the indictment in this case resulted in a guilty plea in August 2021.

Although Criminal Investigation has access to a number of data analytics tools, selected employees working in IRS civil compliance areas including the Small Business/Self-Employed (SB/SE) Division’s Examination, the LB&I Division, and Research Applied Analytics, and Statistics (RAAS) have access to a subset of the tools Criminal Investigation uses to identify digital asset noncompliance. For example, RAAS performs its own research to detect specific characteristics associated with digital asset transactions as part of its ongoing projects to identify taxpayer noncompliance.

Over the past few years, RAAS has forwarded 354 digital asset leads to Criminal Investigation for further evaluation; [REDACTED] officials stated Criminal Investigation [REDACTED] of those leads into criminal cases. When asked if past referrals sent to Criminal Investigation were rejected and sent to other IRS business units for evaluation, RAAS officials acknowledged that nothing is done with Criminal Investigation rejected leads. Criminal Investigation should send leads that are not suitable for it to work to IRS civil compliance functions. RAAS personnel confirmed that Criminal Investigation is the sole customer for its research because the queries that generated those leads were designed to detect potential criminal noncompliance.

RAAS performs research to support business units including Criminal Investigation and works in collaboration with Criminal Investigation to design research for identification of potential criminal activity. As Figure 4 shows, on average the volume of RAAS digital assets leads nearly doubled each year since FY 2021.

Figure 4: RAAS Digital Assets Leads Sent

FY	RAAS Leads Sent to Criminal Investigation
2020	0
2021	53
2022	96
2023	205
Total	354

Source: TIGTA's analysis of RAAS digital assets leads (as of May 2023).

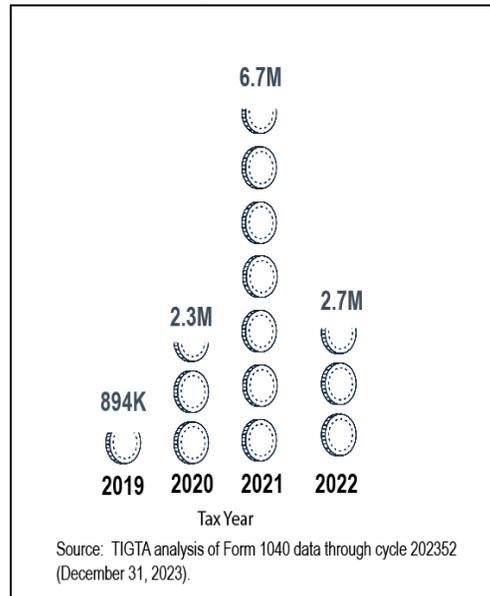
Criminal Investigation special agents perform additional analysis to identify the leads having the greatest criminal potential. Most IRS business units are unable to apply the same techniques as Criminal Investigation special agents to conduct this type of casework.

Use of the Form 1040 digital assets question data **2*****

As stated earlier, for TY 2019, the IRS created a question on Schedule 1 of Form 1040 asking whether taxpayers have received, sold, sent, exchanged, or acquired an interest in digital assets. Since the question was added, the IRS has processed over 662 million Form 1040 taxpayer returns for TYs 2019 through 2022. Figure 5 shows that taxpayers' self-reported use of digital assets increased substantially from TYs 2019 to 2022.

These data are available to the IRS and can be used to enhance its compliance activities to identify digital assets noncompliance. From TYs 2019 to 2022, using Form 1040, nearly 12.6 million taxpayers self-reported as having owned digital assets. The number of taxpayers who annually self-reported as having digital asset transactions increased by 649 percent from TYs 2019 to 2021. In TY 2022 that number decreased to 2.7 million, but that was still a 202 percent increase from TY 2019.

Figure 5: IRS Form 1040 Digital Assets Question Results



Everyone who files Form 1040 is required to select one box, answering either "Yes" or "No" to the digital asset question. If the "Yes" box is selected, taxpayers are instructed to report all income related to their digital asset transactions using Form 8949 to calculate their capital gain or loss. Then they are to report it on Form 1040, Schedule D, Schedule 1 if ordinary income, Schedules C, F, or E if the transaction is business related, or Form 709 in case of gifts. Although the virtual question data are available, the IRS stated that it

The digital assets question must be answered by all taxpayers, not just those who engaged in a transaction involving digital assets. Figure 6 shows that over 2 million taxpayers either selected both “Yes” and “No” or neither for TYs 2020 to 2022. Whether due to taxpayer error or a failure to comply with the Form 1040 digital asset question by these 2 million taxpayers, it is unlikely that the IRS confirmed [REDACTED] because of how the IRS uses the data.

Figure 6: IRS Form 1040 Digital Asset Question

TY	Both Yes and No Checked	Neither Yes nor No Checked	Total
2020	4,450	1,182,920	1,187,370
2021	2,862	729,276	732,138
2022	1,706	506,232	507,938
Totals	9,018	2,418,428	2,427,446

Source: TIGTA’s analysis of Form 1040 data through cycle 202362 (December 31, 2023).

Also, selecting “Yes” does not mean the taxpayer has a taxable or even a reportable transaction. Accordingly, there are limitations on how the response can be used. While IRS business units do [REDACTED] the IRS stated that it uses the information as [REDACTED] to support the IRS’s ongoing compliance activities. For example:

- The LB&I Division combines the Form 1040 virtual question response data with other data points to identify high risk compliance taxpayers. For instance, while under an examination, a taxpayer who the IRS has determined [REDACTED] to the question is considered a higher compliance risk than a taxpayer who [REDACTED] the question. An example of incorrectly answering the question occurs when the IRS determines that a taxpayer answered “No” on the form when evidence exists that the taxpayer has associated virtual currency transactions. However, without third-party information reporting on digital asset ownership, the circumstances of when the IRS would have [REDACTED] [REDACTED]
- The SB/SE Division’s Examination uses Form 1040 responses to generate [REDACTED] in a widely used database that signals to tax examiners that [REDACTED]. This information is used with other data during taxpayer examinations.
- The Automated Underreporter (AUR) unit in the SB/SE Division, [REDACTED]. However, [REDACTED] because without [REDACTED] to match taxpayer responses against.

While the IRS does [REDACTED] use taxpayers’ responses to the Form 1040 digital assets question to increase tax compliance, for TY 2023 the IRS expanded the question to other forms. Specifically, TY 2023 IRS forms show the added question, *Did the partnership or corporation*

receive, or otherwise dispose of a digital asset (or financial interest in a digital asset)? to Form 1065, *U.S. Return of Partnership Income*; Form 1120, *U.S. Corporation Income Tax Return*; Form 1120-S, *Income Tax Return for an S-Corporation*; and Form 709 (Line 20), *United States Gift (and Generation Skipping Transfer) Tax Return*. The IRS should use the additional information it plans to gather to expand its digital assets case selection process to encourage and enforce digital assets reporting compliance.

Operation Hidden Treasure project lacked any enforcement deliverables

When the IRS established “Operation Hidden Treasure,” IRS representatives described it at a Federal Bar Association meeting as a partnership between the criminal and civil functions to identify taxpayers who omit cryptocurrency from their tax returns.³⁰ However, we learned as part of this audit that the primary purpose of the operation has been limited to the acquisition of data analytics tools and of software licenses and employee training, rather than specifically pursuing taxpayers as part of a criminal-civil taskforce. Since December 2020, prior to and including the timespan of Operation Hidden Treasure, the Office of Fraud Enforcement (OFE) has acquired and issued over 600 licenses for blockchain analysis tools to IRS employees.³¹ The OFE cited that the acquisition and issuance of these licenses were the project’s primary results.

This project is a partnership between the IRS’s Criminal Investigation and the OFE.³² According to the project’s charter, Operation Hidden Treasure’s purpose is for the OFE to identify taxpayers and trends with high indications of fraud, routing those cases to IRS Criminal Investigation for further evaluation. Trained Criminal Investigation special agents analyze virtual currency blockchain transactions to work criminal cases. We found that the program charter did not include any specific enforcement deliverables pertaining to either criminal investigation or civil examination results and success statements identifying what it sought to achieve. OFE officials confirmed that there are no written accounts available summarizing project results or the effectiveness of this compliance initiative.

These tools acquired by the IRS are being used to identify unlawful activities involving digital assets. For example, in a recent criminal case finding that the Government’s use of software to search Bitcoin public ledgers constituted probable cause, the court noted:

Repeated government seizures and forfeiture actions should disabuse the uninformed of the myth that BTC [Bitcoin] is untraceable, yet this myth abides. Indeed, the IRS alone seized \$1.2 billion worth of cryptocurrency in fiscal year 2021.³³ *See The IRS has seized \$1.2 billion worth of cryptocurrency this fiscal year – here’s what happens to it*, <https://www.cnbc.com/2021/08/04/irs-has-seized-1point2-billion-worth-of-cryptocurrency-this-year-.html>.

³⁰ Guinevere Moore, *Operation Hidden Treasure Is Here. If You Have Unreported Crypto, Get Legal Advice*, Forbes (March 6, 2021).

³¹ Some employees have licenses for more than one data analytics tool and/or multiple access levels for one tool.

³² The OFE is an office within IRS’s SB/SE Division.

³³ Sigalos, MacKenzie, *The IRS has seized \$1.2 billion worth of cryptocurrency this fiscal year – here’s what happens to it* August 4, 2021, www.cnbc.com (last visited Feb. 17, 2024).

In another recent case, an IRS special agent testified to the court how the defendant used special “tumbler” software to further mask Bitcoin transactions from scrutiny.³⁴ However, the IRS has been [REDACTED] in case selection for civil examinations.

The LB&I Division used digital asset account information obtained via John Doe Summons for compliance purposes

The LB&I Division started implementing compliance campaigns in January 2017 to improve taxpayer compliance. The goal of a campaign is to improve return selection for audit, identify noncompliance risk issues, and more effectively use limited LB&I Division resources. There are 48 active campaigns that focus on specific issues and risks. Since 2018, the LB&I Division has used its virtual currency campaign to address digital assets tax compliance in part through the John Doe Summons process to identify taxpayers with digital asset activity.³⁵ Taxpayers identified through a summons issued by the Department of Justice are placed into treatment streams within the campaign framework and contacted to bring them into compliance.

In 2018, the IRS obtained, in the first of [REDACTED] John Doe Summons, digital assets transactional data from a virtual currency exchange for TYs 2013 through 2015.³⁶ According to the IRS, information for all three fiscal years was included in case files as agents were to address all years prior and subsequent as applicable. As of June 2023, this has resulted in a total of 216 taxpayers being placed under examination and nearly 15,000 taxpayers being sent virtual currency “soft letters” requesting that they take the necessary steps to come into tax compliance.

The IRS stated that it plans to continue to study the John Doe Summons data and after the data analysis is complete, a determination will be made regarding moving forward with its compliance actions. The IRS has aggressively pursued the information requested via the John Doe Summons through litigation. However, the time taken by the litigation process can make the information less usable due to the age of the data. Given the critical information required to be reported on Form 1099-DA, the need for John Doe Summons of digital assets exchanges should be eliminated for those exchanges that comply with the proposed requirements.

Most of the LB&I Division’s digital asset compliance activities have been focused on the use of John Doe Summons to obtain data. The LB&I Division has additional John Doe Summonses in process [REDACTED]

Other virtual currency compliance activities that are associated with the LB&I Division's Virtual Currency Campaign include:

³⁴ *U.S. v. Sterlingov*, 573 F. Supp. 3d 28 (Dist. Col. 2021).

³⁵ In addition to the John Doe Summonses, the LB&I Division obtains leads from Foreign Account Tax Compliance Act, Joint International Taskforce on Shared Intelligence, and other data to develop its compliance workload.

³⁶ *United States v. Coinbase, Inc.*, No. 3:17-cv-01431, 2017 WL 5890052 (N.D. Cal. Nov. 28, 2017) (finding that the narrowed IRS summons served the IRS's legitimate purpose of investigating account holders who may not have paid federal taxes on their virtual currency profits).

- Compliance efforts (letters and audits) initiated from spontaneous exchanges of information from other jurisdictions.³⁷
- Participation in two international forums through the Joint International Taskforce on Shared Intelligence and Cooperation and the Organization of Economic Cooperation and Development.

The LB&I Division's Withholding Exchange and International Individual Compliance Practice Area also provides input and feedback on emerging issues and guidance. The LB&I Division has provided training and guide papers pertaining to digital assets to its field personnel conducting examinations.

SB/SE Division Examination and AUR compliance efforts can be improved

In December 2022, the SB/SE Division's Examination initiated a Compliance Initiative Project (CIP) pertaining to examinations involving digital assets. The purpose of the CIP is to evaluate leads and referrals involving digital assets received from Criminal Investigation and IRS's Bank Secrecy Act examiners.³⁸ The CIP is set to end in February 2025. As of June 2023, there were 48 cases included in the CIP; however, there are no measurable results as none of the CIP examinations have been closed. Figure 7 shows the status of the 48 cases.

Figure 7: Status of CIP Examinations

Status	Number of Examinations
Central Storage – Selected – Not Assigned	14
Status Code Field Office – Assigned-No Time Applied	9
Status Code Field Office – Examination Started	25
Total	48

Source: TIGTA's review of Audit Information Management System data.

In addition to the CIP for digital assets, the SB/SE Division's Examination also works cases resulting from the 2018 John Doe Summons, routine examinations, and other information available to the IRS that may include digital assets activity.

Since FY 2020, the SB/SE Division's Examination performed over 365,000 taxpayer examinations. Although not specifically selected to address digital assets compliance, during that same period, Examination performed 1,144 examinations of taxpayer returns that included a review of digital assets activity. The IRS's coverage of digital assets activity could be considered insignificant, with only 1,144 (0.31 percent) of the 365,391 total examinations conducted having a digital asset

³⁷ The exchange of information that typically involves information discovered during a tax examination, investigation, or other administrative procedure that suggests or establishes noncompliance with the tax laws of a foreign partner, or that is otherwise determined to be potentially useful to a foreign partner for tax purposes.

³⁸ Pub. L. No. 91-508, 84 Stat. 1114 to 11244 (1970) (codified as amended in scattered sections of 12 U.S.C., 15 U.S.C., and 31 U.S.C.). Regulations for the Bank Secrecy Act, and other related statutes, are 31 C.F.R. 103.11-103.77 (2010).

component.³⁹ Figure 8 provides a summary of the number of all examinations along with those identified as having a digital assets component as of May 2023.⁴⁰

Figure 8: SB/SE Division Examinations With a Digital Asset Component

Fiscal Year	Total Number of Returns Examined	Number of Returns Examined That Had a Digital Asset Component	Number of Returns Examined With a Digital Asset Component With Tax Assessed	Total Tax Assessed on Those Returns With a Digital Asset Component	Average Assessment Amount
2020	101,371	27	16	\$507,850	\$31,741
2021	108,660	241	120	\$3,904,431	\$32,537
2022	98,682	486	267	\$13,187,349	\$49,391
2023	56,678	390	224	\$12,258,798	\$54,727
Totals	365,391	1,144	627	\$29,858,428	\$168,396

Source: TIGTA's review of SB/SE Division examinations (as of May 2023).

The amount of total tax assessments from examinations of returns with a digital asset component has risen from \$507,850 in FY 2020 to over \$12.2 million as of May 2023. At least one-half or slightly more than one-half of all returns examined from FYs 2020 to May 2023 that had a digital asset component had the average assessment amount increasing to nearly \$55,000. We cannot determine whether this increase is due only to examinations of the digital asset component; however, it is an indicator that digital assets examinations have the potential to uncover significant underreporting of digital asset activity if performed on a larger scale.

The SB/SE Division's AUR Program routinely matches information return data to tax return information to detect taxpayer noncompliance and generate proposed assessments. Although unable to integrate digital asset characteristics to detect noncompliance, the AUR uses its case selection criteria to choose cases with potential Form 1099-K, *Payment Card and Third-Party Network Transactions* and Form 1099-MISC filing data discrepancies for further screening. AUR examiners screen these returns to identify digital asset and other noncompliance issues and if after screening unresolved discrepancies exist, the AUR will contact taxpayers for verification. For TYs 2018 through 2020, AUR screened and identified over 7,000 returns associated with digital assets activity and reviewed nearly 5.8 million returns in total. Figure 9 summarizes both all AUR and digital assets returns reviewed during TYs 2018 through 2020.

³⁹ $1,144 \div 365,391 \times 100$ percent = 0.31 percent.

⁴⁰ Based on IRS codes indicating examinations with a digital asset component.

Figure 9: SB/SE Division AUR Coverage of TYs 2018 Through 2020

TY	Total Returns Reviewed	Returns Reviewed With a Digital Asset Component				
		Cases Completed	Cases With Tax Assessed	Tax Assessed Percentage of Returns Reviewed	Total Tax Assessment Dollars on Reviewed Returns	Average Assessment Per Case With Tax Assessed
2018	2,489,165	3,791	1,285	34%	\$150,190,871	\$116,880
2019	1,955,681	1,384	468	34%	\$40,674,933	\$86,912
2020	1,312,081	1,895	948	50%	\$27,332,426	\$28,832
Totals	5,756,927	7,070	2,701	38%	\$218,198,230	\$232,624

Source: TIGTA's review of AUR cases (as of March 2023).

The AUR's review of TY 2020 returns with a digital asset component resulted in the closure of 1,315 of the 1,895 returns reviewed with results as of March 2023.⁴¹ We determined that 948 of the 1,315 cases resulted in total tax assessments exceeding \$27.3 million with an average assessment of \$28,832. For returns that were reviewed with a digital asset component for TYs 2018 and 2019, 34 percent ended with an additional assessment and for TY 2020, that rose to 50 percent.

While a small percentage of all AUR cases reflected digital assets activity for past tax years, AUR's reviews have untapped potential to address digital assets compliance if performed on a larger scale, which the AUR is able to do. The AUR's ability to affect compliance is measurable and will be more evident when the digital assets reporting requirements become effective.

Impact of the Form 1099-DA delay on IRS compliance efforts

Although Criminal Investigation uses data mining tools, special agents must put forth a substantial amount of effort to link many of these transactions directly to taxpayers, which is the most difficult part of the process. According to IRS Criminal Investigation officials, roughly 6 to 7 percent of a special agent's investigative time is currently dedicated to digital assets criminal cases. Criminal Investigation's Director of Cyber Crimes confirmed that when the broker data are provided via the newly proposed Form 1099-DA, the data will allow them to operate in a more efficient manner. In many instances, the taxpayer will be identified through the Form 1099-DA, allowing them to obtain more attribution data and will improve the work done.

Like Criminal Investigation, the AUR is awaiting the issuance of the final regulations along with the new Form 1099-DA.⁴² AUR management stated that the new Form 1099-DA will allow them to identify digital asset reporting discrepancies through matching of the information form and taxpayer returns. They plan to build cases based on the discrepancies identified.

In addition, LB&I and SB/SE Divisions' revenue agents rely on third-party information documents when conducting income probes of taxpayers during their examinations. The new Form 1099-DA will allow the examiners to be more efficient when determining if a taxpayer has not correctly reported income from digital asset transactions because gross proceeds from

⁴¹ The remaining 580 cases remained open or were closed after March 2023.

⁴² As previously stated, the IRS posted a draft version of Form 1099-DA on its website on April 19, 2024. The draft Form 1099-DA is for information purposes and brokers and taxpayers are instructed not to file the draft form.

transactions will be reported on all forms. In some instances, basis will be included on the forms once regulations are finalized. Taxpayers intentionally not reporting gains from their digital asset transactions will have at least two more tax years before the IRS will be able to increase its enforcement of digital asset tax compliance. In the interim, the IRS should be preparing to launch a comprehensive digital asset compliance enforcement program while developing line of sight into digital asset transactions.

The Deputy Commissioner should ensure that:

Recommendation 1: The LB&I Division, SB/SE Division Examination, Criminal Investigation, RAAS, and the Digital Assets Initiative Project Office analyze [REDACTED] of digital assets.

Management's Response: IRS management agreed that [REDACTED] with digital asset transactions. It will use [REDACTED] in the development of an IRS-wide Compliance Strategic Plan.

Recommendation 2: The LB&I Division, SB/SE Division Examination, RAAS, and the Digital Assets Initiative Project Office leverage data pertaining to [REDACTED] compliance activity.

Management's Response: IRS management agreed that tax return data should be used to [REDACTED] It will [REDACTED] the development of an IRS-wide Compliance Strategic Plan.

Recommendation 3: The LB&I Division, SB/SE Division Examination, Criminal Investigation, RAAS, and the Digital Assets Initiative Project Office develop a compliance plan that includes the use of Form 1099-DA data, case identification, and case selection of digital asset cases.

Management's Response: IRS management agreed that Form 1099-DA data should be used to develop an IRS-wide Compliance Strategic Plan. It noted that the revision to I.R.C. § 6045 is not self-executing and that final regulations are required before the Form 1099-DA and the information required on the form can be finalized for filing with the IRS.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective of this review was to determine how effectively the IRS identifies income earned from virtual currency transactions. To accomplish our objective, we:

- Evaluated the statutory provisions and IRS policies, procedures, and goals related to virtual currency tax compliance. We determined the status of IRS and Department of the Treasury guidance pertaining to Provision 80603 of the IJA and reviewed any interim guidance, Chief Counsel Advisories, or applicable Private Letter Rulings that provided guidance for information reporting for brokers and taxpayers reporting income or loss from virtual currency activity.
- Determined whether the LB&I Division has information with respect to compliance results from the Coinbase John Doe Summons efforts and determined whether those efforts are ongoing. We determined the steps the IRS has taken to address virtual currency tax compliance risks.
- Analyzed the IRS enforcement history pertaining to virtual currency. Also, we interviewed officials in the SB/SE and LB&I Divisions, Criminal Investigation, and RAAS regarding any enforcement data compiled on virtual currency tax compliance and assessed plans for data analyses.
- Assessed the line of sight the IRS has on virtual currency transactions across the enforcement programs, as well as opportunities to use the new Form 1099-DA and make appropriate recommendations for increased use of available information to improve tax compliance with virtual currency transactions.
- Assessed the IRS's progress towards implementing the Form 1099-DA and planned use for compliance activities and determined whether compliance efforts will be different from other Form 1099 efforts.
- Determined the scope of potential taxable events/income via virtual currency by using TIGTA's Data Center Warehouse to obtain the universe of returns with a response to the digital assets question on IRS Form 1040 for TYs 2020 through 2022.

Performance of This Review

This review was performed with information obtained from personnel in the LB&I and SB/SE Divisions along with the IRS Office of Chief Counsel, Criminal Investigation, and RAAS, located in various IRS offices including Washington, D.C.; Bloomington, Minnesota; and Buffalo, New York, during the period November 2022 through January 2024. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Phyllis Heald London, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations); Tim Greiner, Audit Director; Gena Smoak, Audit Manager; and Jamelle Pruden, Lead Auditor.

Data Validity Methodology

We used Return Transaction File data to obtain Form 1040 virtual currency question transaction code data from the TIGTA Data Center Warehouse. We compared Form 1040 data including Taxpayer Information Number, Tax Period, Master File Tax, document locator number, virtual currency transaction code, and transaction date to the IRS's Integrated Data Retrieval System and/or Modernized e-File System for five cases associated with each tax year's data. We found no significant issues and thus determined that the data were sufficient and reliable for purposes of this report.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the IRS's policies, procedures, existing and proposed regulations, and practices related to the digital asset tax reporting and compliance. We evaluated these controls by interviewing IRS management and reviewing IRS data, forms, processes, case statistics, and other correspondence related to digital asset tax reporting and compliance.

Appendix II

**Selected Legal Provisions and Guidance
for Reporting Digital Asset Transactions**

Section	Provision Description
I.R.C. § 1211(b)	Provides for a limitation on capital losses.
I.R.C. § 1212(b)	Allows non-corporate taxpayers to carry forward unused capital losses.
I.R.C. § 6045(a)	Requires that every person doing business as a broker shall make a return, showing the name and address of each customer, with such details regarding gross proceeds and other.
I.R.C. § 6045(g)(3)(D)	Defines the term “digital asset” as any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary of the Treasury.
I.R.C. § 6045(g)(3)(B)(iii)	Defines a specified security to include a commodity, thereby requiring commodity brokers to issue Form 1099-B to customers for commodity transactions.
I.R.C. § 6045A	Requires transfer reporting, whereby brokers who transfer specified securities provide a transfer statement to the receiving broker. The transfer statement includes information about the specified security, the customer, the transferor, and the recipient. Transfer statements must be provided within 15 days of the settlement of the transfer.
I.R.C. § 6050I	Requires that any person engaged in a trade or business that receives in the course of such trade or business more than \$10,000 in cash must make a report to the Government as required by the statute.
I.R.C. § 6050W	Requires reporting of certain payments made in settlement of payment card and third-party network transactions.
IRS Notice 2014-21	Guides individuals and businesses on the tax treatment of transactions using convertible virtual currencies.
IRS Notice 2023-27	Addresses treatment of certain nonfungible tokens as collectibles.
Frequently Asked Questions on Digital Asset Transactions	Expands upon the examples provided in Notice 2014-21 and applies those same longstanding tax principles to additional situations.
IRS Revenue Ruling 2019-24	Provides guidance on the income tax consequences of “airdrops” and “hard forks.”

Virtual Currency Tax Compliance Enforcement Can Be Improved

Section	Provision Description
IRS Revenue Ruling 2023-14	Addresses whether a cash-method taxpayer who receives additional units of cryptocurrency from staking must include those rewards in gross income.
Chief Counsel Advice (CCA) 202302011	Addresses the applicability of I.R.C. § 165 to cryptocurrency that has declined in value.
Chief Counsel Advice (CCA) 202302012	Addresses the qualified appraisal requirement for charitable contributions of cryptocurrency.
Chief Counsel Advice (CCA) 202316008	Describes the tax consequences to an individual who holds cryptocurrency that undergoes a protocol upgrade.

Management's Response to the Draft Report



CHIEF TAX COMPLIANCE OFFICER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

June 5, 2024

MEMORANDUM FOR DANNY VERNEUILLE
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Heather C. Maloy Heather C. Maloy Digitally signed by Heather C. Maloy
Date: 2024.06.05 14:32:15 -04'00'
Chief Tax Compliance Officer

SUBJECT: Draft Audit Report – Virtual Currency Tax Compliance
Enforcement Can Be Improved (Audit No. 202330015)

Thank you for the opportunity to review and comment on the subject draft audit report. We appreciate your acknowledgement that the use of virtual currency has grown exponentially in recent years.

The IRS agrees that digital asset compliance enforcement can be improved. IRS compliance efforts are still recovering from years of underfunding. The multi-year funding provided by IRA enables us to hire more enforcement personnel as well as invest in using data, analytics, and technology solutions to support compliance efforts. We will use enhanced data, analytics and technology tools to select compliance cases based on highest risk of noncompliance.

Attached are our comments and proposed actions for your recommendations. If you have any questions, please contact me, Seth Wilks, executive director, Digital Assets Strategy and Development at Seth.C.Wilks@irs.gov or Sulolit "Raj" Mukherjee, executive director, Digital Assets Compliance and Implementation, at Sulolit.Raj.Mukherjee@irs.gov.

Attachment

Virtual Currency Tax Compliance Enforcement Can Be Improved

Recommendations

The Deputy Commissioner should ensure that:

RECOMMENDATION 1

The LB&I Division, SE/SE Examination, Criminal Investigation, RAAS and the Digital Assets Initiative Project Office analyze [REDACTED] of digital assets.

CORRECTIVE ACTION

We agree that [REDACTED] with digital asset transactions. This data will be used in the development of an IRS-wide Compliance Strategic Plan.

IMPLEMENTATION DATE

October 1, 2025

IMPLEMENTATION DATE

October 1, 2025

RESPONSIBLE OFFICIAL

Deputy Chief Tax Compliance Officer, Strategy and Analytics
Executive Director – Digital Assets Strategy and Development
Executive Director – Digital Assets Compliance and Implementation

CORRECTIVE ACTION MONITORING PLAN

The Chief Tax Compliance Officer will monitor this corrective action as part of development of the IRS-wide Compliance Strategic Plan.

RECOMMENDATION 2

The LB&I Division, SB/SE Examination, RAAS and the Digital Assets Initiative Project Office leverage data pertaining to [REDACTED] compliance activity.

CORRECTIVE ACTION

We agree that tax return data should be used to [REDACTED] This information will be used in the development of an IRS-wide Compliance Strategic Plan.

IMPLEMENTATION DATE

October 1, 2025

RESPONSIBLE OFFICIAL

Deputy Chief Tax Compliance Officer, Strategy and Analytics
Executive Director – Digital Assets Strategy and Development
Executive Director – Digital Assets Compliance and Implementation

CORRECTIVE ACTION MONITORING PLAN

The Chief Tax Compliance Officer will monitor this corrective action as part of development of the IRS-wide Compliance Strategic Plan.

RECOMMENDATION 3

The LB&I Division, SB/SE Examination, Criminal Investigation, RAAS and the Digital Assets Initiative Project Office develop a compliance plan that includes the use of Form 1099-DA data, case identification and case selection of digital asset cases.

CORRECTIVE ACTION

We agree that Form 1099-DA data should be used to develop an IRS-wide Compliance Strategic Plan. The revision to IRC 6045 enacted as part of the Infrastructure Investment and Jobs Act is not self-executing. Final regulations are required before Form 1099-DA and the information required on the Form can be finalized and the forms filed with the IRS.

IMPLEMENTATION DATE

October 1, 2027

RESPONSIBLE OFFICIAL

Deputy Chief Tax Compliance Officer, Strategy and Analytics
Executive Director – Digital Assets Strategy and Development
Executive Director – Digital Assets Compliance and Implementation

CORRECTIVE ACTION MONITORING PLAN

The Chief Tax Compliance Officer will monitor this corrective action as part of development of the IRS-wide Compliance Strategic Plan.

Glossary of Terms

Term	Definition
Airdrop	A marketing effort where new coins are sent to all wallet addresses that currently hold units of a different virtual currency on a blockchain at that given moment.
Bitcoin	The world's first and largest cryptocurrency by market capitalization.
Blockchain	A digital ledger cryptographically secured to prevent alteration in which transactions made in a digital asset are recorded chronologically. Blockchains may be public or private.
Cash Method	Cash accounting is an accounting method where payment receipts are recorded during the period in which they are received, and expenses are recognized in the period in which they are paid.
Cryptocurrency	A type of virtual currency that utilizes cryptography to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of cryptocurrency are generally referred to as coins or tokens.
Cryptocurrency Exchange (Centralized)	A person or entity engaged in the business of exchange of digital assets for fiat currency, fiat currency for digital assets, or one type of digital asset for other types of digital assets. A centralized exchange provides a hosted wallet service, and the customer generally does not have control over their private key associated with the respective address. Examples include Coinbase, Gemini Trust, and Kraken.
Cryptocurrency Exchange (Decentralized)	A decentralized exchange that has no central repository and no single administrator, allowing for trustless transactions (no third- party intermediary). Examples include Uniswap and SushiSwap.
Darknet	The part of the internet that is not indexed by search engines and requires an anonymizing browser called Tor to be accessed.
Digital Asset	Broadly defined as any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary of the Treasury.
Distributed Ledger	Ledger in which data are stored across a network of decentralized nodes. A distributed ledger may be public or private.
Fiat Currency	A form of currency that is legal tender and whose value is backed by the government that issued it. Examples include the U.S. dollar, the Japanese yen, and the euro.

Virtual Currency Tax Compliance Enforcement Can Be Improved

Term	Definition
Hard Fork	Occurs when a cryptocurrency undergoes a protocol change and the cryptocurrency splits into two which may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the original distributed ledger.
Hardware Wallet	A secure offline storage device that stores the user's private keys and public keys. When kept offline, hardware wallets are generally more secure than hot wallets. Examples are Trezor and Ledger Nano.
Individual Return Transaction File	A database the IRS maintains that contains information on the individual tax returns it receives.
Information Reporting Document	A return that includes any form, statement, or schedule required to be filed with the IRS with respect to any amount from which tax is required to be deducted and withheld.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Manual	The source of instructions to IRS staff. It includes policies, delegated authorities, procedures, instructions, and guidelines related to the operation of the IRS.
Mining	An action that creates the receipt of new cryptocurrency units which results in ordinary income.
Modernized e-File	A web-based system that allows electronic filing of Individual, Corporate, Partnership, Exempt Organizations, Excise, Estate and Trusts, and Employment Tax Returns through the Internet.
Money Service Business	A type of nonbank financial institution such as money transmitters, currency dealers or exchanges, and check cashers or issuers of traveler's checks, money order, or stored value cards.
Non-Fungible-Token	A digital asset (or token) that is unique. Examples include digital art, virtual trading cards, tokenized audio and videos, and virtual real estate.
Peer-to-Peer Exchange	Digital asset exchange platform where users can directly and privately exchange crypto or fiat with one another without the use of an intermediary. Examples are LocalBitcoin, Paxful, and LocalCoin Swap.
Pseudo-anonymous	Data is given, for example, a code number and only a limited number of key researchers have the code to translate the number into the data and it is still possible to connect the data to the person. Pseudo-anonymous data are where Personally Identifiable Information such as first name and last name within a data record are replaced by a virtual wallet address.

Virtual Currency Tax Compliance Enforcement Can Be Improved

Term	Definition
Staking	Occurs when a taxpayer locks up the coins in the blockchain to help support the operation and maintain its security. Some crypto chains reward participants for putting up their coins/virtual currency as collateral and then certifies the transactions. The reward coins are treated similar to bank interest, as ordinary income.
Store of Value	Any commodity or asset that would normally retain purchasing power into the future and is the function of the asset that can be saved, retrieved, and exchanged at a later time.
Tainted Cryptocurrency	The cryptocurrency was used for illicit activities.
Tax Gap	The estimated difference between the amount of tax taxpayers should pay and amount they voluntarily pay on time.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Token	A digital asset that does not have its own native blockchain and is built on top of another existing blockchain.
Tumblers	Websites that mix potentially identifiable or 'tainted' cryptocurrency funds with others and obscure the trail back to the fund's original source.
Virtual Currency	A digital representation of value, other than a representation of fiat currency, that functions as a unit of account, a store of value, and/or a medium of exchange.
Wallet	Hardware or software program that generates and stores a user's blockchain addresses and private keys. The keys are used to send and receive digital assets and monitor balances. Wallets do not store digital assets, but rather they store the private keys associated with public addresses.

Abbreviations

AUR	Automated Underreporter
CIP	Compliance Initiative Project
FY	Fiscal Year
IJA	Infrastructure Investment and Jobs Act of 2021
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
OFE	Office of Fraud Enforcement
LB&I	Large Business and International
RAAS	Research Applied Analytics, and Statistics
SB/SE	Small Business/Self-Employed
TY	Tax Year
TIGTA	Treasury Inspector General for Tax Administration



**To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via e-mail at
oi.govreports@tigta.treas.gov.**

**To make suggestions to improve IRS policies, processes, or systems
affecting taxpayers, contact us at www.tigta.gov/form/suggestions.**

Information you provide is confidential, and you may remain anonymous.