

INSIGHTS

## The IRS Is Mining for Crypto Account Holders

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For years, the cryptocurrency wallets of U.S. taxpayers have existed in a reporting gray zone. However, as it becomes clear that crypto asset transactions are not slowing down, the Internal Revenue Service (IRS) has signaled its expanded focus on regulation and enforcement efforts in the cryptocurrency industry, specifically utilizing “John Doe” summons. The “John Doe” summons, a tool used to target unknown taxpayers, is a mechanism through which the IRS, with court approval, can compel information from a third party—such as a crypto exchange—concerning a taxpayer not identified by name in the summons. The IRS’s use of “John Doe” summons, which it is increasingly using to compel the production of information from popular cryptocurrency exchanges, continues to demonstrate the growing strength of the IRS’ arsenal of enforcement tools as it relates to cryptocurrency. As the cryptocurrency market continues to grow, so too will enforcement agencies’ desire to make sure it is not being used for nefarious purposes.

### What’s Happened So Far

It is no secret that the cryptocurrency industry is in the IRS’s crosshairs. An IRS attorney [stated](#) just last week that the IRS plans to increase its use of “John Doe” summons with regard to cryptocurrency. Further, in March 2021, the IRS announced the launch of Operation Hidden Treasure, a new enforcement initiative for tax violations related to cryptocurrency. This year, federal courts authorized the IRS to issue two “John Doe” summons to popular cryptocurrency exchanges, Circle Internet Financial (Circle) and Payward Ventures (aka Kraken). These inquiries centered on platform users with at least \$20,000 in crypto transactions. The IRS sought data ranging for the five-year period from 2016 through 2020. The documents the IRS sought from the exchanges included account registration records, Know-Your-Customer (KYC) due diligence, account related correspondence, anti-money laundering (AML) exception reports, records of account activity, and records of account funding.

The Circle and Kraken “John Doe” summonses are by no means the end of the line for IRS cryptocurrency enforcement. As these two inquiries show, the IRS is seeking extensive information related to those engaged in cryptocurrency transactions, and cryptocurrency exchanges will face onerous requirements to produce such information going forward. This increased information gathering by the IRS as part of its cryptocurrency enforcement efforts will likely lead to a greater scrutiny of cryptocurrency exchanges and others who provide or receive services for cryptocurrency.

### The Compliance Viewpoint

Cryptocurrency industry participants should anticipate that the IRS might begin to scrutinize customers and business processes, and specifically focus on AML and KYC compliance measures. Before the IRS comes knocking with a “John Doe” summons, a prepared organization

would be proactive and start taking measures to protect itself, its business, and its customers. Working to ensure that proper protocols are in place to safeguard against customers looking to exploit gaps in KYC measures will be helpful in keeping the scrutiny of the IRS's enforcement efforts on customers and not exchange platforms.

#### **How Bracewell's Cryptocurrency Team Can Help**

There is no question that cryptocurrency will remain at the forefront of the IRS's enforcement efforts for some time. With the increased regulatory and enforcement attention from agencies such as the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), and most recently, the Department of Justice (DOJ) with the [launch](#) of its National Cryptocurrency Team, the regulatory landscape is poised to become more convoluted and burdensome for cryptocurrency exchanges for the foreseeable future. As Operation Hidden Treasure ramps up, IRS's "John Doe" summonses issued to cryptocurrency exchanges will likely be the norm rather than a rare occurrence. Cryptocurrency exchanges should take the time now to improve internal procedures regarding AML compliance, specifically KYC policies.

Bracewell's multi-disciplinary cryptocurrency team is available to assist with AML and KYC compliance and responding to "John Doe" summons from the IRS. Our attorneys are well-versed in IRS, CFTC, SEC, and DOJ regulations and enforcement practices. In fact, many of our team members are former high-ranking officials from the agencies themselves. Because we come from inside the government, we know the inner workings of these and other agencies, and can effectively help clients navigate the rapidly shifting regulatory and enforcement landscape facing the cryptocurrency industry today.