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VIRTUAL CURRENCIES

Additional Information Reporting and Clarified Guidance Could Improve Tax Compliance

GAO Highlights

Highlights of GAO-20-188, a report to the Ranking Member, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Virtual currencies, such as bitcoin, have grown in popularity in recent years. Individuals and businesses use virtual currencies as investments and to pay for goods and services. GAO was asked to review IRS's efforts to ensure compliance with tax obligations for virtual currencies.

This report examines (1) what is known about virtual currency tax compliance; (2) what IRS has done to address virtual currency tax compliance risks; (3) the extent to which IRS's virtual currency guidance meets taxpayer needs; and (4) whether additional information reporting on virtual currency income could assist IRS in ensuring compliance.

GAO reviewed IRS forms and guidance and interviewed officials at IRS, FinCEN, and other federal agencies, as well as tax and virtual currency stakeholders.

What GAO Recommends

GAO is recommending that IRS clarify that part of the 2019 guidance is not authoritative and take steps to increase information reporting, and that FinCEN and IRS address how foreign asset reporting laws apply to virtual currency. IRS agreed with the recommendation on information reporting and disagreed with the other two, stating that a disclaimer statement is unnecessary and that it is premature to address virtual currency foreign reporting. GAO believes a disclaimer would increase transparency and that IRS can clarify foreign reporting without waiting for future developments in the industry. FinCEN agreed with GAO's recommendation.

View GAO-20-188. For more information, contact James R. McTigue, Jr., at (202) 512-9110 or mctiguej@gao.gov

What GAO Found

Taxpayers are required to report and pay taxes on income from virtual currency use, but the Internal Revenue Service (IRS) has limited data on tax compliance for virtual currencies. Tax forms, including the information returns filed by third parties such as financial institutions, generally do not require filers to indicate whether the income or transactions they report involved virtual currency.

IRS also has taken some steps to address virtual currency compliance risks, including launching a virtual currency compliance campaign in 2018 and working with other agencies on criminal investigations. In July 2019, IRS began sending out more than 10,000 letters to taxpayers with virtual currency activity informing them about their potential tax obligations.

IRS's virtual currency guidance, issued in 2014 and 2019, addresses some questions taxpayers and practitioners have raised. For example, it states that virtual currency is treated as property for tax purposes and that using virtual currency can produce taxable capital gains. However, part of the 2019 guidance is not authoritative because it was not published in the Internal Revenue Bulletin (IRB). IRS has stated that only guidance published in the IRB is IRS's authoritative interpretation of the law. IRS did not make clear to taxpayers that this part of the guidance is not authoritative and is subject to change.

Examples of Virtual Currency Transactions that Can Produce Taxable Capital Gains

Source: GAO analysis of Internal Revenue Service guidance. | GAO-20-188

Information reporting by third parties, such as financial institutions, on virtual currency is limited, making it difficult for taxpayers to comply and for IRS to address tax compliance risks. Many virtual currency transactions likely go unreported to IRS on information returns, due in part to unclear requirements and reporting thresholds that limit the number of virtual currency users subject to third-party reporting. Taking steps to increase reporting could help IRS provide taxpayers useful information for completing tax returns and give IRS an additional tool to address noncompliance.

Further, IRS and the Financial Crimes Enforcement Network (FinCEN) have not clearly and publicly explained when, if at all, requirements for reporting financial assets held in foreign countries apply to virtual currencies. Clarifying and providing publicly available information about those requirements could improve the data available for tax enforcement and make it less likely that taxpayers will file reports that are not legally required.