

Crypto Cos. Should Prep For More IRS John Doe Summonses

By Shivani Poddar and Andrew Heighington (May 23, 2022)

In anticipation of new reporting requirements going into effect in 2024, companies that facilitate and individuals who conduct cryptocurrency transactions should become familiar with the Infrastructure Investment and Jobs Act, signed into law on Nov. 15, 2021.

The infrastructure bill implements reporting requirements for various parties, including brokers, digital asset exchanges and custodians, and individuals related to cryptocurrency transactions.

In particular, the infrastructure bill amends the definition of "cash" in Title 26 of the U.S. Code, Section 6050I, to include digital assets, thereby requiring persons that receive greater than \$10,000 worth of digital assets in the course of their trade or business to report such transactions. Digital assets are also defined broadly and could encompass traditional cryptocurrencies and even nonfungible tokens.[1]

In light of the new reporting requirements, the IRS will undoubtedly turn to a unique mechanism to obtain expansive information about cryptocurrency transactions — the John Doe summons. The John Doe summons, authorized by the U.S. Supreme Court in 1975 in *United States v. Bisceglia* and subsequently codified by Congress, has long been a powerful tool used by the IRS to combat tax fraud schemes.

When the IRS has a reasonable basis for believing a person may fail or has failed to comply with U.S. tax laws, the IRS can issue a John Doe summons to conduct an investigation, directed at an "ascertainable group or class of persons," rather than a specific person.

Historically, the IRS used the John Doe summons to identify individuals who failed to pay their tax obligations by serving credit card companies like American Express Co., MasterCard Inc. and Visa Inc., as well as payment services like PayPal Holdings Inc.

In recent years, the IRS has issued John Doe summons to obtain information from cryptocurrency exchanges, a practice that is likely to expand given the infrastructure bill's reporting requirements.

For example, in 2016 the IRS issued a John Doe summons to Coinbase Global Inc., seeking "information regarding United States persons who at any time during the period of January 1, 2013 through December 2015 conducted transactions in a convertible virtual currency as defined in IRS Notice 2014-21,"[2] which summons was subsequently narrowed to accounts "with at least the equivalent of \$20,000 in any one transaction type (buy, sell, send or receive) in any one year during the 2013-2015 period." [3]

The IRS argued that it was investigating the identities of U.S. persons who conducted transactions in virtual currency and realized a gain. According to the IRS, virtual currency gains were underreported as only 800 to 900 persons reported such a gain from 2013 to 2015.

Coinbase refused to comply with the summons, arguing, among other things, that the IRS



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may not use the summons power to conduct general research absent a specific investigation into noncompliant parties. According to Coinbase, the summons requested information regarding 8.9 million transactions and 14,355 account holders.

In ordering disclosure, the U.S. District Court for the Northern District of California rejected Coinbase's arguments and held that the John Doe summons served a legitimate purpose of investigating the reporting gap between the number of virtual currency users Coinbase claims to have and the 800 to 900 persons reporting a virtual currency gain.

The court noted that "[t]he IRS is conducting the investigation to ascertain if U.S. taxpayers are correctly filing returns, filing returns at all, or self-reporting their proper tax liability ... [t]herefore, the IRS's purpose is related to tax compliance, not research."

Similarly, in *In re: Tax Liabilities Of John Does in April 2021*,^[4] the Northern District of California permitted the IRS to issue a John Doe summons on cryptocurrency exchange Kraken Inc. to "aid in assessing the potential tax liability of Kraken users." The court held that the IRS made a sufficient showing to warrant issuance of the summons.^[5]

The foregoing cases provide helpful takeaways for parties subject to the new reporting requirements. The IRS need only satisfy a low burden to establish its need for a John Doe summons, and courts have been generous in granting such requests.

Although the line between the IRS investigating or researching is hazy, so long as the IRS can attest that it is investigating, the court will find the request legitimate.

The IRS will generally seek expansive information through a John Doe summons, but cryptocurrency exchanges have been successful at narrowing the requests. As a result, with the infrastructure bill's new reporting requirements, the IRS has more ammunition to utilize the John Doe summons expansively.

Cryptocurrency exchanges and custodians should become familiar with the summons and the rules surrounding its issuance, and consider arguments for narrowing such requests. Individuals should also be aware that, apart from being subject to their own reporting requirements, their account information and transaction history on various cryptocurrency exchanges and with financial institutions may be subject to disclosure.

Further, and significantly, on May 3 another governmental agency — the U.S. Securities and Exchange Commission — announced that it was nearly doubling the size of the agency's Cyber Unit, which is being renamed the Crypto Assets and Cyber Unit, in order to "be better equipped to police wrongdoing in the crypto markets while continuing to identify disclosure and control issues with respect to cybersecurity."

Cryptocurrency issuers, exchanges, custodians and individuals conducting these transactions must be aware that they will also be subject to scrutiny from the SEC's Crypto Assets and Cyber Unit. While this nascent industry may have benefited from a confusing lack of regulations in the past, it is now apparent that governmental agencies are focused on cryptocurrency transactions, a trend that is likely to continue.

Update: This article has been updated to reflect that there were two authors.

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[1] The Infrastructure Bill also expands the requirement that brokers issue Forms 1099 relating to customer trades to cover transactions involving cryptocurrency. This change also goes into effect beginning in 2024.

[2] 2014-16 IRB 938.

[3] See [United States v. Coinbase, Inc.](#), 17-cv-01431-JSC 2017 WL 5890052 (N.D. Cal. Nov. 28, 2017); [In re Tax Liabilities Of John Does](#), 1:21-mc-91201 (Apr. 1, 2021); [Zietzke v. United States](#), 125 A.F.T.R.2d (N.D. Cal. Jan. 2020); [United States v. Gratkowski](#), 964 F.3d 307 (2020); [Harper v. Rettig](#), 20-cv-771-JD, 2021 WL 1109254 (D.N.H. Mar. 23, 2021); [In re Does](#), No. 21-CV-02201-JCS, 2021 WL 1222862, at *1 (N.D. Cal. Mar. 31, 2021).

[4] No. 21-CV-02201-JCS, 2021 WL 2314968, at *1 (N.D. Cal. May 5, 2021).

[5] See also [In re Tax Liabilities Of John Does](#), 1:21-mc-91201 (Apr. 1, 2021) (a Massachusetts federal court allowed the IRS to seek identifying information on Circle crypto customers including documents related to their crypto transactions); [Zietzke v. United States](#), 125 A.F.T.R.2d (N.D. Cal. Jan. 2020) (allowing the IRS to seek names, personal information, information concerning bitcoin transactions and counter-parties).