



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

The Honorable Margaret Wood Hassan
United States Senate
Washington, DC 20510

Dear Senator Hassan:

Thank you for your letter dated September 16, 2021. You asked about IRS authority to conduct compliance activity related to virtual currency.

I apologize for the delay responding to your letter. The use of virtual currencies is a rapidly evolving and expanding industry. We share your concern that virtual currencies can be used to evade compliance, and that the anonymous nature of virtual currencies may make them attractive for those who would engage in illicit activities.

I have enclosed our responses to your questions. We remain available to meet with you and/or your staff to discuss matters relating to virtual currency compliance.

I hope this information is helpful. If you have additional questions, please contact me, or a member of your staff may contact Amy Klonsky, Chief, National Congressional Affairs Branch, at 202-317-6985.

Sincerely,

Charles P. Rettig

Enclosure

1. What authority do your agencies have to regulate U.S.-based cryptocurrency exchanges, cryptocurrency kiosks, and OTC cryptocurrency trading desks and their users?

The Secretary of the Treasury (Secretary) delegated the authority to administer the Bank Secrecy Act (BSA) to the Director, Financial Crimes Enforcement Network (FinCEN). FinCEN subsequently delegated authority to the IRS to examine Non-Banking Financial Institutions (NBFIs) to ensure their compliance with BSA requirements. IRS employees conduct examinations of NBFIs, such as Money Service Businesses (MSBs), which include cryptocurrency exchanges, cryptocurrency kiosks, and over-the-counter (OTC) cryptocurrency trading desks.¹

Examinations of BSA requirements for MSBs include:

- Developing and implementing a risk-based Anti-Money Laundering (AML) program,
- Registering as an MSB with FinCEN,
- Filing Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs), and
- Obtaining and maintaining certain records.

BSA law does not require MSBs to develop and implement a know-your-customer (KYC) program; however, MSBs are required to have an adequate SAR review program and verify customer identification for qualified transactions—for example, CTR reporting or recordkeeping for money transfers of \$3,000 and more. BSA examiners analyze the transactions to identify suspicious activities and determine whether the MSB has an adequate SAR program that requires identifying a business purpose for the transactions and a legitimate source of funds. The BSA examiners cite an AML program violation when there is an inadequate SAR program; they cannot cite KYC violations. The IRS has the authority to issue violation letters to MSBs and refer egregious violations to FinCEN.

IRS Criminal Investigation (IRS-CI) has jurisdiction to investigate criminal violations of the U.S tax², money laundering³, and BSA⁴ laws and has conducted numerous investigations involving the illicit use of cryptocurrencies. IRS-CI Special Agents initiated 243 cases involving virtual currency, referred 183 cases for prosecution, and seized \$3.8 billion in virtual currency in fiscal year (FY) 2018 through FY 2021. All these investigations involve the use of cryptocurrency exchanges, kiosks and OTC trading desks.

¹ FinCEN Guidance FIN-2013-G001 and FIN-2019-G001, available at <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf> and <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>, respectively.

² Title 26 of the United States Code (U.S.C.).

³ Title 18 of the U.S.C.

⁴ Title 31 of the U.S.C.

2. What additional authority could be helpful in your agencies' attempts to regulate U.S.-based cryptocurrency exchanges, cryptocurrency kiosks, and OTC cryptocurrency trading desks and their users?

The Department of the Treasury (Treasury) included in the FY 2022 Greenbook several legislative proposals for additional authority to implement broker information reporting requirements related to crypto assets. The Senate included most of these proposals in Section 80603 of that chamber's infrastructure bill (H.R. 3684). The only proposal they did not include that would be helpful is the proposal to require reporting on certain beneficial owners of entities holding accounts with U.S. brokers. This proposal would allow the United States to exchange such information on an automatic basis with appropriate partner jurisdictions. A global automatic exchange of information framework would provide the United States with information on U.S. taxpayers who directly or through passive entities engage in crypto asset transactions outside the United States.

The recently enacted Corporate Transparency Act (CTA) requires certain entities to provide beneficial ownership information to FinCEN in a report to be prescribed by the Secretary. The collection of this information will generate a database that is highly useful to national security, intelligence, and law enforcement agencies, as well as federal functional regulators, including the IRS. The CTA provides that relevant federal agencies shall, to the extent practicable, and consistent with applicable legal protections, cooperate with and provide information requested by FinCEN to maintain this database of beneficial ownership information.

The IRS collects beneficial ownership information from various taxpayer forms, including Form SS-4 and Schedule C attached to Form 1040. The CTA allows beneficial ownership information to be provided to the IRS for tax administration purposes; however, Section 6103 of the Internal Revenue Code (IRC) prohibits the IRS from granting FinCEN access to the IRS's beneficial ownership and responsible party information.

3. Would additional civil or criminal penalties under 18 U.S. Code § 1960 aid your agencies' efforts to prevent and prosecute the criminal use of cryptocurrency?

Existing civil penalties, such as IRC Section 6662 (negligence) and IRC Section 6663 (civil fraud), can be applied to the failure to report income derived from cryptocurrencies. Crimes under 18 U.S.C Section 1960 can be applied to illicit money-transmitting businesses engaged in the use of both crypto and fiat currencies. Enhancements to these civil and criminal penalties for egregious behavior in the cryptocurrency space could also be applied to promote voluntary compliance.

4. Would an additional waiting period requirement for conversion from fiat currency into cryptocurrency help your agencies recover funds before they are converted and become unrecoverable such as in the Peterborough case? Could an additional waiting period be implemented for select transactions that

could be designated as high risk, or according to value, or would a waiting period need to be universally implemented?

The IRS has no authority to regulate waiting periods for cryptocurrency transactions.

5. Would an additional waiting period requirement for conversion from fiat currency into cryptocurrency be permissible under current authorities? If not, what additional authorities would your agencies require to institute one?

The IRS has no authority to regulate waiting periods for cryptocurrency transactions.

6. Would requiring cryptocurrency exchanges to reverse or reimburse users in cases of fraud, similar to what is done with credit cards and wire transfers, help combat the criminal use of cryptocurrencies?

The IRS has no authority to regulate reimbursement of cryptocurrency transactions.

7. Would a requirement that cryptocurrency exchanges reverse or reimburse users in cases of fraud be permissible under current authorities? If not, what additional authorities would your agencies require to institute one?

The IRS has no authority to regulate reimbursement of cryptocurrency transactions.

8. What additional authority or resources would assist your agencies in preventing and prosecuting the criminal use of cryptocurrency?

- **Increase funding for more examiners and enforcement.** The Administration has presented a budget that includes additional funding for IRS enforcement, including the BSA program, which covers MSBs such as virtual currency exchanges. Conducting MSB examinations is an inherently laborious activity. While technology and burden-sharing among states and with the federal government are helpful, BSA examiners need reinforcements to conduct more examinations of both traditional and digital asset MSBs, especially money transmitter principals. Increased funding for personnel and expenses, such as travel and analytical tools, is also necessary to supervise MSBs. Included in the Administration's budget request is additional funding for IRS-CI outside of the IRS Operations Support funding. This \$21 million additional funding is specifically designated to support cyber, cryptocurrency and other highly technical investigations and plays an important role increasing IRS-CI's law enforcement capabilities.
- **Mandatory e-filing of Form 8300.** Each person engaged in a trade or business (other than financial institutions with other reporting obligations) who in the course of that trade or business, receives more than \$10,000 in cash in one

transaction or in two or more related transactions, must file a Form 8300, *Report of Cash Payments Over \$10,000 Received in a Trade or Business*, a joint IRS-FinCEN form. Electronic filing facilitates more accurate tax information and supports the broader goals of improving IRS service to taxpayers and modernizing tax administration. Electronic filing also ensures valuable information is timely available for law enforcement purposes. In May 2021, the Administration made a legislative proposal that would require taxpayers engaged in trade or business to electronically file Forms 8300.⁵ On July 23, 2021, Treasury published proposed regulations in the Federal Register⁶ adding Form 8300 to the list of returns required to be filed electronically if the filer is required to file a certain number of returns per calendar year. The proposed regulations also reduce the number of returns from 250 to 10 for returns required to be filed during calendar years after 2022.

- **Companion Title 31 Form 8300 Legislation for Digital Asset Reporting.**

Currently, persons engaged in a trade or business who receive more than \$10,000 in cash are required to report these transactions on Form 8300. Because of strict tax return information confidentiality and disclosure rules under IRC Section 6103, the expansion of Form 8300 filing requirements to digital assets must be included in Title 31 in addition to Title 26.⁷ A Title 31 digital asset reporting rule will allow taxpayers to continue filing Form 8300 with FinCEN. Without a companion rule, trades or businesses that collect payments in excess of \$10,000 comprised of multiple consideration types (for example, a mix of cash and virtual currency), may have to file multiple information returns for the same transaction. Requiring multiple information returns for a single transaction may increase the chance those trades or businesses will evade filing altogether. Additionally, the IRS generally may not share information it collects with FinCEN or other law enforcement agencies, like the FBI, currently receiving Form 8300 information. If those agencies can't receive digital asset transaction information, it will significantly degrade the utility of the information they do collect. Finally, a companion Title 31 provision will also help prevent structuring.⁸

- **Know Your Customer (KYC).** As discussed above, MSBs generally lack an account relationship with customers and therefore promote anonymity. MSBs currently collect KYC information following FinCEN's risk-based approach. For all

⁵ See General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals, Department of the Treasury (May 2021), pp. 92-93, available at <https://home.treasury.gov/system/files/131/General-Explanations-FY2022.pdf>.

⁶ Electronic-Filing Requirements for Specified Returns and Other Documents, 86 Fed. Reg. 39910 (July 23, 2021).

⁷ The bipartisan infrastructure bill passed by the United States Senate includes an expansion of Form 8300 under Title 26.

⁸ Structuring is the practice of conducting financial transactions in a specific pattern calculated to avoid the creation of certain records and reports required by the BSA and/or IRC Section 6050I.

MSBs, including virtual currency exchanges, either enhancing due diligence procedures on high-volume customers or implementing KYC requirements regardless of volume and risk is likely to decrease the volume of suspicious transactions, provide a stronger SAR program, and help identify both the business purpose of transactions and the source of funds. A stronger SAR program should, in turn, enhance recovery of stolen or embezzled funds or even prevent such crimes in the first place.

- **Established Customers.** The current recordkeeping requirements for a transmittal of \$3,000 or more include a specific requirement to obtain and retain identifying information, such as a driver license and Social Security number, only for transmitters other than “established customers.” However, the law is not clear on what constitutes an established customer. Based on the FinCEN definition of established customer, the Virtual Currency Exchanges (VCEs) do not have established customers since they are not the same type of a financial institution as a bank—VCEs do not onboard customers like banks and do not require and verify the same amount of personal identifying information that banks do. Under this interpretation, VCEs must comply with all the recordkeeping requirements for transmittals of \$3,000 or more. Some VCEs have challenged this interpretation and claim the recordkeeping requirements do not apply to them because they do have established customers. This situation could be resolved by adding a definition to the NBFIs recordkeeping requirement or providing clarification of the term “established customer.”