

Cryptocurrency Holds More Curveballs for Tax Trials

By Nathan J. Richman

Blockchain technology presents an evolving area of trial practice law for Justice Department Tax Division lawyers preparing to present their cases.

There haven't been many cryptocurrency tax cases, so prosecutors are still working on how to conduct them, working through ideas like how to authenticate blockchain evidence, according to Michael Boteler of the Justice Department Tax Division. "This is an evolving area of the law," he said May 14 at the American Bar Association Section of Taxation meeting.

Cryptocurrencies and blockchain technology present a host of complex tax enforcement questions and hurdles, with more appearing regularly.

Boteler noted that investigators and prosecutors have already been dealing with how to prove an improper tax motive — for example, focusing on a taxpayer's sophistication as it relates to proving willfulness.

Who's Bad

Evan J. Davis of Hochman Salkin Toscher Perez PC said the public hasn't seen many cryptocurrency tax charges but acknowledged the area is still new and the cases take a while to develop. He compared the few announcements to date to the tip of an iceberg.

Boteler suggested there might not be many tax charges alleging misbehavior involving only cryptocurrencies. That's mostly because defendants misreporting cryptocurrency transactions or hiding cryptocurrency assets are usually already underreporting other income, so the cases are generally mixed, he said.

Samuel Lyons of the Justice Department Tax Division noted that prosecutors have started issuing grand jury subpoenas in cryptocurrency tax violation cases.

Not many criminal tax cases have involved mere trading of cryptocurrencies, but hopefully more of those will be public soon, Boteler said. When those cases are further along, prosecutors will have to wrestle with more complex case records, such as a taxpayer's reporting some but not all cryptocurrency transactions or reporting an inflated basis on a transaction, he said.

"That's where some of the biggest hurdles going forward" will be, according to Boteler. The government could produce extensive and detailed charts tracking crypto transactions, but there are also the fundamental questions of when a taxpayer bought the assets and for what price, he said.

In other words, many cases will come down to [on- and off-ramps](#) where the cryptocurrency world connects to fiat currency and goods or services, Boteler said.

Matter of Proof

Once it's time for trial, a prosecutor may have to prove some cryptocurrency transactions as part of a tax charge.

Boteler said he wouldn't try to introduce a whole blockchain into evidence because it's too big. To get some of the record into evidence, though, he'd start with an IRS Criminal Investigation division special agent as a witness, he said.

Preferably, that special agent would come from one of CI's cyber units to provide the first step toward authenticating the portion of a blockchain the prosecutor wants in evidence, Boteler said. That process should be mostly about educating the judge because the way the blockchain operates should imply verification of the transactions listed, he explained. "If it's not on the blockchain, it didn't happen," he said.

The blockchain could also look like a business record, fitting most of the conventional aspects of those sorts of records, except for the difficulty of identifying a business to stand in the place of a major bank for conventional financial transaction records, according to Boteler. This approach would also start with a witness to testify about the creation of the blockchain record, he added.

Once the blockchain record has been authenticated, the prosecution may have to address accusations that it's impermissible hearsay, Boteler noted. "First, I'd argue it's not hearsay because it's just computer generated; it's no different than if I had a scientific test that gave results," he said.

If that doesn't reassure the judge, the next argument is to return to the business record comparison, Boteler said. "And I would give notice as [to] a residual hearsay exception," he said.

Asked about how to submit evidence that a defendant used a mixer or tumbler to disrupt the blockchain record, Boteler agreed that that would present a thorny problem. That's another reason for the government to focus on the on- and off-ramps, he said.

Davis noted that a mixer could disrupt the record but suggested that a defendant intentionally disrupting that record could have more to lose by appearing to attempt to obstruct an investigation. That's a really bad fact, he said.