

DEC 08, 2017

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Crypto “Prophets” From 1997 Point to IRS Showdown: Expert Blog



EXPERT BLOG

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Milton Friedman is not the only thinker who may have predicted the rise of cryptocurrencies two decades ago. In *The Sovereign Individual: Mastering the Transition to the Information Age*, James Dale Davidson and William Rees-Mogg wrote in 1997 about financial technology in strikingly prescient terms:

“After the turn of the millennium, much of the world's commerce will migrate into the new realm of cyberspace, a region where governments will have no more dominion than they exercise over the bottom of the sea or the outer planets.”

Seems about right. It's fun to examine some of these early prophecies of cryptocurrency and how they imagine the future. And especially, to compare them to how the world actually looks today.

What makes Davidson and Rees-Mogg's book particularly interesting, though, is its economic and political predictions. They envision a world rife with offshore [tax](#) evasion and fiat currency debasement, which leads to an economic flight to “cyberspace.” Here's how they put it:

“When the state finds itself unable to meet its committed expenditure by raising tax revenues, it will resort to other, more desperate measures. Among them is printing money.... In almost every competitive area, including most of the world's multitrillion dollar investment activity, the migration of transactions into cyberspace will be driven by an almost hydraulic pressure—the impetus to avoid predatory taxation, including the tax that inflation places upon everyone who holds his wealth in a national currency.”

Indeed. These points may seem obvious to many in the cryptocurrency world today, but in 1997 this was somewhat prophetic thinking.

What happens to taxation?

But what did Davidson and Rees-Mogg predict governments will do in response to this flight to cyberspace? They envisioned a fairly bleak future, where western governments will “turn nasty” and “seek to suppress the cybereconomy by totalitarian means.”

One might argue that we're already there. Anyone who's been audited by the [IRS](#) for cryptocurrency transactions might surely feel that way! Or maybe this future is just around the corner.

But are we really in store for a totalitarian imposition of tax on cryptocurrency transactions? Attempts to outlaw transactions in Bitcoin?

We could be, but it's also worth looking at what Davidson and Rees-Mogg got wrong. For example, they predicted that governments will find themselves virtually unable to track these cyberspace transactions, especially those that end up in offshore banks. They write:

Widespread adoption of public-key/private-key encryption technologies will soon allow many economic activities to be completed anywhere you please.... Once the next logical steps have been taken, and offshore banking locations offer the services of communication in hard RSA-encrypted electronic mail using account numbers derived from public-key

systems, financial transactions will be almost impossible to monitor at the bank or in communications. Even if the tax authorities were to plant a mole in the offshore bank, or burglarize the bank records, they would not be able to identify depositors.

Moles in offshore banks? Burglarizing the bank records? Clearly, the authors underestimated the power of western governments.

Nowadays, IRS tax collectors don't need to burglarize any offshore bank records, because Swiss banks (and almost every other country's banks) regularly open their books to the US and other western tax collectors.

Davidson and Rees-Mogg did not foresee the United States' offshore enforcement efforts over the past decade or Congress's passing of the Foreign Account Tax Compliance Act (or FATCA). How could they? It seemed impossible that the Swiss would just abandon their long-held bank secrecy tradition when the US came knocking. But never say never.

Will governments get their hands on crypto?

So are we really due for a totalitarian tax future in cyberspace? Well, it's probably not going to be **as** bleak as they imagined it. Western governments are more adept at tracking financial transactions than Davidson and Rees-Mogg envisioned, for sure.

But is the cryptocurrency economy going to avoid a showdown with the IRS? Also unlikely. Due to the difficulty of tracing transactions, and the amount of tax revenue at stake, we can expect some pushback by the IRS.

As a tax attorney, I've seen the IRS's offshore tax enforcement efforts over the last decade, and it may offer some clues to what is coming for the cryptocurrency economy. In the early stages, we saw subpoenas to foreign banks, like UBS, for their US client's records. This is now starting with Coinbase and other exchanges.

Next came ramped up pressure on the Swiss banks to comply, including criminal prosecutions of major banks and key officers. The IRS also looked to mail carriers like Federal Express for records of mailings between Swiss banks and US persons. This might mean subpoenas to ISPs, wallet app providers, or others, for their transaction records.

Finally, as the IRS lacked the resources to audit everyone with a Swiss Bank account, it instituted a disclosure program. Offshore account holders could come forward through the Offshore Voluntary Disclosure Program (the "OVDP"), file back taxes, pay a penalty, and avoid jail time. Those who came forward earliest got a better deal. The IRS got the best deal, bringing in more than \$10 bln in tax revenue.

If the last decade of offshore tax enforcement efforts is any guide, a showdown between the IRS and the cryptocurrency world is probably looming. But it may be more efficient and bureaucratic and less totalitarian than Davidson and Rees-Mogg envisioned.

Still, the notion that western governments will be unable to tax cryptocurrency gains is unrealistic. Taxes are one of the two guarantees in life, and it makes sense to plan for them, even with cryptocurrencies. How's that for a prediction?

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