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Bitcoin User Files To Block IRS Access To Coinbase Accounts

The IRS's [push to obtain vast amounts of data on digital currency transactions](#) is finally receiving some push-back. In fact, a Coinbase, Inc. customer has filed a [motion](#) in federal court seeking to intervene in the federal case. The motion hopes to block the IRS from enforcing its recent John Doe summons for information on Coinbase users. Still, the motion may face a steep uphill battle.

Typically, the courts give the IRS wide latitude to enforce summonses that may uncover information regarding potential tax evasion. The IRS doesn't need "probable cause," or even "reasonable suspicion," like the police might need to investigate a crime. Rather, under federal law, the IRS has the power to examine any data that may be relevant to determining the correct tax owed by any taxpayer. If that sounds sweeping, it is.



Bitcoin uses peer-to-peer technology to operate with no central authority or banks; managing transactions and the issuing of bitcoins is carried out collectively by the network. (Photo credit: KAREN BLEIER/AFP/Getty Images)

The IRS's goal here is to use this broad power to obtain heaps of data on digital currency transactions. What's more, the IRS hopes to get clues on who should be targeted for audits. That is the real prize. But the IRS doesn't have this data yet. And the motion makes a number of arguments as to why the IRS summons is flawed.

For one, it points out that the Summons may impact more than one million taxpayers who have accounts with Coinbase. The motion argues that the summons is too broad in its scope, which by itself could support quashing it. It also argues that, as a practical matter, the IRS would be extremely hard-pressed to accurately review this much data due to its severe underfunding.

The motion goes on to note that the IRS has, according to its own Inspector General, issued [confusing and vague guidance](#) regarding the taxation of virtual currency transactions, and that it has failed to provide any further clarity for taxpayers transacting in Bitcoin, even after this criticism. The motion suggests that the government is not proceeding in good faith, muddying the water by not providing taxpayers with clear information on how these transactions should be taxed, yet still seeking to investigate them wholesale.

Finally, the motion argues that the IRS's computer systems are not secure. That means any data the government receives from Coinbase is likely to be hacked and fall into the wrong hands, the motion contends. There is something to be said for this argument, given [the IRS's recent computer debacles](#). The IRS has been roundly criticized for being too slow in responding to the security breach, and for failing to adequately notify those affected.

But are these claims likely to succeed? Just peeking at the government's success rates, one would have to say no. In fact, the U.S. Taxpayer Advocate Service says the IRS wins over 90% of its summons cases. The IRS also uses its summons power frequently, and court fights are becoming common. According to the [Taxpayer Advocate](#), there were 44 such disputes in 2005. By 2013, the number of cases filed over a one year period had ballooned to 117.

So is there any hope for Coinbase users? Of course, it is possible that the motion could succeed. Some taxpayers do successfully challenge IRS summonses. And even if the motion fails, it may still be some value. For one thing, it might slow down the IRS's march towards audits. If the court allows the Coinbase users to join the case and contest the motion, this might postpone the handover of user data to the IRS. Besides, there may be appeals,

which could lead to further delays.

Ultimately, though, should Coinbase users breathe easy that the IRS will never get their data? Probably not. The fact that lawyers are fighting on their behalf in court may provide some comfort. Yet it is hard to defeat an IRS summons. Coinbase users should not be too optimistic that that these efforts will prevail in the long run. Eventually, the IRS is likely to get what it wants, and there will surely be audits of some Bitcoin users. Taxpayers who are concerned should prepare now, and consider amending past filings. With the IRS, assuming that you won't be caught—or that you can fix it if you are—can be dangerous.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.