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17 UNITED STATES DISTRICT COURT FOR THE
18 NORTHERN DISTRICT OF CALIFORNIA

19 IN THE MATTER OF THE TAX)
20 LIABILITIES OF:)
21 JOHN DOES, United States persons who,)
at any time during the period January 1, 2013,)
22 through December 31, 2015, conducted)
transactions in a convertible virtual currency)
23 as defined in IRS Notice 2014-21.)
24 _____)

Civil Number:

**UNITED STATES' MEMORANDUM IN
SUPPORT OF *EX PARTE* PETITION
FOR LEAVE TO SERVE JOHN DOE
SUMMONS**

25 The United States of America submits this memorandum in support of its petition for an order
26 approving the service of an Internal Revenue Service "John Doe" summons on Coinbase, Inc. for
27 information related to transactions conducted in convertible virtual currency as defined in IRS Notice

1 2014-21. Pursuant to 26 U.S.C. § 7609(h)(2), the Court’s determination to approve a John Doe
2 summons shall be made *ex parte* and shall be made solely on the petition and supporting affidavits.
3 Thus, the pleadings filed in this proceeding will not be served upon any person or entity and no other
4 filings are permitted from other persons or entities. Accordingly, this matter is ripe for the Court’s
5 consideration. The United States requests that the Court review the petition and supporting documents
6 and enter the proposed order at the Court’s earliest opportunity.

7 INTRODUCTION

8 The IRS is responsible for monitoring ways in which United States taxpayers evade their United
9 States tax obligations by concealing or otherwise failing to report their proper amount of taxable income
10 and thus underpay their taxes. The ever-changing digital age and innovation pose new risks for the IRS
11 and tax compliance by United States taxpayers. One such innovation is the creation of virtual currency
12 which, unlike U.S. dollars or other government-issued currencies, does not have a physical coin or bill
13 associated with their circulation and is not owned by any government.

14 Since 2009, the use of virtual currency has increased exponentially. Some users value the
15 relatively high degree of anonymity associated with virtual currency transactions because only a
16 transaction in virtual currency, such as buying goods or services, is public and not the identities of the
17 parties to the transaction. Because of that, virtual currency transactions are subject to fewer third-party
18 reporting requirements than transactions in conventional forms of payment. However, due to this
19 anonymity and lack of third-party reporting, the IRS is concerned that U.S. taxpayers are underreporting
20 taxable income from transactions in virtual currencies. Further, because the IRS considers virtual
21 currencies to be property, United States taxpayers can realize a taxable gain from buying, selling, or
22 trading in virtual currencies. There is a likelihood that United States taxpayers are failing to properly
23 determine and report any taxable gain from such transactions.

24 In order to identify taxpayers who have may have underpaid taxes associated with transactions in
25 virtual currency, the United States brings this *ex parte* proceeding under § 7609(f) and (h) of the Internal
26 Revenue Code (26 U.S.C.) for leave to serve a John Doe summons on Coinbase. The John Doe
27 summons seeks records relating to transactions in convertible virtual currency as defined in IRS Notice

1 2014-21. *See* Declaration of Senior Revenue Agent Davide Utzke in Support of *Ex Parte* Petition for
2 Leave to Serve “John Doe” Summons (“Utzke Decl.”) Exhibit B. The John Does whose identities are
3 sought by the summons are United States persons who, at any time during the period January 1, 2013,
4 through December 31, 2015, conducted transactions in a convertible virtual currency. The issuance of
5 the summons is warranted here because (i) the summons relates to an ascertainable group or class of
6 persons; (ii) there is a reasonable basis for believing these U.S. taxpayers failed to comply with internal
7 revenue laws; and (iii) information sufficient to establish these U.S. taxpayers’ identities is not readily
8 available to the IRS from other sources.

9 BACKGROUND

10 A. What virtual currency is and how it works

11 Virtual currency is a digital representation of value that functions as a medium of exchange, a
12 unit of account, and/or a store of value. Utzke Decl. ¶ 7. In some situations, virtual currency operates
13 like “traditional currency,” i.e., the coin and paper money of a country that is designated as legal tender.
14 However, it does not have legal tender status in any jurisdiction. *Id.* A virtual currency is considered
15 “convertible” if it has an equivalent value in traditional currency or acts as a substitute for traditional
16 currency. Convertible virtual currency can be digitally traded between users and can be purchased for,
17 or exchanged into, U.S. dollars, Euros, and other traditional or virtual currencies. *Id.*

18 In order to transact in a virtual currency system, a user would need to create a “wallet.” A wallet
19 is a digital computer file that contains information necessary to send and receive units of a virtual
20 currency. *Id.* at ¶ 8. When the wallet is created, a random wallet address is generated; this is a unique
21 alphanumeric identifier, which is conceptually similar to an e-mail address. *Id.*

22 A wallet holds any number of public keys and their associated private keys. The public key and
23 private key are conceptually similar to a user ID and a digital signature, respectively. In order to
24 exchange units of a virtual currency, a virtual currency user needs to electronically send their public key
25 to anyone with whom they want to transact. *Id.* at ¶ 9. The public key contains information that verifies
26 the wallet and the private key is used to authenticate a transaction. Only once the transaction is signed
27 by both parties, is the transaction complete. A completed transaction is then introduced to a network of

1 computers monitored by competing groups of people called miners. After computers on the network
2 confirm that a transaction is authentic, the transaction is posted to a “block” – a grouping of transactions.
3 When a specified number of confirmed transactions have been grouped, a block is formed. *Id.* at ¶ 11.
4 Miners then compete against each other to find a solution to a mathematical puzzle that depends on the
5 contents of the block; once a solution is found, that block will be added to the blockchain.

6 Miners maintain the integrity of the blockchain: a sequential public list of all transactions.
7 Miners also validate transactions that go into the blockchain with the motive of earning virtual currency.
8 *Id.* When a new block is added to the blockchain, new virtual currency coins are generated and awarded
9 to the miner who discovered the mathematical puzzle solution that allows the new block to be added to
10 the blockchain. The cycle then repeats. *Id.*

11 All transactions in a virtual currency blockchain can be viewed by the public on any computer
12 connected to the Internet. However, the blockchain transactional history only reveals the date, the time,
13 the amount (denominated in virtual currency), and the wallet addresses associated with a transaction.
14 The blockchain does not identify the actual identities of the wallet owners. *Id.* at ¶ 12.

15 There are nearly a thousand virtual currencies, but the most widely known virtual currency, and
16 largest by capitalization, is bitcoin. Other virtual currencies mimicking bitcoin using the blockchain
17 technology are known as alternative coins or altcoins for short. Just a few examples of altcoins are
18 Ethereum, Litecoin, Ripple, Feathercoin, and Dogecoin. *Id.* at ¶ 13.

19 **B. How virtual currency can be obtained and used**

20 In order to buy virtual currency with a medium of exchange denominated in a traditional
21 currency, such as a conventional check, credit card, wire, or Automated Clearing House (ACH)
22 electronic payment, a virtual currency user will have to find some way to transfer traditional currency to
23 someone who already has virtual currency and wishes to exchange it for traditional currency. *Id.* at ¶ 14.
24 In theory, this could be anyone with a virtual currency; in practice, this tends to be managed by
25 businesses called virtual currency exchangers that trade between virtual currencies and traditional
26 currencies. *Id.*

1 A virtual currency exchanger functions much like an exchanger for traditional currency except it
2 can exchange virtual currency for traditional currency or vice versa. Because virtual currency
3 exchangers may receive conventional checks, credit card, debit card, or wire transfer payments in
4 exchange for virtual currency, they are a link between virtual currency systems and conventional
5 banking and money-transmittal systems. *Id.* at ¶ 15.

6 A virtual currency exchanger may operate on one or more virtual currency platforms. The
7 exchange rate between traditional currency and virtual currency, and between different virtual currency
8 systems, is typically set by supply and demand, and different exchangers compete for business. Because
9 mechanisms exist for exchanging virtual currencies and traditional currencies, virtual currencies have
10 spread beyond online transfers between consumers; they are now used for purchases from brick-and-
11 mortar businesses as well as online merchants. *Id.* at ¶ 16.

12 Virtual currency exchangers may also provide wallet services, which allow a user to quickly
13 authorize virtual currency transactions with another user through the use of a traditional money account
14 held at the exchanger, similar to a margin account held with a stock broker. Wallet accounts are easily
15 accessed through a computer or mobile device like a smartphone. *Id.* at ¶ 17.

16 **C. How Coinbase operates in the virtual currency world**

17 Coinbase is a virtual currency exchanger headquartered in San Francisco, California. It offers
18 buy/sell trading functionality in 32 countries, maintains over 4.9 million wallets with wallet services
19 available in 190 countries, 3.2 million customers served, and \$2.5 billion exchanged in bitcoin. *Id.* at ¶
20 39. As of December 2015, Coinbase was the fourth largest exchanger globally of bitcoin into U.S.
21 dollars and the largest exchanger in the United States of bitcoin into U.S. dollars. Coinbase started
22 business in June 2012 as a digital wallet service. By October 2012, the company launched the ability to
23 buy and sell bitcoin through bank transfers. *Id.* By 2014, Coinbase had grown to one million users and
24 had formed partnerships with Overstock, Dell, Expedia, Dish Network, Time Inc., and Wikipedia and
25 assisted Stripe, Braintree, and PayPal in accepting bitcoin payments. *Id.* at ¶ 40.

26 As of December 2015, Coinbase has four main products: (1) an exchange for trading bitcoin and
27 fiat currency (fiat currency is legal tender that is backed by the government that issued it); (2) a wallet

1 for bitcoin storage and transactions; (3) an application programming interface (API) for developers and
2 merchants to build applications and accept bitcoin payments; and (4) “Shift Card,” the first U.S.-issued
3 bitcoin debit card. *Id.* at ¶ 42. The Shift Card is a VISA branded debit card that enables Coinbase users
4 in the United States (that reside in one of twenty-four states and Washington, D.C.) to spend bitcoin
5 anywhere VISA is accepted. *Id.*

6 **D. The IRS’s investigation into the use of virtual currency**

7 In 2013, at the request of the Senate Finance Committee, the Government Accountability Office
8 (“GAO”) issued a report regarding tax compliance issues relating to virtual currencies. *See* U.S. Gov’t
9 Accountability Office Report GAO-13-516, *Virtual Economies and Currencies: Additional IRS*
10 *Guidance Could Reduce Tax Compliance Risk*, <http://www.gao.gov/products/GAO-13-516>. Through
11 interviews with industry representatives, tax professionals, IRS officials and academics, the GAO report
12 identified several tax compliance risks associated with virtual currencies, including lack of third-party
13 reporting, lack of knowledge among taxpayers, and uncertainty over the characterization of gains
14 realized from virtual currencies. *Id.* at 14. The report found that “some taxpayers may use virtual
15 economies and currencies as a way to evade taxes. Because transactions can be difficult to trace and
16 many virtual economies and currencies offer some level of anonymity, taxpayers may use them to hide
17 taxable income.” *Id.* The report recommended that the IRS promulgate additional guidance tax
18 regarding convertible virtual currencies. *Id.* at 17.

19
20
21 In response to this report, in March 2014, the IRS issued Notice 2014-21, which describes how
22 the IRS applies U.S. tax laws and general tax principles to transactions involving virtual currency. *See*
23 Notice 2014-21 (Utzke Decl. Exhibit A). In Notice 2014-21, the IRS stated its position that virtual
24 currencies that can be converted into traditional currency are property for tax purposes, and a taxpayer
25 can have a gain or loss on the sale or exchange of a virtual currency, depending on the taxpayer’s cost to
26 purchase the virtual currency (that is, the taxpayer’s tax basis).
27

1 In May 2014, the GAO issued a second report that focused more broadly on the public policy
2 challenges posed by the use of virtual currencies. The report found that due in part to “the higher degree
3 of anonymity” offered by virtual currencies, they “may be attractive to parties seeking to . . . move or
4 conceal money obtained by illegal means.” See U.S. Gov’t Accountability Office Report GAO-14-496,
5 *Virtual Currencies’ Emerging Regulatory, Law Enforcement, and Consumer Protection Challenges*,
6 <http://www.gao.gov/products/GAO-14-496>; see also Omri Marian, *Are Cryptocurrencies Super Tax*
7 *Havens?*, 112 Mich. L. Rev. First Impressions 38 (2013) (concluding that virtual currencies share the
8 characteristics of tax havens because earning are not subject to taxation, taxpayer anonymity is
9 maintained, and their operation is not dependent upon financial institutions); Nicholas Godlove,
10 *Regulatory Overview of Virtual Currency*, 10 Okla. J. L. & Tech. 71 (2014) (identifying an advantage of
11 virtual currency as ease of use in illegal or sensitive transactions, including money laundering and tax
12 evasion); *Virtual Currency: Hearing Before the Committee on Banking, Housing, and Urban Affairs*,
13 *Subcommittee on National Security and International Trade and Finance with Subcommittee on*
14 *Economic Policy*, 113th Cong. (2013) (statement of Jennifer Shasky Calvery, Director Financial Crimes
15 Enforcement Network, United States Department of the Treasury) (virtual currency has the potential to
16 be exploited for money laundering because of its anonymity, accessibility, and regulatory challenges);
17 *Money Laundering in Digital Currencies*, United States Department of Justice National Drug
18 Intelligence Center, Product No. 2008-R0709-003 (June 2008) (virtual currencies provide an ideal
19 money laundering instrument because they facilitate payments without the concern for documentation,
20 identification, or law enforcement suspicion). Recently, the Treasury Inspector General for Tax
21 Administration issued a report on the increased use of virtual currencies and the associated risks of
22 reporting noncompliance in taxable transactions. Treasury Inspector General for Tax Administration
23 Reference Number: 2016-30-083, *As the Use of Virtual Currencies in Taxable Transactions Become*
24
25
26
27

1 *More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance* (September 21, 2016)
2 <https://www.treasury.gov/tigta/auditreports/2016reports/201630083fr.pdf>.

3 The IRS has continued to gather information regarding the tax compliance issues posed by the
4 use of virtual currency. Senior Revenue Agent Utzke identified and interviewed three taxpayers who
5 had used virtual currencies as a means of evading taxes. Utzke Decl. ¶¶ 30, 34. Two of these taxpayers
6 were corporate entities with annual revenues of several million dollars that bought and sold bitcoins. *Id.*
7 at ¶ 34. Both entities had wallet accounts at Coinbase and attempted to conceal bitcoin transactions as
8 technology expenses on their tax returns. *Id.* The third taxpayer diverted his income to an offshore tax
9 haven and used virtual currency to repatriate his assets without government detection. *Id.* at ¶ 31. In
10 addition to these, Senior Revenue Agent Utzke’s research identified individuals prosecuted and
11 convicted of federal crimes for anti-money laundering and/or operating an unlicensed money services
12 business involving virtual currency transactions. *Id.* at ¶ 35. IRS records indicate that these defendants
13 never reported to the IRS their virtual currency transactions. *Id.*

14
15
16 Senior Revenue Agent Utzke also identified a host of factors that increase the likelihood that the
17 proposed summons will reveal the identities of delinquent taxpayers. These include:

- 18 • The fact that virtual currency transactions are subject to fewer third-party reporting
19 requirements than conventional forms of payment, which in the IRS’s experience,
20 significantly increases tax underreporting (*id.* at ¶ 37);
- 21 • The relatively high degree of anonymity associated with virtual currency transactions
22 (*id.* at ¶ 38);
- 23 • A public perception that virtual currency can be used to evade taxes, including at least
24 one instance of open acknowledgement by bitcoin users that tax evasion is a sought-
25 after feature of using bitcoins (*id.* at ¶ 35 *citing* “Bitcoin Celebrated As Way To
26 Avoid Taxes,” Huffington Post (April 16, 2013) *available at*
27 www.huffingtonpost.com/2013/04/16/bitcoin-taxes_n_3093182.html (accessed
November 16, 2016)); and
- Failure among virtual currency users to afford virtual currency transactions the proper
tax treatment, including the proper valuation of such transactions (*id.* at ¶ 29).

1 To further its investigation into the identities of U.S. taxpayers who have failed to disclose tax
2 information relating to their participation in virtual currency transactions, the IRS is seeking to issue a
3 summons that will allow it to identify U.S. persons who have not properly reported income arising from
4 their use of virtual currency. The John Doe class, therefore, is as follows:

5
6 United States persons who, at any time during the period January 1, 2013,
7 through December 31, 2015, conducted transactions in a convertible
8 virtual currency as defined in IRS Notice 2014-21.

9 Utzke Decl. Exhibit B. This summons seeks account registration records and any Know-Your-Customer
10 due diligence performed for each account owned or controlled by a user during the stated period, the
11 associated transaction records, account statements, and records of payments made and processed for
12 these users. These types of documents should reveal the identity of account holders, as well as amounts
13 of transactions from those accounts. As discussed below, the summons and its John Doe class are
14 authorized and appropriate under 26 U.S.C. § 7609.

14 ARGUMENT

15 **The Summons Meets the Requirements for an IRS “John Doe” Summons**

16 One of the primary functions of the IRS is to review and audit tax returns submitted by U.S.
17 taxpayers to ensure that all applicable taxes have been paid. Accordingly, § 7601 of the Internal
18 Revenue Code requires the Secretary of the Treasury to “cause officers or employees of the Treasury
19 Department to proceed, from time to time, through each internal revenue district and inquire after and
20 concerning all persons therein who may be liable to pay any internal revenue tax.” 26 U.S.C. § 7601.
21 To aid the IRS in carrying out this function, § 7602 authorizes the Secretary to summon records and
22 testimony that may be relevant or material to an investigation. 26 U.S.C. § 7602. Specifically, § 7602,
23 from which the IRS derives its principal information-gathering powers, authorizes the IRS:

24 [f]or the purpose of ascertaining the correctness of any return, making a
25 return where none has been made, [or] determining the liability of any
26 person for any internal revenue tax . . . [t]o summon . . . any person having
27 possession, custody, or care of books of account containing entries relating
to the business of the person liable for tax . . . , or any other person the
Secretary may deem proper, to appear . . . and to produce such books,
papers, records, or other data, and to give such testimony, under oath, as
may be relevant or material to such inquiry.

1 In passing § 7602, Congress intended “to provide the Secretary with broad latitude to adopt
2 enforcement techniques helpful in the performance of his tax collection and assessment responsibilities.”
3 *United States v. Euge*, 444 U.S. 707, 715 n.9 (1980). The Supreme Court has noted that § 7602 forms
4 the “centerpiece” of the IRS’s “expansive information-gathering authority.” *United States v. Arthur*
5 *Young & Co.*, 465 U.S. 805, 816 (1984); see *United States v. Clarke*, 134 S. Ct. 2361, 2367 (2014)
6 (“And such an investigatory tool, we have recognized, is a crucial backstop in a tax system based on
7 self-reporting.”). “Under 26 U.S.C. § 7602, the IRS has wide latitude to issue a summons for
8 investigatory purposes.” *Reiserer v. United States*, 479 F.3d 1160 1166 (9th Cir. 2007) (citing *United*
9 *States v. Jose*, 131 F.3d 1325, 1327 (9th Cir. 1997) (en banc)). ““To establish a need for judicial
10 enforcement, this showing need only be minimal [T]he statute must be read broadly in order to
11 ensure that the enforcement powers of the IRS are not unduly restricted.”” *Jose*, 131 F.3d at 1327-28
12 (quoting *Liberty Fin. Servs. v. United States*, 778 F.2d 1390, 1392 (9th Cir. 1985)); see also *Arthur*
13 *Young*, 465 U.S. at 816 (“the very language of § 7602 reflects . . . a congressional policy choice *in favor*
14 *of disclosure* of all information relevant to a legitimate IRS inquiry. In light of this explicit statement by
15 the Legislative Branch, courts should be chary in recognizing exceptions to the broad summons
16 authority of the IRS”).

17 The IRS’s authority to issue John Doe summonses to banks or other depositories to discover the
18 identity of individuals who may have failed to disclose all of their income was expressly recognized by
19 the Supreme Court in *United States v. Bisceglia*, 520 U.S. 141 (1975), and later codified in § 7609(f),
20 which provides:

21 Any summons . . . which does not identify the person with respect to
22 whose liability the summons is issued may be served only after a court
proceeding in which the Secretary establishes that –

- 23 (1) the summons relates to the investigation of a particular person or
24 ascertainable group or class of persons,
- 25 (2) there is a reasonable basis for believing that such person or group
26 or class of persons may fail or may have failed to comply with any
27 provision of any internal revenue law, and
- (3) the information sought to be obtained from the examination of the
records or testimony (and the identity of the person or persons with
respect to whose liability the summons is issued) is not readily
available from other sources.

1 26 U.S.C. § 7609(f). The Court’s determination as to whether the IRS has met the requirements under §
2 7609(f) for the issuance of a John Doe summons “shall be made ex parte and shall be made solely on the
3 petition and supporting affidavits.” 26 U.S.C. § 7609(h)(2).

4 Here, the Court should authorize service of the summons because all three statutory prerequisites
5 have been met. First, the summons relates to the investigation of an ascertainable group or class of
6 persons, namely U.S. taxpayers who have conducted transactions in convertible virtual currency.
7 Second, there is a reasonable basis for believing that U.S. persons who conducted such transactions may
8 have failed to report income to the IRS, thereby violating one or more provisions of the internal revenue
9 laws. Third, the information sought is not readily available to the IRS from other sources.

10 **A. The IRS investigation concerns an ascertainable class**

11 The summons here clearly relates to an investigation of an ascertainable group of people, which
12 the summons defines as “United States persons who, at any time during the period January 1, 2013,
13 through December 31, 2015, conducted transactions in a convertible virtual currency as defined in IRS
14 Notice 2014-21.” Utzke Decl. Ex. B. In other words, the summons relates to the IRS’s investigation of
15 U.S. taxpayers who transacted in virtual currency between 2013 through 2015. This is sufficient to
16 establish that the summons relates to an ascertainable group of persons.

17 Although neither the statute nor the case law further define the term “ascertainable group or class
18 of persons” as it is used in § 7607(f), cases have endorsed the service of John Doe summonses seeking
19 information on a group of people defined in a similar manner (*i.e.*, by the type of transaction they
20 engaged in and the date of the transaction. *See, e.g.*:

- 21
- 22 • *In re Tax Liabilities of John Does, United States Taxpayers Who, at Any Time During the*
23 *Years Ended December 31, 2004 Through December 31, 2012, Directly or Indirectly*
24 *Had Interests In or Signature or Other Authority With Respect to Any Financial Accounts*
25 *Maintained At, Monitored By, Or Managed Through CIBC FirstCaribbean International*
26 *Bank Limited (Collectively FCIB) or Other Financial Institutions FCIB Permitted To*
27

1 *Transact Client Business Through its United States Correspondent Account at Wells*
2 *Fargo Bank, N.A., Order Granting Ex Parte* Petition for Leave to Serve “John Doe”
3 Summons, Docket No. 6, Case No. 13-CV-1938 (TEH) (N.D. Cal. Apr. 29, 2013)
4 (holding that IRS investigation related to ascertainable group of people for “John Doe”
5 summons to Wells Fargo Bank, N.A. seeking documents establishing the identity of U.S.
6 taxpayers for the years ended December 31, 2004 through December 31, 2012, who had
7 interests in or signature or other authority with respect to financial accounts that FCIB
8 permitted to transact business through its correspondent account at Wells Fargo Bank,
9 N.A. (a copy of this Order is attached herewith);

- 11 • *In re Tax Liabilities of John Does Who from December 31, 2002 through December 21,*
12 *2010 had Interests in Financial Accounts Managed through HSBC India, Order Granting*
13 *Ex Parte* Petition for Leave to Serve “John Doe” Summons, Docket No. 10, Case No. 11-
14 CV-1686 (LB) (N.D. Cal. Apr. 7, 2011) (holding that IRS investigation related to an
15 ascertainable group of people for “John Doe” summons on HSBC Bank USA, N.A.
16 seeking documents establishing the identity of U.S. taxpayers “who at any time during
17 the years ended December 31, 2002 through December 31, 2010, directly or indirectly
18 had interests in or signature or other authority ... with respect to any financial accounts
19 maintained at, monitored by, or managed through [HSBC India]”)(a copy of this Order is
20 attached herewith);
- 23 • *In re Tax Liabilities of John Does Who from January 1, 2005 through December 31,*
24 *2010, Transferred Real Property in the State of California, 2011 WL 6302284, at *2,*
25 Case No. 2:10-mc-00130 (E.D. Cal. Dec. 15, 2011) (holding that IRS investigation
26 related to an ascertainable group of people where the summons “squarely particularize[d]
27 the individuals sought from the general public” by identifying the class as California

1 residents who between 2005 and 2010 were involved in certain real property transfers for
2 little or no consideration);

- 3
- 4 • *In re Tax Liabilities of John Does*, 2003 WL 22953182, at * 1, Case No. 03-22793-CIV
5 (S.D. Fla. Oct. 30, 2003) (holding that IRS investigation related to an ascertainable group
6 of people where summons identified class as U.S. taxpayers who between 1997 and 2003
7 sold credit insurance policies where the policies were reinsured with entities in the Turks
8 and Caicos Islands).

9 Here, similarly, the IRS has established that the investigation underlying the summons relates to an
10 “ascertainable group or class of persons.” 26 U.S.C. § 7609(f).

11 **B. There is a reasonable basis to believe that the unknown persons may fail, or may**
12 **have failed, to comply with the internal revenue laws**

13 The IRS has a reasonable basis to believe that the unknown individuals who comprise the group
14 of persons set forth in the summons failed or may have failed to comply with provisions of the internal
15 revenue laws. When enacting § 7609(f), Congress did “not intend to impose an undue burden on the
16 [IRS] in connection with obtaining a court authorization to serve this type of summons.” H. Rep. No.
17 940658, 94th Cong., 1st Sess., at 311. Accordingly, to meet the “reasonable basis” prong, the IRS need
18 only show that a transaction has occurred that is “of such a nature as to be reasonably suggestive of the
19 possibility that the correct tax liability with respect to that transaction may not have been reported.” *Id.*
20 Courts, therefore, have interpreted this requirement narrowly as intended only “to prevent the Service
21 from exercising its summons power in an arbitrary or quixotic manner.” *In re Tax Liabilities of John*
22 *Does, Members of the Columbus Trade Exchange in the Years 1977 and 1978*, 671 F.2d 977, 980 (6th
23 Cir. 1982) (authorizing John Doe summons to barter exchange organization seeking identities of barter
24 transaction participants for two tax years).

25 Here, based on the IRS’s experience, U.S. taxpayers have made use of virtual currencies to evade
26 the reporting and payment of taxes. *See* Utzke Decl. at ¶¶ 30, 34. As described above, Senior Revenue
27 Agent Utzke is aware of three instances of U.S. taxpayers using virtual currency transactions to conceal

1 income, two involve Coinbase. *Id.* There have also been criminal proceedings in the United States in
2 which the defendants were proved or alleged to have used virtual currencies for money laundering
3 and/or the operation of an unlicensed money services business. *Id.* at ¶ 35. IRS records indicate that
4 these defendants never reported to the IRS their virtual currency transactions. *Id.*; *see, e.g., Sarah*
5 *Gruber, Trust, Identity, and Disclosure: Are Bitcoin Exchanges the Next Virtual Havens for Money*
6 *Laundering and Tax Evasion*, 32 *Quinnipiac L. Rev.* 135 (2013) (“money laundering naturally pairs well
7 with shirking one’s tax responsibility”). Finally, there are additional factors indicating the likely
8 incidence of tax delinquency involving virtual currency, including a lack of third-party information
9 reporting; relative anonymity of the transactions; a public perception that tax evasion is possible with
10 virtual currency; and a failure among virtual currency users to afford virtual currency transactions the
11 proper tax treatment, including the proper valuation of such transactions. *Id.* at ¶ 29. These facts,
12 coupled with the IRS’s experience (*Id.* at ¶¶ 30, 34, 35) with other modes of payment not accompanied
13 by third-party reporting, show that U.S. taxpayers utilizing Coinbase may have failed to report income
14 and other information required under the internal revenue laws.

15 This information is sufficient to establish that the IRS has a reasonable basis for issuing the
16 summons. *See, e.g., United States v. Kersting*, 891 F.2d 1407 (9th Cir. 1989) (“John Doe” summons
17 enforced after district court found “the existence of at least one case in which a Tax Court found some of
18 Kersting’s programs to be abusive of the tax code.” 891 F.2d at 1409. The Ninth Circuit affirmed:
19 “There was ample basis for believing that the persons about whom records were sought had not
20 complied with the tax law.” 891 F.2d at 1412); *United States v. Pittsburgh Trade Exchange, Inc.*, 644
21 F.2d 302, 306 (3d Cir. 1981) (IRS agent’s testimony that transactions of the type the summoned party
22 arranged for its clients were “inherently susceptible ... to tax error” sufficient to meet “reasonable basis”
23 prong); *United States v. Ritchie*, 15 F. 3d 592, 601 (6th Cir. 1994) (clients’ payment for legal services
24 with large amounts of cash provided a reasonable basis to issue a “John Doe” summons). Here, as
25 Senior Revenue Agent Utzke’s Declaration demonstrates, the IRS not only has a suspicion that the John
26 Doe class includes U.S. taxpayers who are not complying with the law—it knows that the class in the
27 past included such violators, and very likely includes others.

1 **CONCLUSION**

2 The United States has met the requirements of 26 U.S.C. § 7609(f) in order to be allowed to
3 serve its John Doe summons on Coinbase, Inc. Accordingly, the United States' Petition should be
4 granted.

5 Dated this 17th day of November, 2016.

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