

Tax

If you think cryptocurrency income is hidden from the CRA, you're wrong

By Rob Winters and Peter Muto



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(March 9, 2018, 8:53 AM EST) -- Much is written about how the Canada Revenue Agency (CRA) taxes income or capital gains earned from the disposition of bitcoins and other cryptocurrencies (collectively called BTC). Something that has not attracted much attention is CRA's power to obtain information from third parties about BTC holdings and transactions of Canadian taxpayers.

Cryptocurrencies are often regarded as being anonymous. That is incorrect. BTC holdings are not directly associated with the user's identity, but records of all BTC transactions are part of a public ledger, and close analysis of BTC transactions may reveal identities. In a recent article in *The Lawyer's Daily*, David Rotfleisch wrote that the IRS reportedly has software to automate such analysis.

Users generally do transactions through BTC exchanges to convert BTCs back and forth for traditional, government-issued (i.e. fiat) currencies. Anti-money laundering legislation in most countries requires these exchanges to obtain and retain client information just as banks and other financial institutions do.

For example, the Canadian BTC exchange Coinsquare requires clients to send in copies of government-issued photo ID, a recent proof-of-residence document containing their name and address (i.e., utility bill or bank statement), a "selfie verification" photo displaying the client's face, and their account number.

BTC users aren't the only situation where CRA doesn't initially know the identity of the taxpayer or group of taxpayers whose compliance it wants to verify. Successful sellers on Ebay and those involved in retail tax shelters are also in this group. Under both the *Income Tax Act* (ITA) and *Excise Tax Act* (ETA), CRA can compel anyone to provide information about unnamed third parties. This is called a "third party requirement."

To issue a requirement CRA needs authorization from a judge of the Federal Court of Canada, but the bar to obtain such authorization is low. CRA merely must demonstrate that the authorization is sought to verify compliance of the unnamed person or group with the relevant taxing statute.

When issuing authorization, the court retains the right to impose appropriate conditions (i.e., restricting the scope to the minimum information necessary). Generally, a requirement may not be granted for a "fishing expedition" (i.e., CRA doesn't have reason to believe that the unnamed persons are non-compliant) or when the inquiry is a criminal investigation.

We can see how a third party requirement works in *eBay Canada Ltd. v. Canada (Minister of National Revenue)* 2007 FC 930 aff'd 2008 FCA 348. In that case, CRA was interested in eBay Canada's records concerning "Power Sellers" — users who sell over a certain value of goods on eBay.

CRA thought these taxpayers were not reporting or were under-reporting income and/or HST. CRA required personal information of the Power Sellers to match the taxpayers' reported income. The application was granted because the taxpayers could be identified, there was a connection to the information CRA wanted, and the purpose was about administering and enforcing the ITA.

It's only a matter of time before CRA issues a third party requirement for a bitcoin exchange and the IRS has already done this. Coinbase is the largest cryptocurrency exchange in the United States. Last November, *United States v. Coinbase, Inc.* granted the IRS a summons of the identity and trading activity of all Coinbase customers who had the equivalent of \$20,000 in any one transaction type (buy, sell, send, or receive) in any one year during the 2013-2015 period. Armed with this information, the IRS can match taxpayers' trading activity to what was reported on their returns.

One issue CRA may encounter in this regard is jurisdiction. Where is the information and can its location be used to thwart CRA? In *eBay Canada Ltd. v. Canada*, the case turned on the fact that information CRA sought was physically located on servers outside Canada.

Since the information was readily accessible by eBay Canada, Justice Roger Hughes concluded that data stored on U.S. servers was subject to domestic, third party requirement rules under the ITA. Justice Hughes said in paragraph 24 that “the situation may be different if the information never had been used in Canada.” With no Canadian office or presence, CRA may lack jurisdiction to directly obtain third party information. But even then Tax Information Exchange Agreements (TIEAs) present another option for CRA, and Canada has many bilateral TIEAs.

If CRA can't reach directly into another country via a third party requirement, it may be able to share or obtain the information from a TIEA country. Therefore, BTC users who think cryptocurrencies allow income to be hidden from CRA are mistaken. User information exists, and CRA has the authority to obtain it.

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