



PILLA TALKS TAXES

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN



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Crypto Cases To Top CI's "To-Do List" In 2023 *You Can't Hide Crypto Assets*

The Internal Revenue Service's (IRS) [Criminal Investigation](#) (CI) function is charged with investigating allegations of criminal tax fraud, and assisting the Department of Justice (DOJ) and the United States Attorney's Office with the prosecution of those cases.

The Inflation Reduction Act is breathing new life into IRS enforcement action, including CI. Next year, the agency intends to hire an additional 360 special agents, agents who investigate alleged tax and financial crimes, along with another 150 professional support staff. These include computer, Internet and other technology experts trained to unravel complicated digital transactions. That will push [CI's workforce](#) to 2,427 special agents and 1,088 professional support staff, the highest it's been since 2010.

The complicated digital transactions awaiting scrutiny are crypto-currency transactions. According to CI's [2022 Annual Report](#),

Digital assets pose a significant risk of facilitating money laundering, cybercrime and ransomware, narcotics and human trafficking, terrorism, and proliferation financing. Digital assets may also be used as a mechanism to circumvent U.S. tax law and financial sanctions.

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This is why CI is currently teeing up hundreds of crypto cases for investigation and potential prosecution. Such cases will be a priority throughout 2023. In fact, because of the rise in crypto cases overall, in 2021, the IRS created the Office of Cyber and Forensic Services to function under the umbrella of CI. That office unifies the agency's digital asset investigations, cybercrime investigations, digital forensics, and physical forensics support teams, all in one place. A key priority, according to the Annual Report, is to investigate "the illicit uses of digital assets and how they can be used to exploit the U.S. tax and financial system."

The Internal Revenue Code does not address the tax consequences of crypto currency in particular. A few years after its emergence on the scene in 2009 as a financial asset, [IRS Notice 2014-21](#) deemed "virtual currency," – Bitcoin in particular – as "property," to be treated no differently than a share of stock or an automobile. The IRS refers to "virtual currency" as "convertible" currency in that it has a value measured in real currency, or it acts as a substitute for real currency. Any one of the hundreds (and growing) of today's digital currencies meets this broad definition.

Of course, the mere investment in or use of digital currency is not at all illegal. Such assets provide great opportunities for both citizens and businesses. These include market innovation, expansion of access to a broad range of financial services and investments, reduction of costs associated with domestic and cross-border money transfers for both buyers and sellers, and the speed, safety and accuracy of merchant payments.

Tax problems with virtual currency arise as a result of two issues: 1) the failure to report the gains on trading crypto assets, and 2) failure to report income paid in the form of crypto assets. Let me address them in turn.

1. Reporting crypto gains. When Bitcoin showed up on the market in 2009, it was essentially worthless. By the end of 2009, it had some value only because of very limited trading. However, by Novem-

ber 2021, one [Bitcoin was worth \\$69,000](#). Much trading was done by investors throughout the wild ride. Those who bought low and sold high (the key to making money, I'm told) realized gain on their trades. The gain is taxable as income. For example, suppose you purchased crypto at \$5 per coin, and sell at \$15. You realize gain of \$10 per coin. That gain is subject to capital gain tax. The rate of tax depends on a number of factors, most notably the length of time you held the asset.

The problem is that people often do not understand that gains realized from trading crypto must be reported and the tax paid. But as I point out, as early as 2014, the IRS classified virtual currency as an asset to be treated for tax purposes just like any other asset.

The other element of the trading problem shows itself when there are mere portfolio transactions. Suppose you have a portfolio of 50 Bitcoin, worth \$1,000 each. Your basis (cost price) in the Bitcoin is \$100 each. You trade all your Bitcoin for some other digital currency without taking any cash from the portfolio. The typical taxpayer probably believes there are no tax consequences to the trade because he took no cash. He would be wrong.

The swap of the Bitcoin is treated as a sale. The fact that you acquire another digital currency without taking cash in the process does not change the fact that you sold Bitcoin in order to acquire the other currency. It's no different than if you sell 100 shares of IBM stock and use all the proceeds to purchase 3M stock. You are taxed on the profit of the IBM stock, measured as the difference between the purchase and sales prices.

2. Payments in crypto. Now let's address what happens when you take crypto in payment for goods or services rendered. Suppose you're in business as an attorney. Your retainer fee is \$5,000. A client engages your services and pays you with five crypto coins worth \$1,000 each. The fair market value of the coins as of the date they are paid to you is \$5,000. That amount must be reported by you as income in the year received.

Now, you may counter by saying that since you didn't sell the coins, there's no profit. Not true. Your profit is measured by the fair market value of the coins as of the date you take them as payment.

At that point, your basis (purchase price) in the coins is equal to the fair market value on the date of receipt—in this case, \$1,000 per coin. Suppose you sell the coins later for \$1,500. At that, you have a profit (capital gain) of \$500 per coin, which also must be reported on your tax return in the year of the sale. On the other hand, if you sell for \$800 per coin, you have a loss of \$200 per coin, which may be claimed as a capital loss (subject to certain limitations) in the year of the sale.

IRS AND THE TRACKING OF DIGITAL CURRENCY

Too many people believe that the IRS has no way to track digital currency and therefore, if one fails to report trades, nobody will be the wiser. This is a serious mistake. The IRS has made great strides in tracking digital currency. I believe it is pure folly to believe they cannot find your trades, or that you can fail to report income from crypto with impunity. The best proof of this is the case of [Ilya Lichtenstein and his wife, Heather Morgan](#), of New York.

The pair were arrested in Manhattan in February 2022, and charged with conspiracy to launder \$4.5 billion in Bitcoin they allegedly stole by hack-

ing a virtual currency exchange in 2016. The IRS's CI was instrumental in breaking the case.

CI traced the stolen crypto using the Bitcoin blockchain to various destinations, including accounts on the darkweb, seven interconnected accounts at various virtual currency exchanges, various unhosted Bitcoin wallets, accounts owned by Lichtenstein at six virtual currency exchanges, and to an unhosted Bitcoin wallet containing a majority of the stolen crypto. CI accessed the wallet by decrypting a file saved to Lichtenstein's cloud account which they obtained via a search warrant. The cloud account contained a list of 2,000 virtual currency addresses, along with corresponding private keys. Special agents then seized more than 94,000 stolen Bitcoin valued at over \$3.6 billion at the time of seizure.

For all the bungling the IRS appears to have been doing over the past two or three years, the agency's special agents are not among the bunglers. They are highly trained professionals who are singularly focused. They know exactly what they are doing and how to do it. If you have crypto profits, do not make the mistake of believing the IRS cannot or will not find them. The agency is making these cases a priority in 2023.

If you are unaware or unsure of the tax consequences of your crypto trades, do not go it alone. Get counsel. Proceeding otherwise is simply not worth the risk.

White House Nominates New IRS Commissioner *Look for Danny Werfel to Take the Agency's Reins*

This is a most troubling time for the IRS, for several reasons. The agency is plagued with massive document processing and telephone backlogs, mostly attributable to Covid-19 shutdown orders that all but stopped government operations in the summer of 2020. The agency must deal with the fact that about 30 percent of its current workforce is eligible to retire by the end of 2023. If that plays out, the IRS could lose close to 25,000 employees in the next fourteen months. Recently the agency has come under criticism for the apparent imbalance between audits of low-income citizens

versus those of high-income earners. Critics assert that most of the tax cheating goes on among the rich, and therefore, they should be the targets of IRS scrutiny.

Perhaps the biggest challenge facing the IRS is what to do with the infusion of \$80 billion of new revenue (over and above its usual annual appropriation) it will receive over the next ten years. That will put the IRS's combined appropriation for next year at right about \$22.5 billion, nearly double its current allowance.

All are agreed that this money cannot be squandered. It must be used in the best interest of all taxpayers. The challenges are: 1) how to do that, and 2) who will guide the process.

HOW TO SPEND THE MONEY

I adamantly opposed the idea of pumping an additional \$8 billion into the IRS's annual budget every year for the next ten years. But that ship has sailed. The question now is what must they do with the money to get the most bang for the buck?

In my opinion, the answer is taxpayer assistance and education.

The friction between enforcement and education has shown itself mightily in the past forty or so years. The tax code in the 1950s and 1960s was not particularly complicated. And while we have gone through periods of very high tax rates, the breadth and scope of the code was such that most people could fairly easily determine and discharge their legal duties for themselves. That's no longer the case, and has not been so since the 1980s.

In 1992, former IRS Commissioner Shirley Peterson pointed out that much of what we call non-compliance with the tax code is not non-compliance at all. Rather, she noted, it's a lack of understanding of what the law requires. This was a clear signal that the IRS needed to spend more money on education rather than enforcement.

It didn't take long for that attitude to change. Margaret Richardson was named commissioner by President Clinton during his first term. She once observed that then it came to making a choice between enforcement and education, enforcement would win every time. She brought back the heavy hand of the IRS, which eventually led to the Senate Finance Committee's hearings into IRS abuse in 1997, followed by the IRS Restructuring and Reform Act of 1998.

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Doug Shulman assumed the role of commissioner in March 2008. He quickly announced that the question of enforcement versus education was not an “either/or” proposition. He explained that the IRS had to do both; that is, enforce the tax laws fully and fairly, while at the same time, educating citizens as to their responsibilities so they are better able to comply in the first place.

Former National Taxpayer Advocate Nina Olson repeatedly pointed out that 98 percent of all federal revenue is paid to the government “voluntarily,” that is, without the need of IRS intervention. I have said repeatedly that people screw themselves into the ground to comply with the code, but the complexities are often what trip them up.

The code now consists of more than 4 million words, and has been changed more than 6,000 times just since 2001. Nearly 80 percent of all taxpayers now use tax professionals or commercial tax preparation software to comply with their filing obligations. As former Commissioner Shulman once said, the code has gone from complexity to perplexity, and the chief victims of this morass of non-sense are American taxpayers.

As long as Congress has made it perfectly clear that they just will not simply the tax code in any meaningful way, the IRS simply must focus on taxpayer education and assistance as the principal means of combating non-compliance.

WHO WILL GUIDE THE IRS?

President Biden nominated Danny Werfel to fill the role of IRS Commissioner, vacated when Chuck Rettig’s ended in November. Werfel has both private and public sector experience. He was acting commissioner of the IRS during 2013, just prior to the appointment of John Koskinen as commissioner. Werfel served while the IRS was under attack for singling out the applications for exempt status filed by various conservative groups for higher scrutiny and improper delay. Werfel also worked at the Office of Management and Budget for several years.

Werfel’s experience in the private sector includes his most recent work with Boston Consulting Group (BCG), a management consulting firm based in (guess) Boston. This experience may give him an edge when it comes to allocating the \$80 billion windfall the IRS will receive. One of BGC’s core consulting services is to help large companies decide how to move cash within their business units, with the goal of allocating resources in the best possible manner to maximize growth and profit potential.

With a government agency, however, the success matrix is much different. American citizens interacting with the IRS are not doing so voluntarily in the sense that they have the free choice to pay taxes or not. Their participation is forced as a matter of law. Thus, the challenge for the IRS (and its new leader) is to gain the greatest amount of compliance from citizens with the least amount of heavy-handed enforcement. That must be accomplished in an era where the tax code is wildly complex and changing regularly. The chief way to accomplish that is through education.

MY CHALLENGE TO THE NEW COMMISSIONER

In light of the above, assuming his nomination is confirmed by the Senate, I challenge Commissioner Werfel to do two things.

First, he must rebuild—and increase—the IRS’s pre-filing education, assistance, and outreach functions to citizens. That should include working with the departments of education in the various states to develop and incorporate a tax education program into high school curricula. Today, our students graduate high school without completing a single program that teaches them about taxes generally, or tax law compliance in particular. High school graduates don’t know the difference between a K-1 and a hole-in-one. The graduates of the best business schools in the nation do not get any basic training on tax law compliance. Even in our law schools, federal tax is an elective course. And yet, the Internal Revenue Code touches every American.

Second, he must pressure Congress to engage in honest and legitimate discussions on real tax law simplification. To this end, the new commissioner must insist that the IRS immediately begin complying with § 4022(a) of the IRS Restructuring and Reform Act of 1998.

That provision requires the IRS to submit an annual report to Congress identifying the chief sources of tax law complexity and the sources of frustration for citizens in the area of compliance. The report is to provide recommendations for reducing complexity, and for the repeal or modification of whatever laws that add undue and unnecessary complexity to the code. The

idea is that the commissioner is to be on the front lines of the tax simplification battle.

The problem is that while the law requires the IRS to issue the complexity report annually, the agency has submitted just two such reports since the law was enacted in 1998, and no such report has been issued since 2002. Thus every former IRS Commissioner has failed miserably to address what is probably the single largest problem with the tax code—complexity—despite having an affirmative duty to do so.

Whether that changes under Commissioner Werfel only time will tell.



Paul R. Tom, Attorney at Law

The 2022 Paul R. Tom Award *And the Winner Is...*

As many of you know, we lost our good friend and colleague Paul Tom in December 2017.

In our newsletter tribute to Paul in January 2018, I stated that his memory will live on in TFI/TDI through the annual presentation of the Paul R. Tom Award for Outstanding Contributions to the Mission and Goals of the Tax Freedom Institute/Taxpayers Defense Institute. The 2018 Paul R. Tom Award—the very first—was presented to Paul posthumously through his wife, Melissa.

On Thursday, October 27, 2022, on the first day of the Defense Conference, I presented the fifth Paul R. Tom Award.

The award winner was determined on the basis of the model created by Paul Tom himself.

Paul was selfless in giving his time to those in our group who needed help. He was willing and anxious to contribute articles to the newsletter, which he did often. He was a speaker at past conferences. And, he was always present on our email list answering questions and giving guidance. He loved TFI/TDI and its members. He was completely dedicated to our mission as evidenced by the fact that he never missed a conference. He even attended the 2017 conference at a time when he was quite ill.

On top of all that, Paul was my friend. I greatly valued that relationship and his counsel, which I leaned on regularly. I miss him every day. But as we march on, please help me congratulate our fifth Paul R. Tom Award winner. We selected this person because he most closely resembles Paul's dedication and commitment to TFI/TDI.

AND THE WINNER IS...

Robert Cantu, Attorney and CPA, Charter Consulting Member of TFI/TDI.

As a charter member of TFI/TDI, Robert has been with us since the very beginning of this organization, which was 1993. That means he's been on board for 29 years! That's quite an accomplishment in itself.

It is my honor to present Robert Cantu with the 2022 Paul R. Tom Award. Thank you, Robert, for your dedication and commitment to this orga-

nization. In addition to Robert's many contributions to TFI/TDI over the nearly three decades of its existence, he was a speaker at the 2022 Defense Conference.

In response to receiving the Paul R. Tom Award, Robert offered the following comments:

I am deeply honored to have known Paul Tom and to have received the 2022 Paul R. Tom Award. I appreciate all of those who made it possible.

If you look up Paul Tom's name on the lawyer search site Avvo, you would see that he answered 74 questions from the public on many tax issues and as they relate to bankruptcy and Social Security. Paul was always willing to help and he did the same for us regularly. He must have answered at least that many of my questions alone. He was super-knowledgeable in both tax and bankruptcy issues. He was friendly, a gentleman, and was the epitome of a tax professional that we all aspire to be. Paul was a super-penultimate tax mentor, a tax professional's tax professional. Of course, Dan Pilla is the ultimate tax mentor.

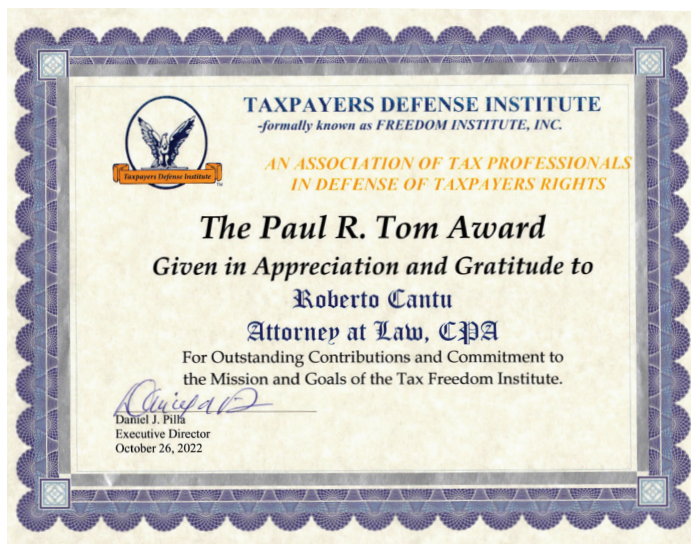
What I did not mention at the conference was it was great to have served over 500 families for seven years through the Texas non-profit Federal Tax Clinic that I formed with Judy Johnson, a former member. Paul R. Tom inspired that kind of work

This award is a prestigious and memorable award, and I am thankful for having worked with many of you informally when the opportunities arose, as Paul Tom did with me and all of the members of Tax Freedom Institute, Inc. while he was with us.

Congratulations, Robert. It's truly my pleasure to be associated with you



Dan Presents the Paul R. Tom Award to Robert Cantu



The 2022 Paul R. Tom Award

Did You Miss The 2022 Taxpayers Defense Conference?

Self-Study Material is Now Available

If you missed the 2022 Taxpayers Defense Conference, our self-study material is available. The set includes audio recordings of all the teaching sessions and all Dan's lecture notes and other hand-out material.

The 2022 Defense Conference theme is Tax Refunds. Topics for the 2022 Defense Conference include the following:

- An analysis of what to expect from the revitalized IRS
- Claim for refund law and procedures
- Addressing refund statute of limitations issues
- The 3-year rule and financial disability
- Employment tax refunds through the Employee Retention Credit
- 2 ethics sessions including negotiating with IRS personnel and understanding the rules regarding legal positions taken on tax returns and with IRS submissions
- And don't forget our live role-playing and group debriefing sessions
- Finally, as always, we have our popular and informative moderated discussion where all topics and problems are fair game.

The Taxpayers Defense Conference is widely regarded as simply the best tax seminar



Dan addressing Defense Conference attendees

in the country—and for good reason. There is no place else you can go to get the up-to-date, cutting edge information you need to effectively represent your clients in problems resolution issues. And that's a fact.

If you missed the live seminar, don't delay in ordering your self-study course now. Get yours by calling the TFI/TDI office at 800-346-6829. Talk to Jean about getting both the 2021 and 2022 Defense Conference materials for self-study. This is the best CE seminar in the county

TFI is an approved IRS CE provider.
800-346-6829



Dan and Jean address the group

Let's Give Thanks to Jean Pilla

Our annual Defense Conference—indeed, much of what we pull off here—would simply not be possible without Jean's knowledge, skill and dedication to our ministry. If you've ever attended our conference, you know how hard she works to address the hundreds of details required to make the conference run as smoothly as it does. I thank God that she is my wife and business partner. I could not do this without her. Please offer her your thanks and appreciation for all that she does to keep this going. jean@taxhelponline.com.

How You Can Ask Dan Pilla a Question

If you have questions or problems you'd like Dan Pilla to address, please write to Dan at:

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Write the word "newsletter" in the subject line.