

Collection Question Might Lead To Outdated Answers on Crypto

by Nathan J. Richman

Wide valuation swings during the collection process can make things even more complicated for taxpayers with both tax debts and cryptocurrency assets.

Little attention has been given to the fact that taxpayers reporting cryptocurrency assets on collection information statements may be providing information that will be substantially out of date by the time the IRS gets around to making decisions on their collection status, Robert Probasco of Texas A&M University School of Law told *Tax Notes*.

While there has been much discussion of uncertainties arising from the IRS's new virtual currency question on Form 1040, those concerns haven't been addressed regarding the slightly longer-standing questions on forms 433-A and -B, "Collection Information Statements."

The Form 433 cryptocurrency questions are more detailed than the Form 1040 checkbox. On Form 433-A, taxpayers are given rows consisting of five fields to list the names of virtual currencies held, the wallet or exchange on which that currency is held, the email address associated with any exchange holdings, a description of the location of the holdings, and the amount of currency held. The last field also asks for the U.S. dollar value of the holdings "as of today."

Taxpayers in the IRS collection process are often called on to fill out Forms 433 when asking the IRS for things like installment agreements, offers in compromise, or to be declared currently not collectible — all of which serve as alternatives to forced collections via liens, levies, and lawsuits. The IRS uses information in those forms, along with things like national standards for specific expenses, to determine a taxpayer's reasonable collection potential (RCP).

The RCP becomes the central value for many collection alternative questions. For example, if a taxpayer owes \$1 million in taxes and wants to settle the debt for \$10,000, the IRS would probably be more inclined to accept if the taxpayer's RCP was \$11,000 rather than \$11 million, notwithstanding other factors like effective tax system administration or doubt as to liability.

Probasco noted that an offer in compromise might be under consideration for four to six months. John Pontius of Pontius Tax Law PLLC said the IRS will keep a Form 433-A on file for a year.

So what happens when market swings substantially increase or decrease the value of a taxpayer's cryptocurrency holdings during that time?

Probasco noted that Forms 433 were amended to have the explicit cryptocurrency questions in 2019, so the issues are relatively new.

Reevaluation

Probasco said the IRS will reevaluate the values listed on a Form 433 when it gets around to considering a taxpayer's proposed collection alternative. "The IRS clearly can and would, if the value has gone up significantly, take that into consideration about whether or not the [offer in compromise] amount that was submitted is acceptable," he said.

This also poses the mirror image question of what a taxpayer can do when the asset's value fluctuated, according to Probasco. That answer is still uncertain, he added.

If the value falls, a taxpayer might not want to withdraw an offer, just in case the cryptocurrency asset recovers enough to make the offer appropriate again, Probasco said. It isn't clear if a taxpayer or practitioner should consider selling virtual currency assets before filing a Form 433 to avoid the problems posed by potential valuation swings, or instead should resolve those problems if they arise, he said.

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In addition to those types of difficult decisions, the volatility of virtual currencies could induce the IRS to shorten its window for reevaluating a taxpayer's "currently not collectible" status, Probasco said.

Pontius said that a Form 433 is merely meant to be a snapshot of a taxpayer's ability to pay. He

agreed that selling cryptocurrency assets before filing those forms as a way to mitigate volatility risk is one potential consideration.

The computation of RCP already includes a quick-sale discount for some assets that could also account for those sorts of price shifts, Pontius said. While there is currently a catchall discount that could apply to virtual currencies, he suggested that the IRS might want to consider creating a specific one for those assets.

Pontius added that in most of the installment agreements he's seen, the monthly income portion of RCP, rather than the asset portion that would include volatile cryptocurrencies, has been the larger issue. For now, just getting cryptocurrency onto a Form 433 is a good step forward, and hopefully more guidance will be coming, he added.

Probasco said taxpayers reporting cryptocurrencies on Forms 433 may need to more frequently update the IRS employees evaluating their situations based on valuation swings.

Daniel Rosefelt of Daniel Rosefelt & Associates LLC said those sorts of updates, which are often routine when a revenue office is assigned a case, should address most of the questions that could arise.

Other Concerns

The new virtual currency question can raise a different sort of issue for some taxpayers, Rosefelt said. Omission of virtual currency despite the explicit question could risk criminal charges like evasion of payment under section 7201 or attempting to obstruct the known collection proceeding under section 7212(a), he said.

"I've unfortunately seen over the years clients — or I should [say] former clients — get prosecuted for filing false 433s. It's serious," Rosefelt said.

An even more complicated issue arises for taxpayers with illegal-source income because of the prevalence of cryptocurrency in illicit activity on the dark web, Rosefelt said. Those taxpayers may want to consider the possibility of selective assertion of their Fifth Amendment privilege when reporting cryptocurrencies in IRS collection proceedings, he said, adding that it's the same sort of consideration for taxpayers selectively asserting the privilege on Forms 1040.

Of course, any voluntary request for a collection alternative would be out of the question if a taxpayer needs to assert the Fifth Amendment on a Form 433, but the issue could come up if the IRS demanded one of those forms, Rosefelt said.

Both Probasco and Pontius also pointed to possible uncertainties around cryptocurrencies during involuntary collection attempts. They noted that the IRS would more likely levy on conventional assets like bank accounts before moving on to virtual currency holdings. ■