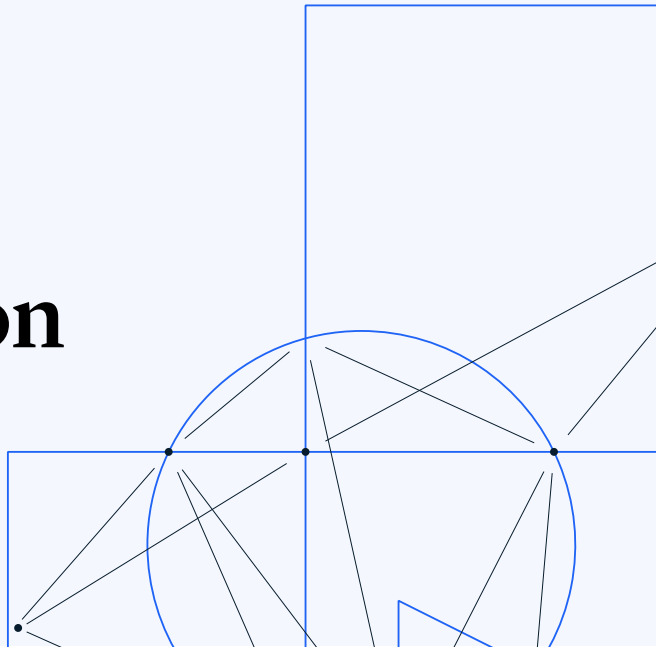
TRM

7 Pillars of Highly Effective Tax Agencies

Pillar 2: Data Collection and Ingestion



Crypto assets are the new frontier of taxation. And tax authorities across the globe are just beginning to operationalize and scale crypto asset programs focused on increasing voluntary compliance and identifying noncompliance.

In this series, TRM Labs and Taxbit explore seven key pillars or principles tax agencies should keep in mind to help shore up their crypto tax compliance efforts. In this article: data collection and ingestion.

Accessing and utilizing transactional data

The foundation of any effective crypto tax compliance program hinges on the ability to access and analyze relevant data at scale. Historically, transactional data for crypto trades and transfers may have been challenging to obtain. In some jurisdictions, exchanges may not have had a regulatory obligation to report customer transactions. Tax authorities may not have had the expertise to analyze the data if it was collected. And transactions in unhosted wallets may not have been collected at all.

Today, that data is more readily available, and tax authorities must adapt their data collection processes to account for the complexities and nuances of the crypto ecosystem. This includes not only gathering data, but also ensuring it is structured and accessible in ways that allow for effective case triage and investigation.

As crypto transactions inherently generate vast amounts of digital records, the challenge lies in identifying the most relevant data points – such as wallet addresses and transaction hashes – and integrating them into workflows that enable precise and efficient tax enforcement.

Understand how tax data differs across geographies

Countries may differ in their approach to the specific data they collect and how they aggregate it. The collected data may range from taxpayer disclosures, to third-party reporting received from entities like Virtual Asset Service Providers (VASPs), to industry notice letters.

One of the key issues for tax authorities is considering whether data collection processes will include the request for crypto identifiers (e.g. wallet addresses, transaction hashes, etc.). These identifiers play a key role in unlocking the ability to gather additional insights from public blockchain data. Early work by tax authorities in crypto assets has demonstrated that a taxpayer's own reporting about transactions and tax liabilities alone may not be enough to identify and verify issues of underreporting or noncompliance.

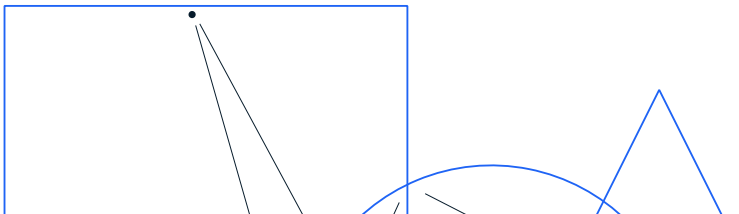
Crypto identifiers help agencies answer key questions that are necessary for a complete assessment, including:

- Is this taxpayer trading at multiple exchanges and services?
- Is this taxpayer disclosing all of the crypto assets it is transacting in?
- Is this taxpayer engaging in behaviors that obfuscate their tax liabilities?

Data acceleration from information-sharing regimes

Another trend to watch closely that could impact the amount of available data is the implementation of various automated information-sharing regimes. These regimes will provide tax authorities with previously unavailable off-chain data – that is, data relating to transactions occurring through custodians inside private wallets held on a blockchain.

For instance, in October 2022, the OECD released guidance on its Crypto-Asset Reporting Framework ("CARF"), which is largely based on existing Common Reporting Standards ("CRS"). Like the CRS, CARF is designed to increase transparency in crypto asset transactions and enable automatic information-sharing among the jurisdictions of resident taxpayers. In the European Union, an eighth amendment to the Directive on Administrative Cooperation ("DAC8") would require crypto asset service providers to report certain information about their customers to participating tax authorities.



John Doe summons

One unique way the US Internal Revenue Service (IRS) has collected relevant data from third parties is through a procedural tool known as a John Doe summons. In 2016, the IRS used this tool to collect information from the cryptocurrency exchange Coinbase. The summons sought information about US taxpayers who had conducted transactions in virtual currency through Coinbase over a certain number of years. A subset of that taxpayer group (approximately 58%) had realized more than USD 100 million of gross proceeds from the sale of crypto during the requested years.

The ultimate output of the summons included a bulk data set of wallet address, transaction IDs, and additional identifying information. By obtaining this information, the IRS was able to identify individuals who failed to report cryptocurrency-related income, and provided the agency with avenues to collect additional tax revenue that otherwise would have been missed.

The IRS has since replicated this approach with summonses to other US-based exchanges, such as Circle and Kraken. Other tax authorities, like the Canadian Revenue Authority and the UK's HMRC have used similar mechanisms to request taxpayer information from crypto exchanges.

Regardless of how traditional fiat and crypto asset data is obtained, tax authorities will have to develop ways to connect existing databases (and information about each taxpayer) with new crypto-specific data points — including crypto asset identifiers such as wallet addresses and/or transaction hashes. Given the rising scale of crypto asset adoption and use, this is a significant data challenge involving sophisticated correlation and analytics — albeit one that has the potential to accelerate the goals of collecting the right tax and closing the tax gap.

Taxbit plays a key role in solving this data challenge, offering robust tools for automated data processing, on- and off-chain data aggregation, and specialized accounting solutions for government operations and tracking. Taxbit's solutions enable tax authorities to scale their operations with precision and efficiency. As crypto adoption continues to grow, partnerships with innovative providers like Taxbit will be critical for ensuring fair and effective tax administration.