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UPDATE

Cryptocurrency: Worldwide Taxation Approaches

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This update addresses the importance of understanding the global tax implications for holding crypto-assets particularly for global citizens with worldwide assets.

This update forms part of our series on cryptocurrency. Our previous article on speculative risks can be found here.

Introduction

We are all aware of the increasing general interest in cryptocurrencies (or crypto-assets), such as Bitcoin, initial coin offering (ICO) tokens and the technology behind such currencies and tokens in recent years. Naturally, much of this focus has been on their valuation - and the profits or losses that individuals holding them might make. The nature of the asset class – currency, investment or business activity – has been debated over the years, but it appears that many countries are now getting to grips with this. While its volatility can create significant issues for holding it in a structure, does its taxation now mean crypto is going mainstream?

There is proving to be a real divergence between how countries class and tax crypto-assets. Traditional principles of taxation have relied on classifying the nature of an asset when determining how it should be taxed. However, tax authorities around the world are taking different approaches to crypto. This creates issues for global citizens and those with worldwide assets.

Cryptocurrencies are not expressly dealt with by double tax agreements or double tax treaties. If one country taxes differently to another, the relief ordinarily granted under the relevant double tax treaty may not apply. In addition, if a double tax treaty is not applicable it may not be clear who has the priority of taxation in situations where residence-based systems and sourced-based systems are competing for the right to tax.

Taxation of currencies generally

Where a person trades in foreign currencies on a regular basis, then the profits of that trade may be subject to tax as trading profits (and within the scope of income tax or corporation tax as appropriate). In the context of crypto, 'trade' can be an interesting point. This usually relies on the volume of transactions, however, with crypto and the use of trading programming, there can be numerous transactions without them qualifying as 'trade'.

In the absence of trading, all forms of property are usually regarded as assets which may or may not be subject to capital gains tax (and wealth tax), depending on the tax rules of the relevant jurisdictions.

However, governments around the globe have not reached a consistent view as to the asset class within which crypto-assets fall. They are colloquially described as currencies backed by block chain technology. They are used and traded in similar ways to other regular currencies, but they are free of a central authority. They are not declared by any governments to be legal tender. For these reasons, many governments class crypto-assets as property or a capital asset, and not a currency.

The starting point for taxation is therefore difficult to identify. This article explores the different tax treatments we see in various jurisdictions, and we will see that there is a divergence in approach: the UK, US, Australia, Canada, Israel and the Netherlands exemplify the formulation of stricter taxation rules, while others, such as Germany, Singapore, Portugal, Switzerland, Malta and Bermuda are more lenient.

Jurisdictions taking a stricter approach

The United Kingdom

In the UK, HMRC has provided guidance on the tax treatment of Bitcoin, other cryptocurrencies and relevant exchange tokens. The guidance recognises two possible treatments for profits or gains made on cryptocurrencies:

- trading profits which may be subject to income tax, and
- capital gains which may be subject to capital gains tax.

There is no specific Bitcoin tax or cryptocurrency tax in the UK. It is important to note that guidance is not law and it can change. In the vast majority of cases, individuals hold crypto-assets as a personal investment, usually for capital appreciation or to make particular purchases. They may be liable to pay capital gains tax when they dispose of their crypto-assets based on their residency.

Personal owners will pay either 10% or 20% on any gains, depending on what band they fall under. This of course will depend on the overall taxable income, size of profit, and deducted allowances, but most investors would be taxed at 20% after the lower tax bands are exhausted by their income.

There may be cases where the individual is running a business which is carrying on a financial trade in crypto-assets, and they may therefore have taxable trading profits. This is likely to be unusual, but in such cases income tax rules would take priority over the capital gains tax rules. The applicable tax rates in these circumstances will be higher.

Individuals may be liable to pay income tax and national insurance contributions on crypto-assets which they receive from:

- their employer as a form of non-cash payment
- mining, transaction confirmation or airdrops

Banking Losses

When a sale is made at a loss, which will be a reality for many investors given the current depreciation, there have been suggestions that those losses can be used to offset future gains on other investments, such as investment property.

The United States, Australia, Canada, Israel and the Netherlands are examples of countries that seem to be taking a similar approach to the UK. We have included details on their stance (as at the date of this publication) in Appendix A.

Jurisdictions taking a more lenient approach

Switzerland

Switzerland is known for being a crypto-friendly jurisdiction, hosting the headquarters of Crypto Valley, the Ethereum Foundation and now the Libra Association. The tax treatment of cryptocurrencies is interesting, with mining income typically declared as self-employment income (and taxed through income tax rules). The professional trading of cryptocurrencies may be subject to business tax, depending on whether or not somebody is qualified as a professional trader. If you receive cryptocurrency as wage income, that may still need to be declared as income tax.

However, if you are qualified as somebody who invests and trades for their individual account, cryptocurrency gains will likely be treated as tax-exempt capital gains.

We note that Switzerland has canton taxes that differ based on what region of Switzerland the owner is in, and that the annual wealth tax it levies includes taxes on the total amount of cryptocurrencies along with the rest of the owner's net worth. Taxes will therefore vary from canton to canton.

Portugal

In Portugal, the government has also chosen to adopt a softer stance on cryptocurrency taxation. Individuals in Portugal who profit from the purchase and sale of cryptocurrency will likely not be taxed on the capital gains. We are seeing some crypto heavy clients move to Portugal but of course they should take tax advice in the event they return home as there may be a tax hangover to pay on returning to their home jurisdiction.

Cryptocurrency is exempt from VAT and from personal income taxes in Portugal, though businesses need to pay taxes on any profits from cryptocurrency gains. Guidance on this was released as recently as 2018.

Germany, Singapore, Malta and Bermuda are other interesting examples of this approach to the taxation of crypto-assets. More detail in relation to those jurisdictions (as at the date of this publication) can be found at Appendix B.

Conclusion

Crypto-assets, and virtual currencies in particular, are still in rapid development and tax policymakers are still at an early stage in considering their implications. The implementation of crypto specific legislation has been delayed by the pandemic but that is likely to change. Any investor therefore needs to keep the tax treatment under regular review. Crypto-assets have a number of inherent and unique characteristics that pose challenges for policymakers. These challenges arise due to their lack of centralised control, pseudo-anonymity, valuation difficulties, hybrid characteristics (including aspects of financial instruments as well as intangible assets, and the rapid development of the underpinning technology. These issues are only enhanced in cases of clients with cross border interests.

Understanding crypto-assets and how different policymakers will classify crypto-assets will be important for individuals and trustees, particularly those with cross-border exposure. The characteristics of cryptocurrencies may mean that many trustees are sceptical of holding them as an investment, but there may be circumstances in which settlors wish to protect these assets with legal structures. An understanding of the tax implications will be important. Tax advisers, lawyers and accountants will also need to ensure that they are up to speed with the concepts, regulations and issues in order to advise their clients properly.

Disclaimer

This article represents our observations in relation to different jurisdictional approaches to the taxation of crypto-assets. It should not be considered legal advice and specific advice should be taken. It is accurate in our view as at the date of publication, but this is a rapidly changing area for policy makers and this guide may not be accurate as taxation approaches to crypto-assets develop.

Appendix A

The United States

In general, the IRS treats crypto-assets like stocks, bonds, or property, which means they may not be taxable until one sells or uses them. Normal capital gains taxes could apply to such transactions — short-term capital gains taxes if the crypto asset was owned for less than a year; and long-term capital gains taxes if it was owned for more than a year. But if all an investor did was buy Bitcoin and hold onto it, there is likely no need to report it to the IRS.

However, a rude surprise may await those who spent their pandemic lock-down time trying their hand in the crypto market by buying and selling many different cryptocurrencies in a short period of time. The IRS may regard each one of those transactions as a taxable event.

Further, we understand that crypto exchanges are not yet required to provide their users with tax documents. That means it is the responsibility of individual crypto owners, their accountants or their trustees to keep track of all the gains and losses that their crypto activity generated. This could include how long each crypto purchase was held, its fair market value when it was bought and sold, and any fees that may be associated with the transaction.

Tax obligations regarding crypto-assets are actively being enforced. In early May 2022, a federal court in the Northern District of California entered an order authorising the IRS to serve a John Doe summons on the crypto exchange Kraken. The summons sought information about U.S. taxpayers who conducted at least the equivalent of $20,000 in transactions in cryptocurrency during the years 2016 to 2020.

Australia

In Australia, cryptocurrency is also treated as an asset and may be subject to capital gains and income tax by the Australian Taxation Office (ATO). The ATO does not class cryptocurrencies as money, nor foreign currency. If someone has bought, sold, or earned interest from cryptocurrency in the past financial year, it will most likely need to be declared on their tax return.

Canada

Crypto-assets are also viewed as a capital asset (like stock or a rental property) in Canada. If crypto is taxed as income, one will usually pay income tax on the entire proceeds of a crypto transaction. If crypto is taxed as a capital gain, the owner may only pay capital gains tax on half of any profits of a crypto transaction.

Israel

The Israel Tax Authority (ITA) contends that distributed means of payments (virtual or cryptocurrencies) do not count as "currency" or "foreign currency." Therefore, the ITA claims that various exemptions for currency gains apparently do not apply to cryptocurrency gains.

Instead, the ITA position is that cryptocurrencies, whether tangible or intangible, are taxable capital assets. Accordingly, the ITA contends:

- A sale of a cryptocurrency is generally subject to Israeli capital gains tax (up to 33%).
- If the activity amounts to a business, based on case law criteria (business organization, expertise, frequency, etc), income tax is applicable (up to 50%).
- In particular, mining of cryptocurrencies (i.e. minting them) is a business activity.
- The tax treatment for barter transactions applies.

Anyone selling an asset or service in consideration for a cryptocurrency may be taxable twice:

- on the profit from the asset or service, and
- on any subsequent increase in value when selling the cryptocurrency.

Netherlands

The Netherlands does not have capital gains tax, which is the method used by many countries to tax gains made on property, collectables or stock. As we have seen, other major jurisdictions also include crypto in this category.

Instead, Dutch taxpayers are taxed on the presumed increase in value of their assets from the day of acquisition to the end of the financial tax year on 1 January. This means simply holding crypto may be taxed.

The cost basis of crypto-assets can only be carried back to 1 January of the given tax year, and it resets again each tax year on 1 January. This means the taxpayer may pay tax on presumed gains from the entire holdings over the course of the financial year.

The Netherlands is an interesting example of a jurisdiction without capital gains tax, but still with a stringent method of collecting tax on gains made by crypto-assets.

Appendix B

Germany

Germany has exempted Bitcoin transactions from VAT and while it stipulates that Bitcoin is not a currency, the capital gains exemption on assets held for more than one year is triggered with Bitcoin. This means that if an investor has held their Bitcoin for one year (and assumedly other cryptocurrencies), you are not taxed from an income standpoint (since it's not money) and the gains that accrue are not taxed from a capital gains standpoint due to the exemption. Businesses, however, still need to pay taxes on gains deriving from bitcoin through corporate income taxes.

Singapore

The Monetary Authority of Singapore (MAS), acknowledges that the crypto-asset economy must be monitored to prevent laundering and other illegal activity, but that innovation must not be stifled. The MAS has stated that the city-state's financial institutions are considering "allowing crypto to be an experimental construct".

The Payment Services Act of 2019 regulates Singapore's legal environment for crypto-assets. The law sets a balance between regulatory necessities and allowing a growth environment for crypto.

Businesses based in Singapore that buy and sell virtual currencies in the course of their business may be taxed on the profit as if it was income. However, businesses and individuals who hold cryptocurrencies for long-term investment purposes may not be taxed in Singapore as there is no capital gains tax in Singapore itself.

Malta

Many crypto exchanges and block chain projects are based in Malta. Malta is also tax free for crypto investors, and exempts capital gains tax and VAT. It has implemented several pieces of virtual currency legislation, which are friendly towards crypto investors.

The tax guidelines differentiate between coins and tokens. Tokens are divided into financial tokens and utility tokens.

"Coins" are defined by Maltese tax law to be treated as regular means of payment. There are specific criteria as to what constitutes a coin. Any profits made from exchanging coins are treated in the same way that regular fiat exchange profits would be treated. When a company holds coins as part of its trading stock, any gains or profits are taxed as income. Any coins rewarded from mining activities are treated as regular income as well. If an individual realizes a capital gain from long-term holding of a coin, and they are not doing so as part of their regular trading activity, there may be no tax implication.

Whether increased regulation arrives in Malta will be interesting to observe. In the meantime, crypto investors from non-EU countries will continue to consider Malta, especially alongside their investment pathway to citizenship.

Bermuda

Bermuda's Digital Asset Business Act 2018 set out the regime for regulating individuals and entities who undertake the following:

- issuing, selling, and redeeming cryptocurrency and other digital assets;
- operating as a crypto payment provider, including the provision of services for fund transfers;
- operating a cryptocurrency exchange and providing wallet services; and
- operating a cryptocurrency services vendor.

This legislation dictates the types of activities that constitute digital business within Bermuda. Bermuda levies zero income and capital gains tax. There are therefore no income, capital gains, withholding or other taxes imposed in Bermuda on digital assets or on any transactions involving them. Moreover, exempted companies or LLCs carrying on digital asset business, including ICO issuers, may apply for, and are likely to receive, an undertaking from the Minister of Finance to the effect that, in the event of there being enacted in Bermuda any legislation imposing tax computed on profits or income or computed on any capital asset, gain or appreciation, then the imposition of any such tax shall not be applicable to the company or any of its operations.

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