

Crypto, blockchain and FinTech – Can tax keep pace with technology?

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Agenda

1. Recognition of tax losses on crypto positions
2. PE and other tax issues of crypto funds
3. Tax compliance for crypto traders
4. Tax issues of staking



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1. Recognition of tax losses on crypto positions

South Korea

- Loss in value not recognized until disposal
- Loss realized on disposition may be offset against gains incurred during the course of each taxable year
- No carry-forward rules
- Ordinary business losses can be carried forward for up to 15 years
 - Ceiling of 60%



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1. Recognition of tax losses on crypto positions

Spain

- Individuals (PIT):
 - Income or loss derived from the transfer of an the interest in a crypto position is characterized as a capital gain or loss (Ruling DGT V.0999-18, April 18 2018).
 - Losses are generally deductible against capital gains (special compensation rules allowing compensation within same fiscal year with regular income – max. 25% of regular income-).
 - Carry-forward losses: 4 years.
 - Unrealized losses are non-deductible until disposition of the asset.



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1. Recognition of tax losses on crypto positions

Spain

- Entities (CIT):
 - CIT follows the accounting treatment (Spanish GAAP follows IFRS characterization of cryptocurrencies: IAS 38 – intangibles- and IAS 2 – inventories).
 - Accounting rules taken from interpretations by the Spanish Accounting and Audit Institute – ICAC- (Ruling rnr/38-14 of March 5, 2014 and Ruling 4 BOICAC 120/2019 of December).
 - Investments in crypto positions are not treated either as financial assets (not contractual in nature) or cash.
 - Conversely they may be characterized as
 - (i) an intangible (amortization 10 years / 20 years taxwise). Highly controversy at doctrine level, with other potential interpretations denying the amortization or
 - (ii) as inventory if the entity is engaged in trading activities.



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1. Recognition of tax losses on crypto positions

Spain

- Entities (CIT) (cont.):
 - Impairment losses are not tax deductible (intangible assets) / deductible (inventory).
 - Gains and losses are recognized when the fund transfers crypto positions or an interest in the fund. Extraordinarily difficult to manage.
 - The fact that the cryptocurrencies are not treated as a means of payment, in the same way as cash, constantly gives rise to swaps, with their own valuation rules, adding a high complexity for companies trading in crypto currencies.



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1. Recognition of tax losses on crypto positions

Switzerland

- The buying and selling of crypto positions (payment token, asset token, utility token) raises questions, particularly in the case of individuals.
- Private assets: The buying and selling of crypto private investment positions represents tax-exempt capital gains or non-deductible capital losses.



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1. Recognition of tax losses on crypto positions

Switzerland

- Business assets: Depending on the type, scope and financing of the transactions, it is not a case of private investment but of self-employment.
 - Crypto traders with turnover of at least CHF 500,000: statutory financial accounting and reporting (income statement, balance sheet and notes). Tax losses on crypto positions are recognized on an accrual basis. The principles of prudence and imparity under financial accounting law apply. Unrealized losses must be written off. Gains may and must only be recognized when they are realized.
 - Crypto traders with a turnover of less than CHF 500,000: cash statements (revenue and expense statement, assets and liabilities statement). Tax losses on crypto positions are recognized on a cash basis.
 - Recognized losses on crypto positions may be offset against other taxable income (e.g. employment income, private investment income, income from real estate).
 - Loss-carry forward: 7 years



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1. Recognition of tax losses on crypto positions

USA

- Trading losses
 - US investors: Trading losses incurred directly or through a tax-transparent fund should be capital gains & losses. Liberal tax-loss harvesting opportunities.
 - Non-US investors: ECI risks
 - The U.S. wash sale rules generally disallow losses involving stock or securities
- Application to cryptocurrencies
 - No specific IRC section that applies these wash sale rules to cryptos
- Suspended/unreturned deposits: non-business bad debt deduction possibility for US investors. Short-term capital loss treatment.
- Theft of crypto assets: Casualty loss deduction may be available for US taxpayers



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1. Recognition of tax losses on crypto positions

Austria

- Previous income tax treatment of crypto held as a non-business asset
 - Outside the one-year speculation period: tax-exempt gains, non-deductible losses
 - Within the one-year speculation period: balance of gains over losses taxable at the progressive rate of up to 55%; balance of losses over gains taxable non-deductible
- Since 1 March 2022
 - No differentiation between holding periods
 - Balance of gains over losses taxable at a flat rate of 27.5%; balance of losses over gains taxable deductible against dividends and capital gains from shares
 - The exchange of one crypto asset for another crypto asset is not taxable (roll-over)



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2. PE and other tax issues of crypto funds

Switzerland

- A distinction can be made between centralized and decentralized servers:
 - Fully centralized are local (on premise) servers
 - Fully decentralized is distributed ledger technology (DLT) and blockchain.
- Swiss PE Approach
 - Fixed place must be at disposal (physical access)
 - Human activity is not required



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2. PE and other tax issues of crypto funds

Switzerland

- Mining: To be selected, the validator needs powerful hardware to solve the complex math task. Therefore, the risk of a PE may exist in case of mining where the enterprise operates servers in rented or owned premises in Switzerland (“mining farms”). Physical access generally exists only in case of housing of servers or operation of servers in rented or owned premises.
- Staking: To be selected, the validator needs large amounts of tokens that can be staked. The decentralized server or computing capacity required to document the transaction is provided by a large number of participants. The validator does not have physical access to this hardware. Even if the blockchain is operated within the scope of a business activity, the decentralized servers of the participants are not factually at disposal.



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2. PE and other tax issues of crypto funds

South Korea

- Overall climate not yet conducive to crypto funds
- Place of effective management: key management activities, commercial decisions
- Fixed PE: dependent on location of place of business, employees, servers
- Dependent agent PE: significant role in negotiating or formulating key terms of fund investments



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2. PE and other tax issues of crypto funds

USA

- The commodity trading safe-harbor should allow US funds to trade in crypto assets without causing non-US investors to be subject to US tax.
 - Certain accounting firms are still evaluating their comfort with this conclusion.
 - Activities other than trading, lending and borrowing digital assets could jeopardise the safe-harbor.
- U.S. Income Tax Treaties (articles 5 and 7 of the U.S. Model Income Tax Treaty)
- Permanent Establishment
 - Dependent v. Independent agents
 - Does the agent habitually exercise an authority to conclude contracts of the enterprise in the host country?



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2. PE and other tax issues of crypto funds

Austria

- No statements yet of the Austrian tax authorities
- Staking: unlikely to constitute a PE
- Mining: could constitute a PE (*cf.* Austrian Ministry of Finance, EAS Ruling of 30 April 2018, BMF-010221/0042-IV/8/2018)



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2. PE and other tax issues of crypto funds

Spain

- General rules on PE are applicable.
- PE concept requires either a (i) fixed place of business or (ii) to carry out the activity to be carried out through a dependent agent in Spain.
- Can the fund manager create a PE of the fund itself in Spain? *The activity of the fund management entity is different from that of the fund (pure asset holding entity), so it cannot create a PE* (DGT V0129-17, January 23, 2017 tax ruling, in the context of EU AIFs).



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2. PE and other tax issues of crypto funds

Spain

- For funds investing in crypto positions, some questions may arise in connection with certain activities:
 - Mining when carried out by a dependent agent in Spain [of the fund? the management company?]. Further to DGT V1766-22, July 26 tax ruling, it is unlikely staking will create a PE as it is not deemed to be an economic activity.
 - Can a server constitute a PE? See DGT V0066-18, January 17, 2018 tax ruling and others (follows MCOECD Commentary 42 to article 5).
 - If the exchanger or the custodian of the wallet is a Spanish tax resident entity, can the cryptocurrencies be deemed to be located in Spain, making the fund to be subject to tax in Spain as a non-resident taxpayer? i.e. DGT V1069-19 rules out that income related to custody services rendered in Spain is deemed to be Spanish source income.



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3. Tax compliance for crypto traders

USA

- Legislation requires that brokers provide the IRS & customers with tax reporting beginning in 2024. What does this mean for transactions that are undertaken in 2023?
- IRS & Congress have been wrestling with how broadly the definition of a broker will be expanded.
- Will peer-to-peer and other decentralized exchanges be included?
- Miners & stakers could be treated as brokers under the most expansive interpretation of the U.S. tax reporting rules.
- Tiered rule implementation likely. \$10,000 transaction reporting requirement?
- OECD CARF



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3. Tax compliance for crypto traders

Spain

- Reporting obligations applicable to cryptocurrency service providers (Law 11/2021, July 9, on measures to combat tax fraud). Draft Regulation (expected to be in force in 2023, for relevant information relating to 2022):
 - Applicable to the following service providers tax resident or with a PE in Spain:
 - Crypto custody services (Wallets)
 - Exchangers
 - Spanish entities doing ICOs



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3. Tax compliance for crypto traders

Spain

- Information to be reported:
 - Form 172 (new): Crypto and FIAT currency balances at the beginning and the end of the year and, if applicable, when the balance is withdrawn.
 - Form 173 (new): Transactions (acquisition, sale, swaps and transfers) with cryptocurrencies, with identification of the persons involved, type and amount for the cryptocurrencies concerned, transaction price and date).
 - On both forms, identity of the owners, authorized persons and beneficiaries of the balances



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3. Tax compliance for crypto traders

Spain

- Reporting obligations applicable to individuals owning, who are cryptocurrency owners, authorized persons or beneficiaries (Law 11/2021, July 9, on measures to combat tax fraud). Draft Regulation (expected to be in force in 2023, for relevant information relating to 2022):
 - Form 721 (new) – reporting of cryptocurrency located abroad.
 - Obligation to report information about the virtual currencies by the owner, authorized person or beneficiary, where the crypto-custodian service provider or the exchanger is located abroad, for balances exceeding €50,000 at year end.



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3. Tax compliance for crypto traders

Switzerland

- The tax compliance for crypto traders raises questions, particularly in the case of individuals. Crypto traders are self-employed.
- Crypto traders must prepare:
 - Turnover of at least CHF 500,000: income statement, balance sheet and notes. All principles of statutory financial accounting must be observed (e.g. voucher for each accounting record).
 - Turnover of less than CHF 500,000: revenue and expense statement, assets and liabilities statement. All principles of statutory financial accounting must be observed mutatis mutandis (e.g. voucher for each accounting record).
- Failure to comply with these requirements constitutes a violation of the procedural obligations under Swiss tax law and may cause a taxation on a discretionary basis.



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3. Tax compliance for crypto traders

Austria

- No specific documentation requirements for taxpayers holding crypto assets. Thus, taxpayers must comply with the general documentation requirements.
 - The law, for example, contains the obligation of taxpayers (not already subject to the requirements of double entry bookkeeping) to record revenues and expenses.
 - Intentional violation of this obligation is punishable with a fine of up to EUR 5,000.
 - Taxpayers trading crypto assets on exchanges should therefore download and store their transaction histories in order to be prepared for a tax audit.



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3. Tax compliance for crypto traders

South Korea

- VASPs registered with the Financial Intelligence Unit (FIU) are required to submit transaction details on a quarterly basis for each taxpayer transferring or lending virtual assets through a VASP
- Transaction details include account numbers, asset type, transaction type, quantity and unit price for each transaction
- If the transaction involves an exchange of assets, the counterparty information is also required to be submitted



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4. Tax issues of staking

Austria

- Income from staking is not taxable.
- The acquisition costs of the crypto assets received are assumed to be zero, so that these acquisition transactions are only fully recognized for tax purposes at the time of the subsequent realization.



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4. Tax issues of staking

South Korea

- Discussions on tax consequences of airdrops, mining activity and staking are still at preliminary stages
- Airdrops: reportable by VASPs as acquisition of virtual asset
- Mining activity: expected to be taxed as other income with deduction for expenses
- Staking: unlikely to be deemed as a taxable event in and of itself



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4. Tax issues of staking

USA

- Very generally, “staking” rewards participants of a blockchain system where holders of coins “stake” or “put at issue” their coins to help validate additional transactions on a blockchain
- It is *economically* analogous to earning interest from holding cash deposits in a savings account or earning corporate dividends
- U.S. federal income tax consequence unclear
 - Recall, a virtual currency is treated as “property” – not a security
 - IRS Notice 2014-21 addresses tax consequences of mining as ordinary income
 - Rev. Rul. 2019-24 addressed tax consequence of an “airdrop” following a hard fork, so long as the TP has “dominion and control”



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4. Tax issues of staking USA

- *But see: Jarrett v. United States*, No. 3:21-cv-00419 (M.D. Tenn. 2021)(May 26, 2021). Taxpayer filed a refund suit for federal income taxes paid for staking Tezos tokens in tax year 2019. The taxpayer's staking activities included staking Tezos tokens to create new blocks on the Tezos blockchain. Taxpayer argued that the consequence of the transaction is akin to selling property – difference between price bought and price sold. IRS issued a refund and dropped the case.
- Queries:
 - What's the tax basis or cost in staking rewards?
 - What is the market value on the date the investor received the staking award?
 - IRS Form 8949 – a tracking method used by large platforms



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4. Tax issues of staking USA

- Congressional Legislative Initiatives: The Responsible Financial Innovation Act (S. 4356), is co-sponsored by Sens. Cynthia Lummis, R-Wyo., and Kirsten Gillibrand, D-N.Y., and provides that miners and *stakers* should pay income tax on realized rewards – ergo, when the digital asset is sold or traded...



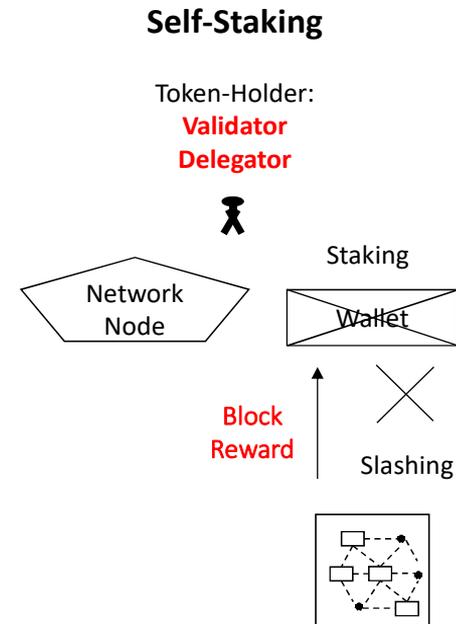
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4. Tax issues of staking Switzerland

- Selection of Validator?
- Transaction Fee paid by Originator of the transaction?
- Block Reward paid by the machine?
- Taxable income? Production or acquisition?
 - Business assets: Capitalisation at cost or at fair market value (= revenue recognition at fair market value)?
 - Private assets: Production or income recognition at fair market value? Income from personal production is realized when the legal ownership of the movable assets is transferred.
 - No Final Statement yet by FTA (tendency towards the theory of acquisition from ?)



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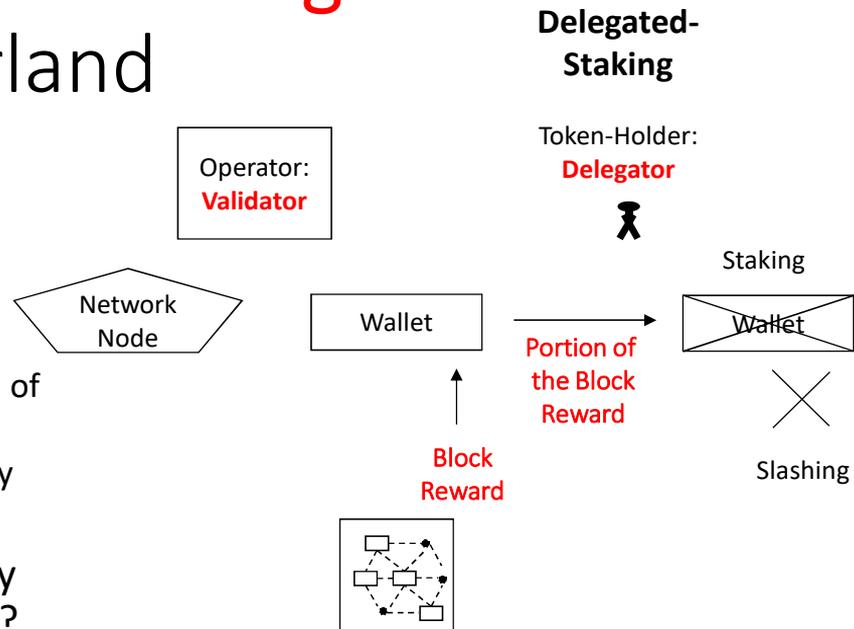
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4. Tax issues of staking

Switzerland

- Selection of Validator?
- Transfer of staked tokens to the validator?
- Forwarded portion of the Block Reward
 - Interest? WHT?
 - FTA tax ruling: no interest, no WHT
- Delegator:
 - Taxable income: Production or acquisition (e.g. non exercise of a right)?
 - No Final Statement yet by FTA (tendency towards the theory of acquisition from the Validator)
- Scenario: Portion of the Block Reward is automatically paid by the machine to the Delegator: Any difference?



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4. Tax issues of staking

Spain

- Individuals (PIT)
 - No express tax regulation regarding staking.
 - Recent DGT V1766-22, July 26 on staking and PIT:
 - Not an economic activity of the validator, as its role is merely to keep blocked the cryptoassets and will only participate in the validation if randomly chosen by the protocol and, in that case, the process of validation is automatic, requiring minimum resources.
 - The rewards obtained from staking are characterized as in-kind interest (*rendimiento del capital mobiliario*). Cryptos received as a reward shall be valued according to market, the day they are transferred to the investor.
 - In principle, subject to withholding tax, but, as the interest is directly derived from the system, not from the validator, there is no person obliged to withholding.



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4. Tax issues of staking Spain

- Entities (CIT)
 - CIT follows the accounting treatment.
 - Any rewards obtained from staking will generate a taxable income.
- Indirect taxes (VAT)
 - DGT V0679-21, November 5 2021
 - Rewards obtained by investors through staking: subject to VAT but exempt (art. 20.One.18th VAT Law: financial transactions).
 - Fees charged for staking services rendered by service providers of staking: subject and not exempt (not a financial service).



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Questions?



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