



Taxation of Virtual Digital Assets



By Nupur Jalan

Cryptocurrency

'A digital or virtual currency secured by cryptography and based on a network that is distributed across large number of computers**.'

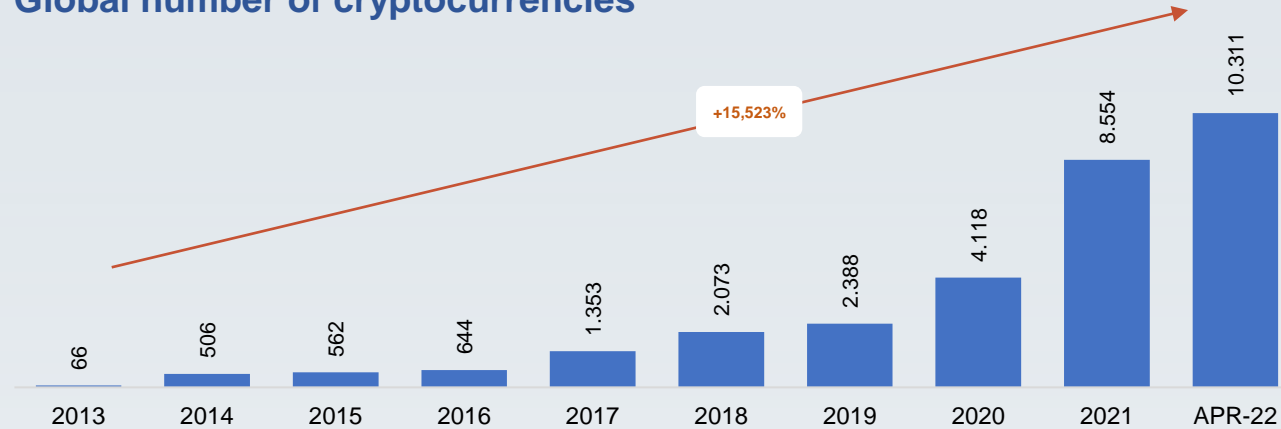
- Investopedia

HOW CRYPTO CURRENCY WORKS?



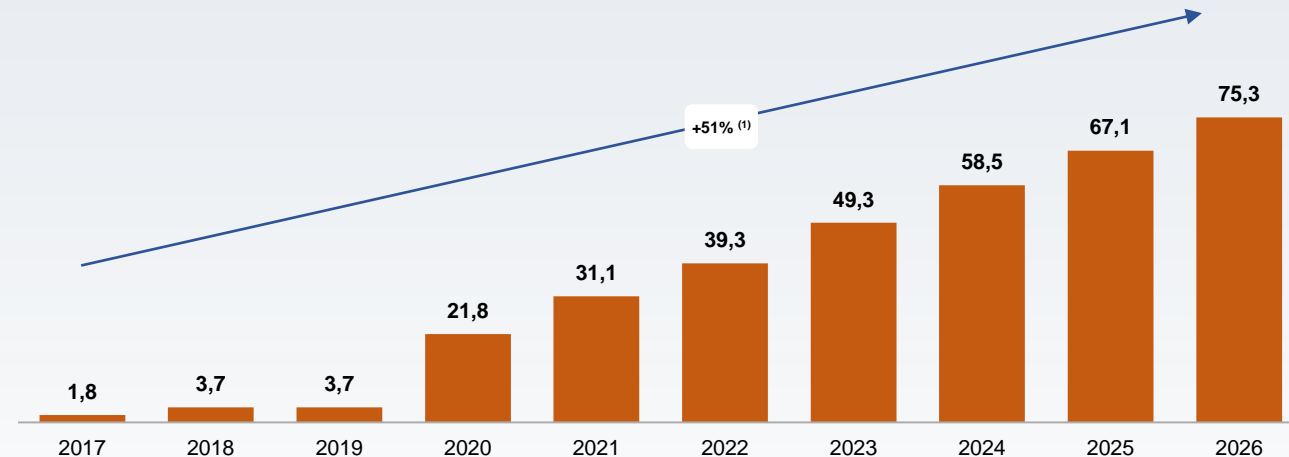
Some statistics around cryptocurrencies

Global number of cryptocurrencies



Data Sources : CoinmarketCap, GP Bullhound, The Motley Fool, Investing.com, Digital Economy Compass (2022) Statista

Global cryptocurrencies revenue forecast in US\$ billion



Data Sources: Statista Digital Market Outlook 2022, CoinGecko, BitinfoChar, Digital Economy Compass (2022) Statista

Cryptocurrencies total market capitalization in US\$ trillion

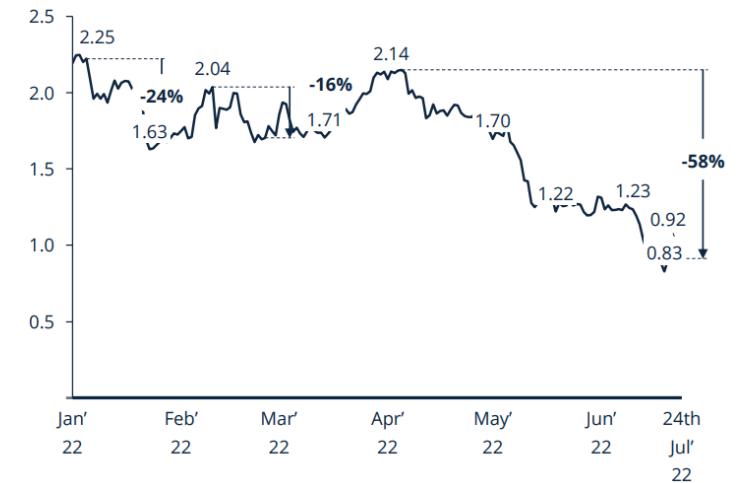
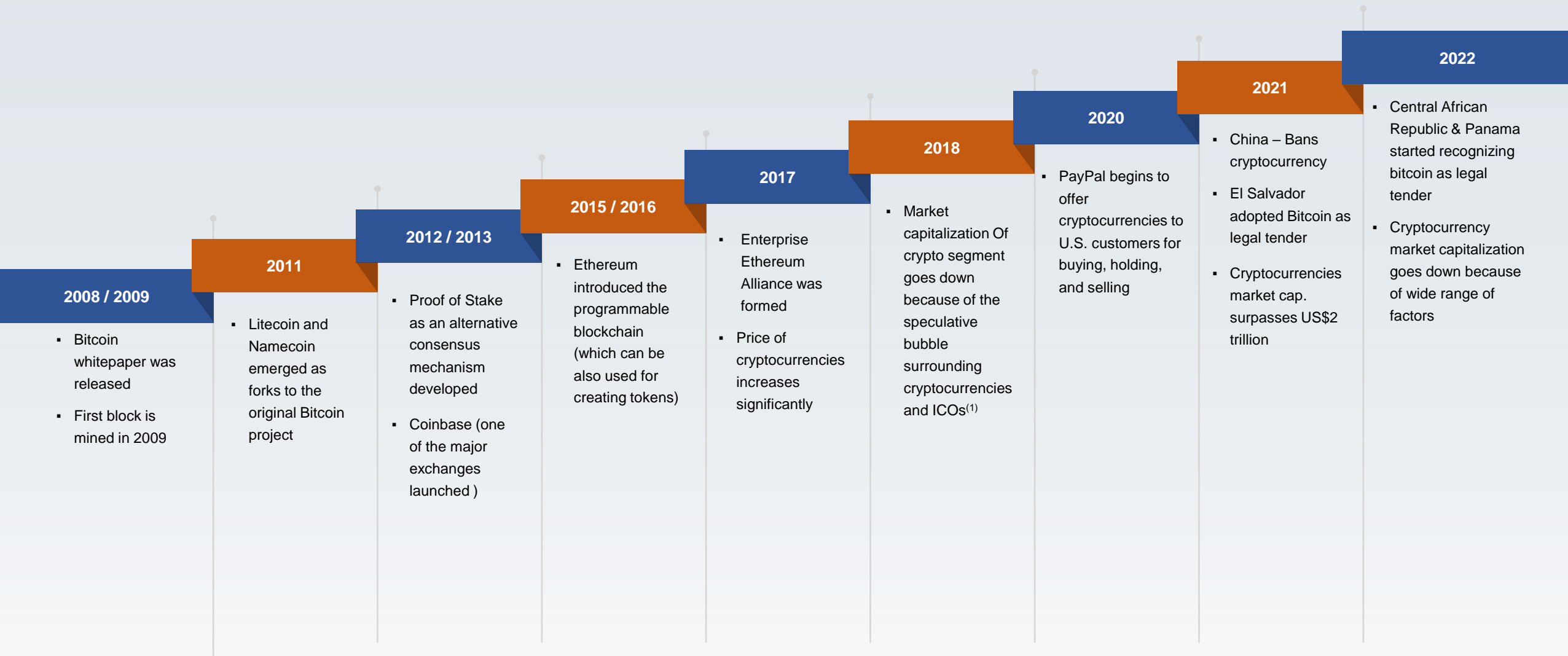


Diagram source :Digital Economy Compass (2022) Statista

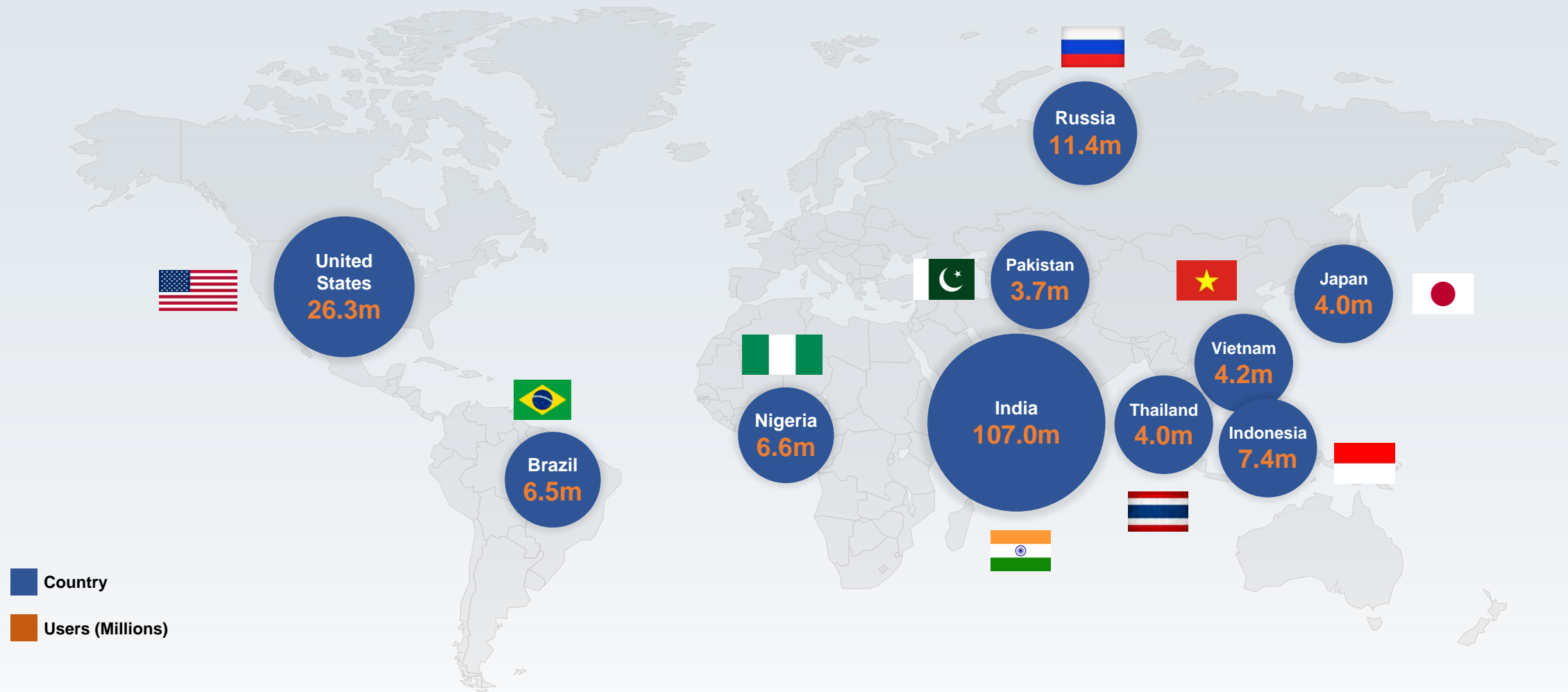
Timelines of some crypto segment events



Notes: (1) Initial Coin Offerings

Data Source : Company information, VentureBeat, Business Insider, Enterprise Ethereum Alliance, Salvadoran Legislative Assembly, BBC, Reuters, Euronews, statista

Top ten countries by cryptocurrency user in 2021



Data source : Statista Digital Market Outlook 2022, Digital Economy Compass (2022) Statista

Public companies and having highest cryptocurrencies in balance sheet



Notes: (1) As of 11.04.2022

Data sources : btcdirect.eu, bitcointreasuries.net, bitinfocharts.com, coinmarketcap.com, Digital Economy Compass (2022) Statista

Virtual currencies and taxes

- No internationally agreed standard definition of crypto-assets
- No standard taxonomy of the different types of assets that comprise crypto-assets
- For classification purposes, one may consider to look also at the economic purpose, the rights and liabilities associated with the token, and the way the token derives its inherent value
- Broadly crypto-assets can be classified into the following categories: payment tokens, utility tokens, or security tokens. Accounting and tax classification will change depending on the nature of token

Definitions of virtual currencies for tax purposes

Intangible assets other than goodwill	Financial instrument or asset	Commodity or virtual commodity	Currency	Legal payment method
<ul style="list-style-type: none"> ▪ Australia ▪ France ▪ Chile ▪ Czech Republic ▪ Luxembourg ▪ Nigeria ▪ Spain ▪ Sweden ▪ Switzerland** ▪ The United Kingdom 	<ul style="list-style-type: none"> ▪ Argentina * ▪ Brazil ▪ Croatia, ▪ Denmark ▪ Israel ▪ Japan ▪ Slovak Republic ▪ South Africa 	<ul style="list-style-type: none"> ▪ Austria ▪ Canada ▪ China ▪ Indonesia 	<ul style="list-style-type: none"> ▪ Belgium ▪ Cote d'Ivoire, ▪ Italy ▪ Poland 	<ul style="list-style-type: none"> ▪ Japan

Modified diagram and content, Source: OECD (2020), Taxing Virtual Currencies: An Overview Of Tax Treatments And Emerging Tax Policy Issues, OECD, Paris. www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.htm

** Argentina: For income tax purposes, virtual currencies are mentioned along with some financial instruments or assets even though there is no clear definition of virtual currencies

** Switzerland: Companies trading in virtual currencies account for it as inventories..

Virtual currencies and taxes

First event on receipt of new tokens from mining

- Andorra
- Argentina*
- Austria**
- Cote d'Ivoire
- Colombia
- Croatia
- Estonia
- Finland
- Japan
- Luxembourg**
- New Zealand
- Slovenia
- South Africa
- United Kingdom
- United States

First event on disposal

- Croatia
- Czech Republic
- Denmark
- Estonia
- France
- Latvia Lithuania
- Poland
- Slovak Republic

Different approaches for businesses/regular traders & individuals/occasional traders

- Australia
- Canada
- Germany
- Hong Kong (China) Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

Modified diagram and content, Source: OECD (2020), Taxing Virtual Currencies: An Overview Of Tax Treatments And Emerging Tax Policy Issues, OECD, Paris. www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.htm

** Argentina: Treatment depends on case-by-case

** Switzerland: Mining income is taxed

As mentioned earlier, tax treatment depends on types of token. Some are discussed below briefly:

- **Payment tokens:** Usable as a means of exchange for goods or services and also as a store of value and unit of measurement. Ex. – Bitcoin
- **Security (or Asset and Financial) tokens:** tradeable assets that are held for investment purposes. Ex – BCAP
- **Utility (or Consumer) tokens:** Facilitate the exchange of or access to specific goods or services (like licence to allow the holder access to a particular service). Ex. - Storj

Select country laws on crypto taxes

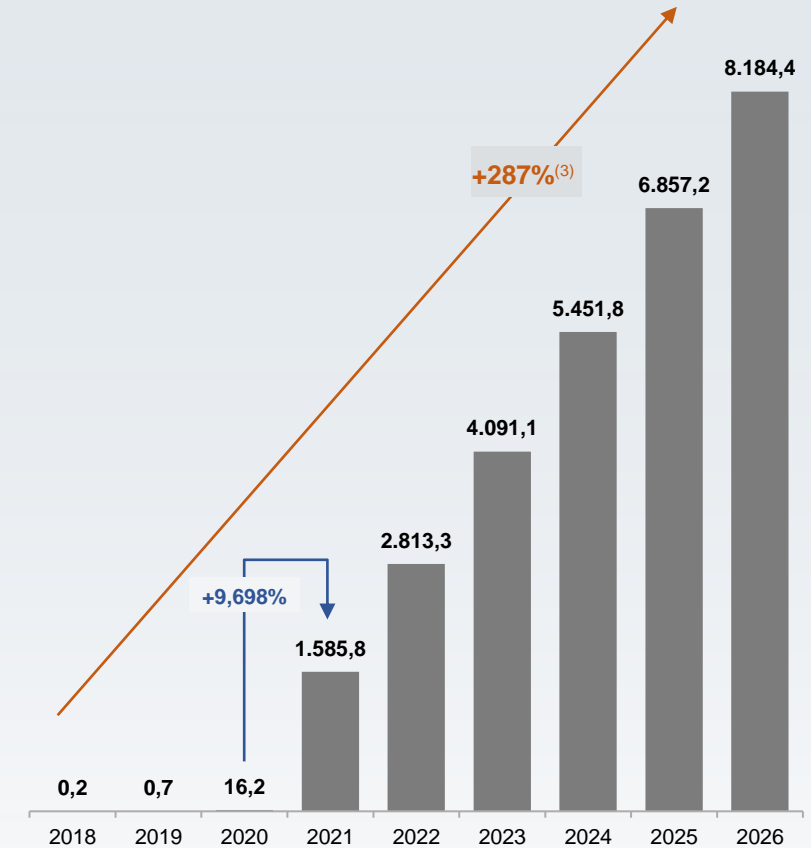
Japan	Cryptos gains are considered miscellaneous income. Tax rates on crypto gains vary - rates can be high upto 55%.
South Korea	Virtual assets are categorized under other income for income tax purposes. Gains will be taxed at a rate of 20%.
Australia	Cryptocurrency are subject to capital gain taxes in Australia in the range from 19 to 45%.
Austria	Cryptos holdings will be counted as income from capital assets, and are taxed at the special rate of 27.5%.
France	Cryptos are taxed similar to movable property. Occasional traders are charged a flat tax of 30% while miners and professional traders are taxed 45%.
Ireland	Ordinary tax rules apply - profits and losses from crypto transaction are taxable as normal income.
Netherlands	Taxes on capital gains are not imposed, but a deemed interest on the value of all assets minus all liabilities is imposed. The deemed interest is taxable against a flat rate of 31% (in 2021, 30% in 2020).

Indirect taxes: Different countries may have different VAT regime for cryptocurrency taxation. However, where not specified taxability should be tested under existing rules. The European Court of Justice (ECJ) in the case of Hedqvist (Skatteverket vs David Hedqvist Case C-264/14) held that virtual currencies can be compared with fiat currencies in that *their sole purpose was to provide a means of exchange* and ruled that transactions including the exchange of fiat currency for virtual currencies and vice versa, performed for consideration, are transactions exempt from VAT within the meaning of Article 135(1)(e) of the EU VAT Directive

Non-fungible tokens (NFTs) – An introduction

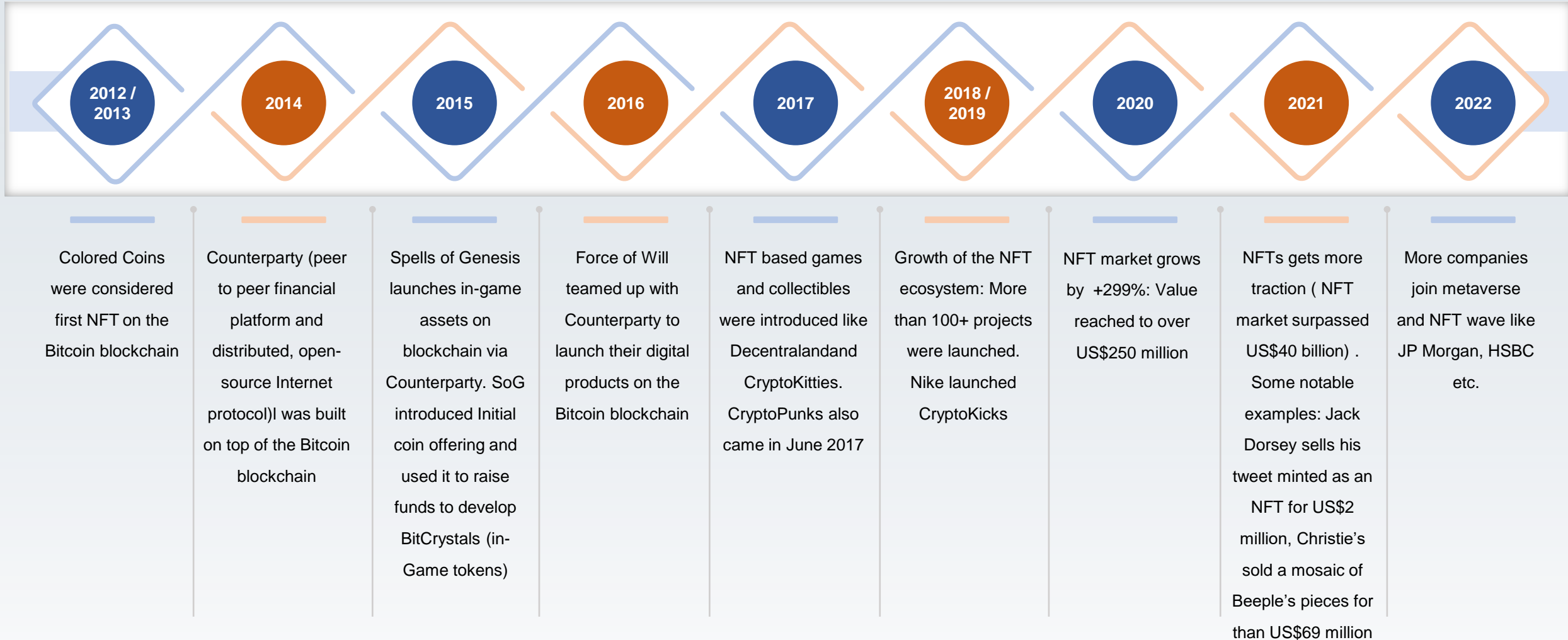
- NFTs are digital files having a unique identity that is verified on a blockchain (i.e., it is a unique cryptographic asset that exists on a blockchain)

Global NFT revenue forecast in US\$ million



Modified diagrams, Source : Statista Digital Market Outlook 2022, Digital Economy Compass (2022) Statista

Timeline of events leading to the rise of NFTs



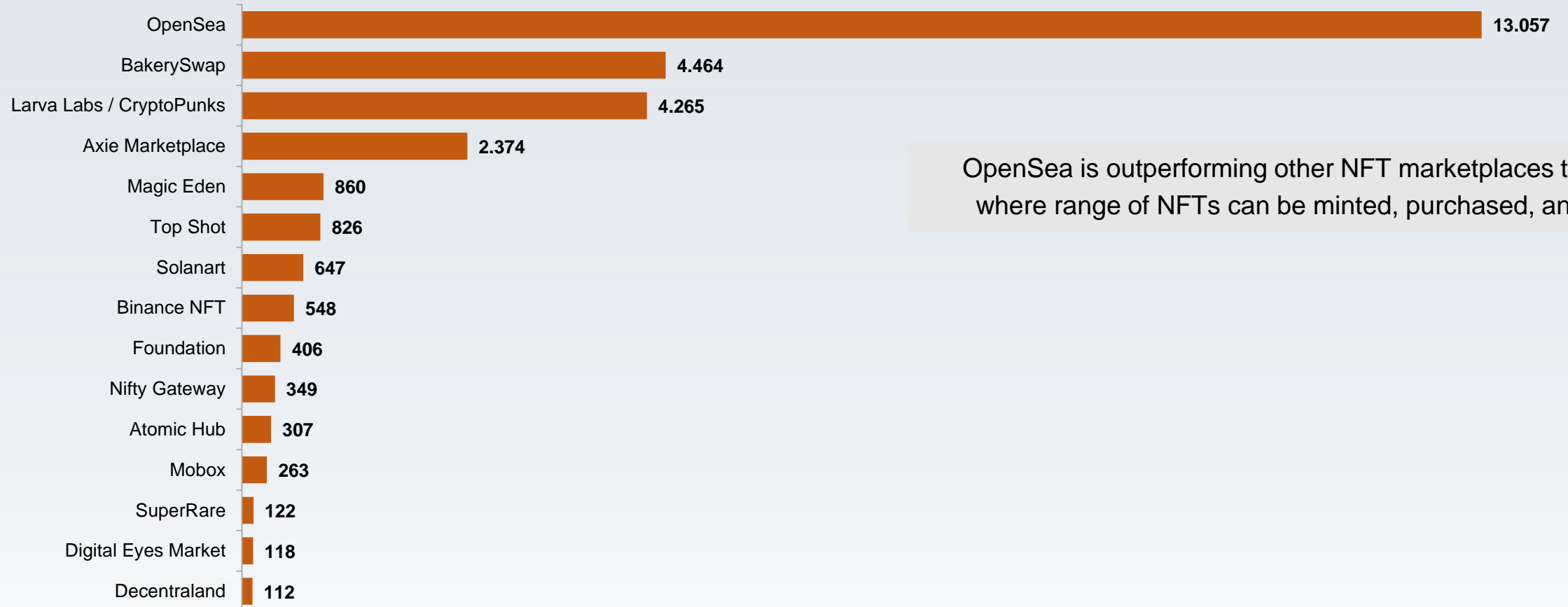
Modified diagram, primary source : Statista Digital Market Outlook 2022, , Digital Economy Compass (2022) Statista

Top ten countries by NFT user in 2021



Data source : Statista Digital Market Outlook 2022, Digital Economy Compass (2022) Statista

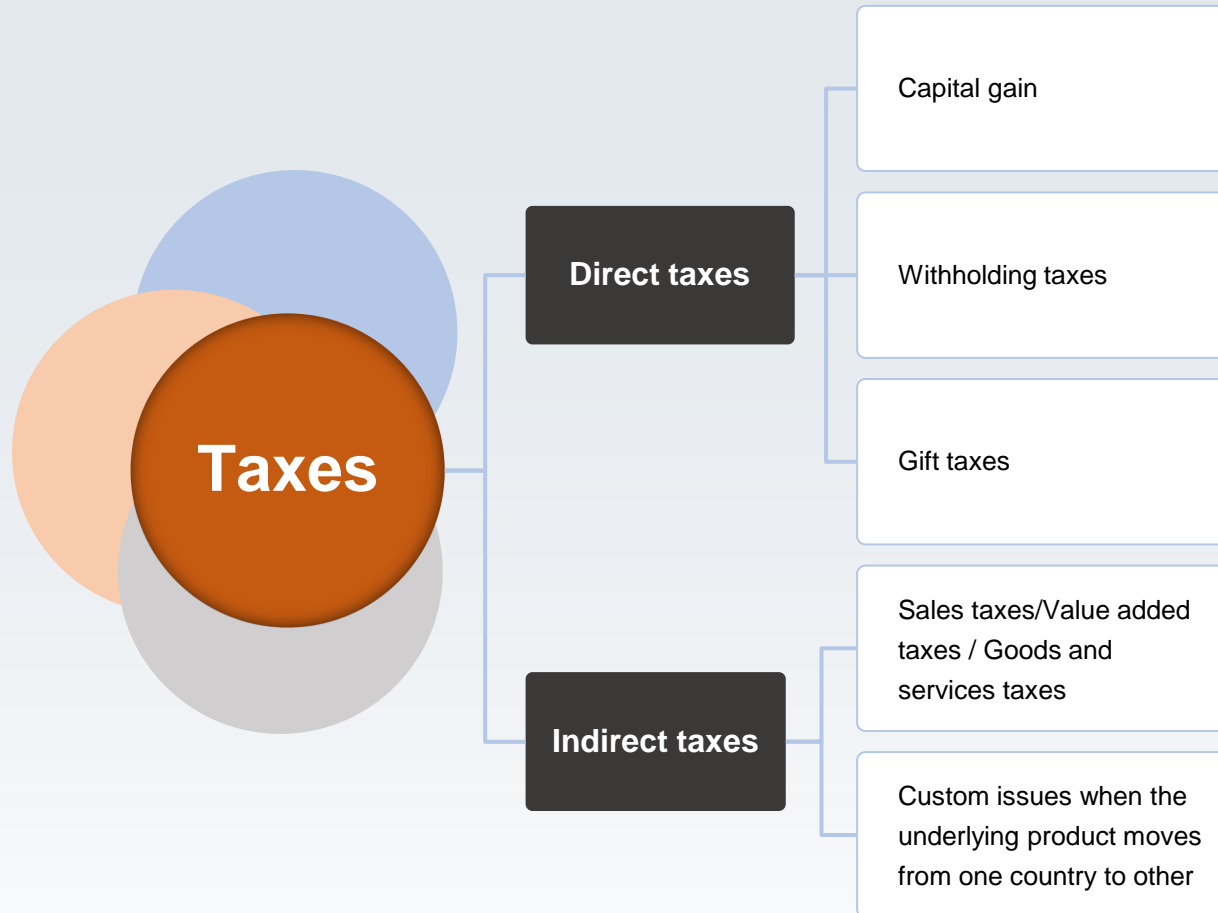
Top-10 NFT marketplaces (Based on sales volume in US\$ million 2021)



OpenSea is outperforming other NFT marketplaces to date where range of NFTs can be minted, purchased, and sold

NFT's and Potential Tax Considerations

From tax side, there could be implications from both direct and indirect tax side depending on the laws of the country. Some of the applicable taxes could be:



Relevant point to consider for tax:

- **Items being sold or transferred? Tangible or intangible property?** It could be regarded as tangible property where NFT gives right to the purchaser to get the underlying physical products too
- **Single product / service or bundled goods/ services**
- **Sale of IP or a limited license of right to use IP?** For ex. - It needs to be checked whether it is outright sale of copyright which gives the purchaser the complete right over exploitation of IP or purchaser has limited right of exploitation of IP
- **Place of supply?** Can the country of customer / buyer be identified? Country of customer can be identified on various metrics that are applied for digital goods / services like billing address on invoice, customer IP address, contract terms and conditions
- **Local laws of the country**
 - Is there law in place in country under which NFTs can be taxed? Whether laws for crypto would apply to NFT's too?
 - Determination of tax characterization of item/s being sold

Indirect taxes on NFTs – Select country discussion

	Some guidance of tax authority on cryptocurrency	Some guidance of tax authority on NFT	Indirect taxes on NFTs
NZ	Yes	Yes	Standard rated
Australia	Yes	No	Standard rated
Germany	Yes	No	Unclear
Ireland	Yes	No	Unclear
Netherlands	Yes	No	Unclear, Potentially standard rated
Middle East	No	No	Unclear
Singapore	Yes	No	Likely to be taxable
South Africa	Limited	No	Unclear, potentially standard rated
UK	Yes	No	Likely to be standard rated
US	Limited	No	Unclear, potentially taxable

Source: Non Fungible Tokens: Significant and Emerging VAT Issues (PWC); available at <https://www.pwc.co.uk/services/tax/indirect-taxes/non-fungible-tokens-significant-and-emerging-vat-issues.html>

VAT implication on non-fungible tokens may not be the same as that of cryptocurrency. In Spain ruling V0482-22, of March 10, 2022, issued by the Spanish General Directorate of Taxes (Dirección General de Tributos), Transfer of NFTs was regarded as ‘supply of services’. Per the ruling, VAT was accorded similar treatment as that of ‘electronically supplied goods | In India, NFTs are included in definition of Virtual digital asset

Metaverse – Certain tax considerations

- **Jurisdictional issues**
- **VAT on virtual transactions (like discussed earlier in case of NFTs)**
- **Tax on sale of virtual real estate (for ex., sale of virtual land in metaverse)**
- **Hard to value intangibles/ data taxation issues**
- Determination of **value of the digital assets** in Metaverse is biggest challenge because of the volatility in value of the digital assets. The same digital assets may have different values at different time of the day.

Virtual Digital Assets

Policy issues:

Valuation of cryptocurrencies for determining the cost basis for tax purposes

The practice for determination of cost basis varies amongst countries. For ex. –

- *specific identification of units (ex. - U.S.)*
- *deemed chronological order (ex. - Finland)*
- *basis pooling (ex. - U.K.)*

Cost basis in cases of gift/inheritance

Should the prevailing rates of the VDA at one of the exchanges when the gift was received be taken as cost of acquisition?

Withholding tax issues where applicable in case of payments to non-residents

Steps that can be taken by policy makers

Simplified compliance mechanism

Clear guidance on taxable transactions and other matters

Time to time review of the policy in light of emerging variants of tokens and used cases