

John Kaburu
International Tax Specialists
15 October 2020

Taxation of Cryptoassets



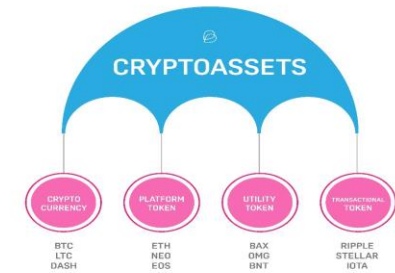
Discussion Topics

- ❑ Types of Cryptoassets
- ❑ General rule to taxation of Cryptoassets
- ❑ Taxable events – Security tokens
- ❑ The taxation regime adopted by some countries



In general

- Cryptoassets are cryptographically secured digital representations of value not issued or guaranteed by a central bank
- They represent a set of claims, or a set of permissions that are enjoyed by the holder
- Cryptoassets can be transferred, stored, or traded **electronically**
- The terminology, types of coins, tokens and transactions can vary
- The tax treatment of cryptoassets continues to develop due to the evolving nature of the underlying technology and the areas in which cryptoassets are used.



Types of cryptoassets

1. Cryptocurrency or payments tokens

- Tokens store value, are a medium of exchange or unit of account.
- Value exists on its use as a means of payment or investment

2. Security tokens

- Their intrinsic features serve or represent financial assets such as “securities” and other financial instruments
- Are debt or equity claims on the issuer or derivative therefrom that generate interest to the holder



Types of cryptoassets

3. Utility Tokens or Consumption Tokens

- They are inherently consumptive in nature, because they are designed to provide immediate or future access to a platform or a particular set of goods, services, or content (e.g., games, music, file storage)
- Tokens exhibiting features of two or more of the three categories are referred to as “hybrid tokens



General rules to taxation of Cryptoassets

- The tax treatment of a token depends **on its use** within the ecosystem that is created;
- Most jurisdictions have not provided guidance on the specific tax treatment of Cryptoassets or tokens
- Challenge is it property or currency?
- ? Is the income or gain realized from Cryptoassets **revenue or capital** in nature?
- In general, for corporations or companies, the tax classification is expected to largely follow the accounting treatment
- In general, possessing or holding a cryptocurrency is not taxable.

- Emphasis is on use
- Income realised
Revenue or capital
- Tax follows accounting

- Income or gain from Cryptoassets, is it business income or capital gain?
- To report income correctly, you must first establish what kind of income it is.
- We use badges of trade to determine whether one is trading (adventure of trade) or investing or just doing a hobby

General rules to taxation of Cryptoassets

- Badges of trade
- Trading or investing

General rules to taxation of Cryptoassets

- The following are common signs (badges of trade) that you may be carrying on a business:
 - You carry on activity for commercial reasons and in a commercially viable way
 - You undertake activities in a business like manner, which might include preparing a business plan and acquiring capital assets or inventory
 - You promote a product or service
 - You show that you intend to make a profit, even if you are unlikely to do so in the short term

- Badges of trade
- Trading or investing

General rules to taxation of Cryptoassets

- Not all taxpayers who buy and sell cryptocurrency are carrying on business activity.
- Taxpayers required to establish if a cryptocurrency activity results in income or capital
- This affects the way the revenue is treated for income tax purposes.
- Income from transactions involving cryptocurrency may be treated as business income or as a capital gain
- Losses are treated as business losses or capital losses
- Paying for goods or services using cryptocurrency may be treated as barter transaction for income tax purposes

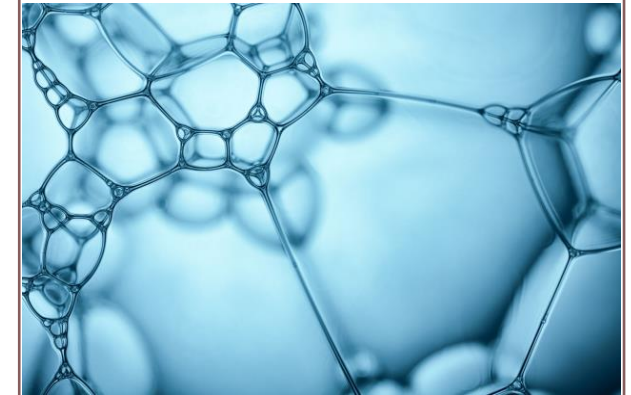
Taxation follows usage

Use	Taxable event	Possible tax treatment
Investment – action or process of investing	<ul style="list-style-type: none">• Return may consist of a gain (loss) from sale• Unrealised capital appreciation• Investment income such as dividends, interest, rental income	<ul style="list-style-type: none">• Capital gains tax• Income tax - interest or rental income• Exempt income
Financial trading – active buying and selling of financial assets with a motivation to profit	Profit (loss)	Generally trading income hence taxed under corporate tax rules, or income on the individual



Taxation follows usage

Use	Taxable event	Possible tax treatment
Loans or other leverage offering - margin trading, decentralised lending of cryptos	Borrowing with interest, or lending to realise a margin	Trading income taxed under corporate tax rules, or income on the individual
Conversion into cash – to buy Cryptoassets we use fiat currency or purchase on trading exchange	Conversion of cryptocurrency realises a gain or a loss	capital gain or normal business income
Compensation / remuneration to employees	A benefit accrues	Taxes as employment income under PAYE



Mining / fees from mining

- Cryptoassets can be awarded to 'miners' for verifying additions to the blockchain digital ledger.
- Mining will typically involve using computers to solve difficult maths problems in order to generate new Cryptoassets.
- Whether mining amounts to a taxable trade (with the Cryptoassets as trade receipts) depends on a range of factors such as:
 - degree of activity
 - organisation
 - risk
 - commerciality



VAT on Cryptoassets?

- Generally VAT is levied where there is a supply of service or goods
- Determination of whether a good or service is challenging
- In the UK VAT is due on any goods or services sold in exchange for cryptoasset exchange tokens.
- Is provision of electronic assets such as crypto a services?



Taxation regime adopted by some countries

- Kenya taxes Cryptoassets under the existing regime – as capital gain if held as an investment property or as business income if trading
- The United States has issued guidance that “virtual currency” is treated as property for federal income tax purposes and, thus, gain or loss is recognised upon an exchange of virtual currency for other property.
- In the United Kingdom, corporations pay corporate tax, unincorporated businesses pay income tax, individuals pay capital gains tax on transactions involving cryptocurrencies
- In Hong Kong and Singapore, corporations and individuals are generally taxed on income and profits derived from cryptocurrency trading, but the transfer of such is not subject to any capital gains tax.
- Similarly, Israel taxes cryptocurrency as an asset, Bulgaria and Slovakia tax it as a financial asset, Norway taxes it as capital property, and Canada taxes it as a commodity.



Future tax issues to consider

- Assigning cost basis
- Loss of access to transaction data
- Lack of clear regulation
- Location of the cryptoasset – where it stored or location of the user



Q&A