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SGH
Warsaw School
of Economics

In Search of Effective Taxation of Digital Assets and Decentralized economic activity – A Review of Taxation Models

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* Ideas presented in this presentation are derived from the author's own research and are not an expression of any views of non-academic institutions in which the author is employed.

Doctoral research - some of the hypotheses

H2	Economic activities undertaken by entities in a tokenized economy based on blockchain technology (DLT) generate economic value.
H3	With respect to at least some of these economic activities, it is possible to assign by analogy relevant events outside the tokenized economy that are included as the subject of taxation in the tax system.
H4	Treating similar activities differently depending on whether they are undertaken in a tokenized or traditional economy leads to inequality in taxation.

Effective Taxation of Digital Assets and Decentralized economic activity – building blocks

FAIR TAXATION

how virtual currencies fit within the existing tax framework - in order to promote clarity and certainty for taxpayers

CLEAR GUIDANCE AND LEGISLATIVE FRAMEWORK

NATIONAL

NATURE OF CRYPTO-ASSETS

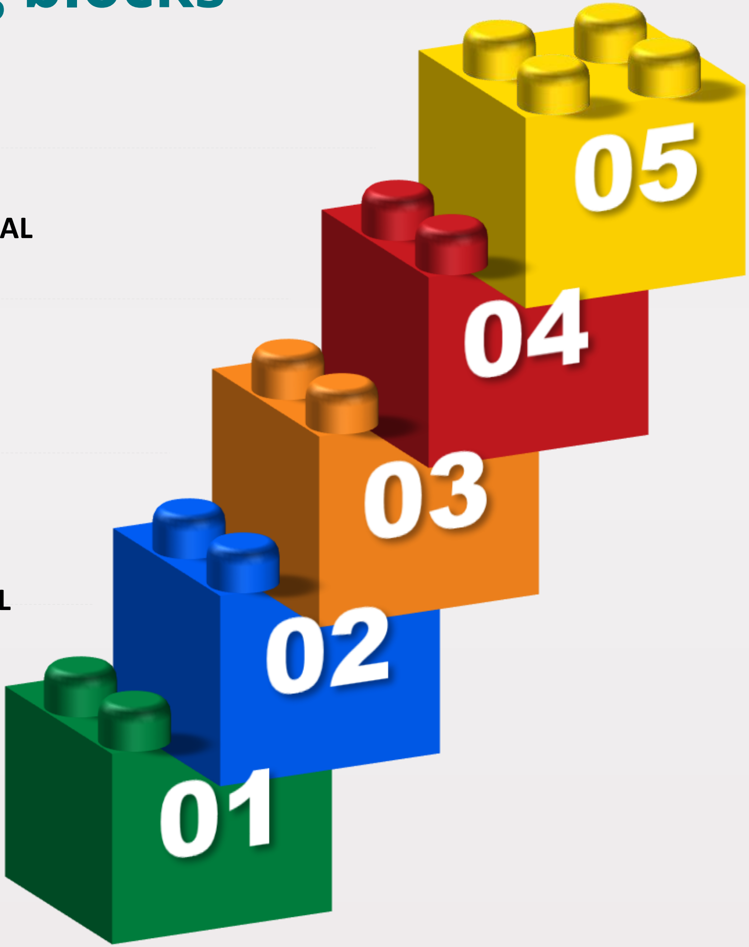
TAX TRANSPARENCY

OECD – CRYPTO ASSETS REPORITING FRAMEWORK
EUROPEAN UNION – DAC8

ADMINISTRATIVE COOPERATION AND EXTENDED EXCHANGE OF INFORMATION

FIGHT AGAINST TAX FRAUD, TAX EVASION AND TAX AVOIDANCE

GLOBAL



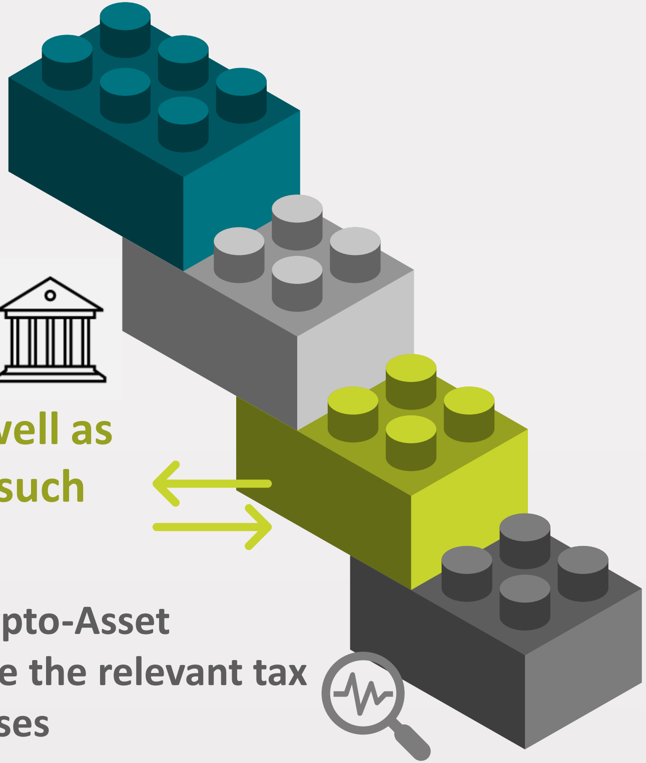
CHALLENGES RESULTING FROM THE NATURE OF CRYPTO-ASSETS

CHALLANGES	FOR TAX TRANSPARENCY
(pseudo-)anonymity decentralized nature of crypto-assets lack of centralised control	Crypto-Assets can be transferred and held without interacting with **traditional financial intermediaries** and **without any central administrator** having **full visibility** on either the transactions carried out, or the location of Crypto-Asset holdings.

RESULTS

- a significant risk that recent gains in global tax transparency will be gradually eroded
- makes it difficult for Member States' tax administrations to ensure tax compliance

TAX TRANSPARENCY - OECD – CRYPTO ASSETS REPORTING FRAMEWORK & UE – DAC8



i) the scope of Crypto-Assets to be covered

Crypto-Assets which can be used for payment or investment purposes

ii) the Entities and individuals subject to data collection and reporting requirements

iii) the transactions subject to reporting, as well as the information to be reported in respect of such transactions

Exchange transactions and transfer

iv) the due diligence procedures to identify Crypto-Asset Users and Controlling Persons and to determine the relevant tax jurisdictions for reporting and exchange purposes

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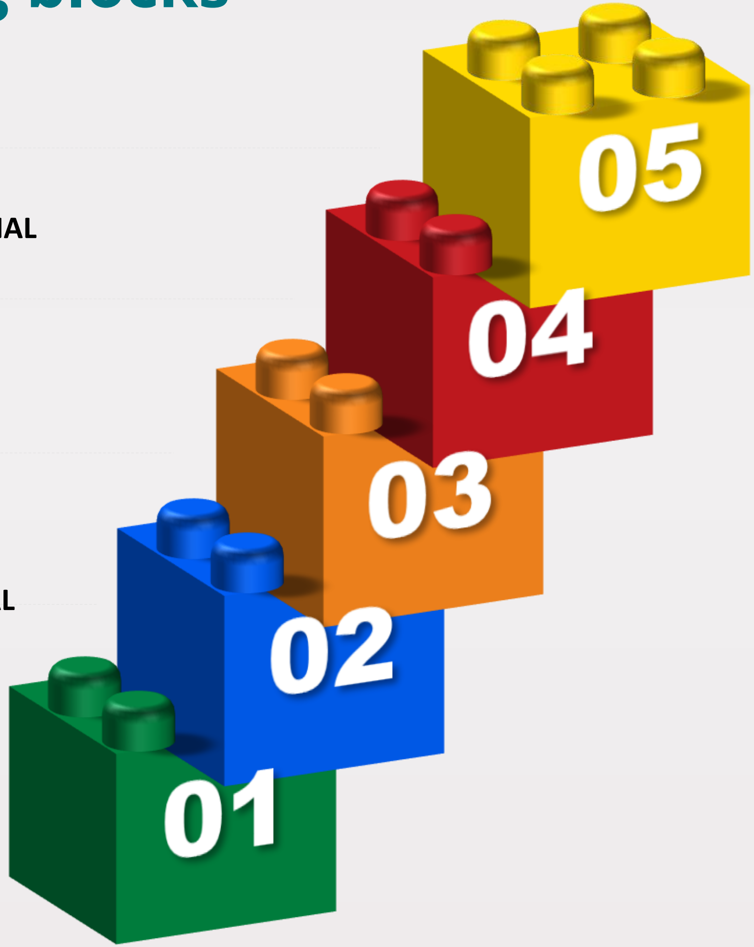


CHALLANGES	Source
„(…) the problem that **the economic activities** surrounding crypto-assets and blockchain technology cause for tax law. At a fundamental level, tax law relies on the ability to place assets and income into categories in order to determine their tax treatment. Crypto-assets does not fall neatly into these categories. It **is not clearly legible to the state**, making uncertain the appropriate tax treatment of trillions of dollars of **wealth being created** in the crypto space.”	Parsons, Amanda, Cryptocurrency, Legibility, and Taxation
"The particular characteristics of cryptocurrency transactions are irreconcilable with the existing provisions of tax law, **which lag behind the dynamic development and ongoing emergence of new forms of taxpayers' economic activity**."	Regional Administrative Court
„hybrid characteristics (i.e. including both aspects of financial instruments and intangible assets)”	OECD

CLEAR GUIDANCE – POLICYMAKERS MAY CONSIDER

Policymakers may consider providing guidance that is comprehensive and:

1) Addresses the **major taxable events**, and **income forms** associated with crypto-assets,
2) Provide details about **the boundaries** between different types of crypto-assets, and on how other forms of these assets are treated for tax purposes,
3) The tax treatment of crypto-assets should be **consistent with** the tax treatment of other assets,
4) Consistency with the tax treatment of other assets of the same type could enhance **tax system neutrality**, unless there is a reason to deviate from it due to the specific characteristics of virtual currencies,

- in order to provide clarity for taxpayers.

CLEAR GUIDANCE – THE MAJOR TAX EVENTS

1) **Creation** of virtual currencies (e.g. via mining, and airdrops) and related expenses;
2) **Exchange** with other crypto-assets, fiat currency, and for goods and services including valuation;
3) **Disposal** via gift or inheritance;
4) Loss or theft;
5) Emerging developments (e.g. hard forks, interest-bearing tokens);

Interdisciplinary concept of income – income funnel

Economic Concept

- Psychic
- Consumption Expenditure
- Unrealised Value Changes

Economists' Deviations

- Periodicity
- Productivity
- Permanence

Accounting Concept

- Market Transactions
- Realised Gains
- Selected Unrealised Gains

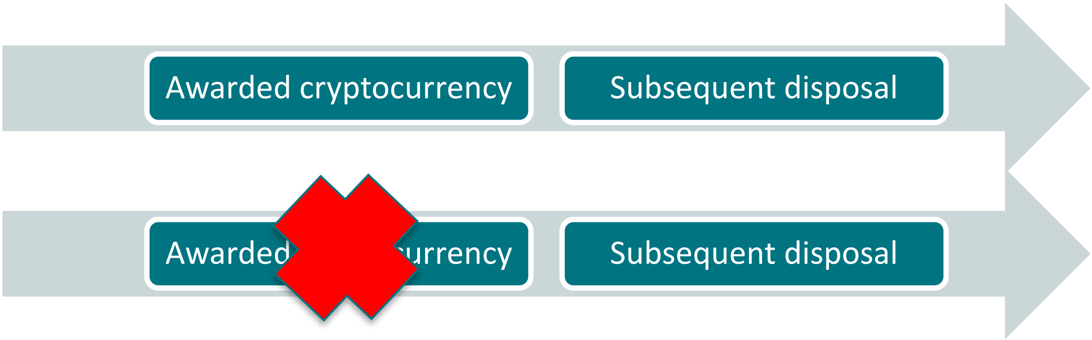
Legal Concept

- **Inflow; Periodicity**
- **Product of labour or Property**
- **Realisation**
- **Separate from Source**
- **Profit Making Purpose / motive**
- **„Ordinary Meaning"**
- **Convertible non-monetary benefits**

TAXABLE INCOME

Mining

Tax treatment – taxable event	Country
The majority of jurisdictions require that: • the awarded cryptocurrency is included in taxable income (generally at market value), and • subsequent disposals might again trigger taxation (in case and to the extent of further appreciation in value)	e.g. Australia / Germany
The minority of jurisdictions: • the subsequent disposal of the cryptocurrency is taxable.	e.g. Poland



Forks

Tax treatment of hard forks (when the taxpayer is deemed to receive the assets for tax purposes)	Country
The majority of jurisdictions: • creation of “new” tokens (with a zero basis) and/ or a continuation of the “old” token (without the existing tax basis)	e.g. Australia
The minority of jurisdictions: • immediately taxes the receipt of a “new” token at its fair market value, or • provide for an apportionment of an existing tax basis between “old” and “new” tokens	e.g. the USA, the United Kingdom

Aidrops

Direct network effects - utility is often dependent on the number of other end-users consuming the same good or service

Tax treatment – The “airdrop” of an established crypto asset might be:	Country
1) Considered as income in the amount of the market value	e.g. Australia
2) Exempt from immediate taxation (and only taxed upon a subsequent disposal)	e.g. Austria
3) Treated as a (taxable) gift	e.g. Denmark
4) Compensation for a promotional service on social media or for providing data	e.g. Finland

Exchange crypto vs. crypto

Tax treatment – crypto-asset vs. crypto-asset	Country
The majority of jurisdictions treat such transactions as: • realization event (most of them as a barter transaction) • potentially realizes the accrued gains in the transferred crypto assets	e.g. Australia
The minority of jurisdictions treat such transactions as: • tax neutral • deferring taxation until, e.g. the conversion into fiat currency or the use for purchasing goods or services	e.g. France

Transactions for goods or services

Tax treatment – transactions for goods or services	**Country**
The majority of jurisdictions treat such transactions as: • payments in kind and hence (taxable) - realization events (as barter transactions), • on the side of the buyer or service recipient, it generally realizes the accrued gain in the transferred crypto asset at its fair market value, • on the side of the seller or service provider, it determines the acquisition costs of the acquired crypto assets and hence the revenue earned	e.g. Australia
The minority of jurisdictions: • on the side of the seller or service provider – discuss that the realization should be postponed to the moment of, e.g. conversion into fiat currency	e.g. Belgium

Extinct

Tax treatment – the "extinct" of the crypto-asset:	The deductibility depends on the qualification of the crypto asset as:
1) loss of access to a wallet	• a capital asset • a speculative asset • a part of business activity • inventory
2) bankruptcy of the wallet provider	
3) „rug pull”	
4) Compensation for a promotional service on social media or for providing data	
5) (…)	

Establish a permanent establishment according to OECD Model Tax treaties

Tax treatment – examples	**Create PE**
• taxpayer renting and operating servers (hardware) for crypto mining <u>might establish a permanent establishment</u>	YES
• while renting mere cloud mining capacity <u>would not establish a permanent establishment</u>	NO

Thank you for your attention!

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