

Taxation of Cryptocurrencies – Staking and Asset Tokens with Equity Rights

The Federal Tax Administration (FTA) updated and published its working paper on the tax treatment of cryptocurrencies and initial coin/token offerings in December 2021. In particular, the working paper contains new explanations on the tax treatment of staking and investment tokens with participation rights. The VAT treatment of cryptocurrencies has to be assessed in application of the independent practice published by the main division VAT of the FTA, particularly VAT leaflet 04, in which the basic principles are set out.

Tax qualification of cryptocurrencies

The tax qualification of cryptocurrencies depends on the functionality of the tokens in accordance with the FINMA guidelines: A basic distinction is made between payment tokens, asset tokens and utility tokens, whereby hybrid forms are also possible.

For income tax purposes, the pure holding of payment tokens and utility tokens does not generally generate taxable income, whereas asset tokens may generate taxable income (e.g. in the form of interest, dividends). In addition, the income tax consequences of so-called staking in particular must be taken into account. Similarly, the VAT treatment can vary depending on the characteristics of the tokens concerned.

Staking

In a blockchain, a consensus has to be established on the valid transactions and the correct data. Newer procedures of certain blockchains (e.g. Ethereum 2, Tezos) use "proof of stake" ("PoS")

algorithms. The correctness of transactions in PoS blockchains is confirmed by people who hold a certain amount of the cryptocurrency in the protocol, the so-called "validators". For making the tokens available and providing as well as operating the infrastructure, the so-called "staking", the validators receive new tokens of the corresponding blockchain (so-called "rewards") and/or a transaction fee upon successful validation.

According to the FTA, the rewards are generally taxable income from movable assets for income tax purposes. This also applies to a transaction fee. The reward or the transaction fee respectively is deemed realised at the time of the inflow (receipt of a benefit or acquisition of a fixed legal entitlement). Costs (e.g. fees) can be deducted from the income for tax purposes. If the validator meets the criteria of self-employment (in particular of the professional securities trading), the rewards or the transaction fees respectively qualify as taxable income from self-employment and are also subject to social security contributions.

If the rewards are received by a corporation, the tax treatment is based on the balance sheet and income statement in accordance with commercial law (authoritative principle).

According to the practice of the FTA, the VAT treatment of income from staking depends on whether a validator is remunerated with rewards or transaction fees. Rewards qualify as so-called non-considerations which are not subject to VAT. The mere staking does accordingly not qualify as entrepreneurial activity for VAT purposes. Furthermore, the practice of the FTA implies that validators, who also carry on a business in the meaning of the VAT, pursue an entrepreneurial and a non-entrepreneurial activity in parallel. In practice, this leads to questions regarding the calculation of the input VAT recovery rate. If, however, validators are remunerated with transaction fees, the income is considered as turnover subject to VAT, taxable at the place of business of the service recipient.

Asset tokens with equity rights

In the context of a fundraising, corporations may issue shares or other equity securities in the form of asset tokens with equity rights, in particular newly as ledger-based securities. Such asset tokens are to be treated for tax purposes like the corresponding equity securities. The payments made by the issuers to the token holders are dividends and therefore subject to income tax and withholding tax. Furthermore, unlike other tokens (payment tokens, utility tokens or asset tokens with a contractual basis), such asset tokens qualify as taxable securities for securities

transfer tax purposes, and their trading is subject to securities transfer tax.

According to the practice of the FTA, issuance of asset tokens is qualifying for VAT exemption without credit. Considering the case law concerning IPO and sale of own shares in the securities sector, it is, however, questionable whether this practice will last.

Further developments in blockchain and tokenisation

The FTA's publications to date do not comment on all tax topics with regard to blockchain and tokenisation. For example, no comments are yet made on the tokenisation of physical art objects or "Non-Fungible Tokens" (NFK) in the area of digital art. Furthermore, essential questions arise with regard to the determination of the place of supply for VAT purposes in the context of particular tokens (utility token). The scope of application of blockchain and tokenisation will expand, which means that the tax practice will also have to evolve.

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