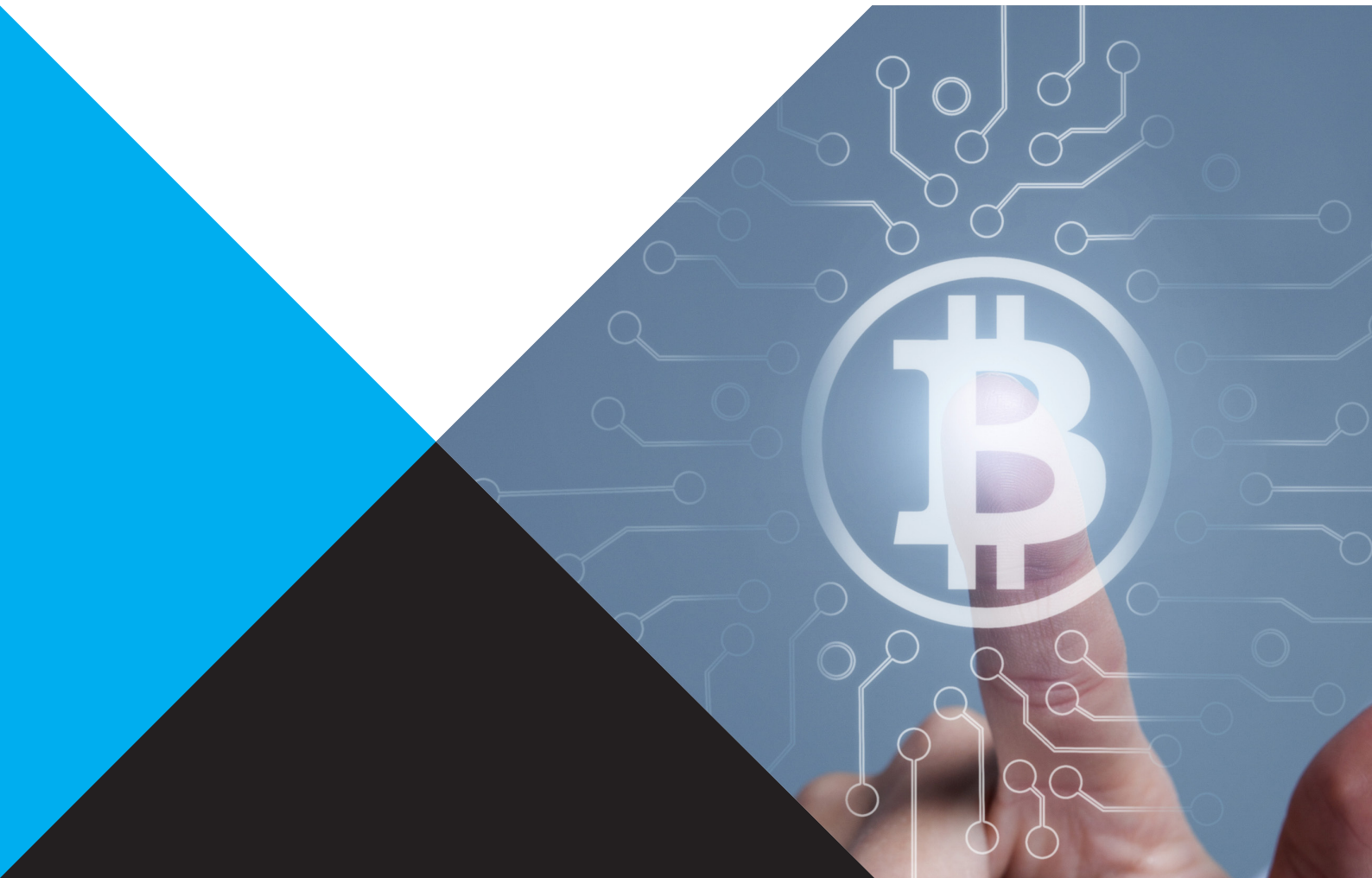




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THE TAX TREATMENT OF CRYPTOCURRENCY: EXTRACTING VALUE

Taxation Consultancy





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THE TAX TREATMENT OF CRYPTOCURRENCY: EXTRACTING VALUE

Over the last few years Cryptocurrency has emerged from being a niche curiosity into wider public ownership and usage. This has left tax authorities around the world facing the challenge of how to treat and tax cryptocurrency transactions.

Their secondary concern relates to maintaining effective controls to protect against money laundering and tax evasion afforded by the simplicity of the borderless shifting of value directly from person to person (peer to peer) allowed by this technology.

INITIAL APPLICATIONS OF TAX LAWS AND CONCEPTS TO CRYPTOCURRENCY

With the rising adoption and move into the main stream of cryptocurrencies a wider audience of people are now realising gains in value from an ever increasing number of cryptocurrencies, such as:

- Bitcoin (including the Cash derivative)
- Litecoin
- Ethereum (including the Classic derivative)
- Ripple
- Dash
- Monero

In addition to this, the use of cryptocurrencies as a digital means of payments is taking off with a growing number of retailers and payment processors accepting these “coins” or “tokens” as a means of payment. There are also new businesses emerging where cryptocurrency is starting to form the basis of company operations, from fundraising stages through Initial Coin Offerings (“ICOs”), to cryptocurrency trade operations, and even the use of cryptocurrency through international supply chains. This has led many individuals and businesses to question what tax treatments might apply to them given their circumstances and uses. Until very recently there was

no definitive guidance issued by the Irish Revenue on the correct tax treatments to be applied, as tax authorities have struggled to identify the right approach to take due to the inherent uncertainty surrounding a new technology. Much reliance was placed in the quite non-committal guidance brief issued by the UK’s HMRC in early 2014 to try and ascertain what the correct tax treatment approaches to adopt might be. However, on the 15th May 2018 the Revenue Commissioners issued guidance on the Irish tax treatment of cryptocurrency transactions. This has now given some definitive direction on the taxation treatments of cryptocurrency transactions within the Irish tax net.

CURRENT REVENUE GUIDANCE ON CRYPTOCURRENCY TRANSACTIONS

The revenue guidance issued on the Irish taxation of cryptocurrency transactions is fairly broad and offers direction on the treatment of cryptocurrency transactions across a range of different transaction types and applicable tax heads.

We set out below the Irish tax treatments applicable to the following groups of taxpayers and operations:

- Individual investors & companies holding cryptocurrency investments
- Unincorporated & incorporated cryptocurrency traders and miners.
- Retailers accepting cryptocurrency for goods or services.
- Considerations affecting both traders and retailers.



Individual Investors & Companies holding Cryptocurrency Investments

There are different treatments between those trading in cryptocurrency to those investing in it. Generally, individuals would be viewed as investing unless they are making very high volumes of transactions for a consistent period of time. However, this should be properly established by each taxpayer given their own circumstances from the outset, as it can be a costly distinction. Once it is established that the cryptocurrency transactions undertaken by a taxpayer do not constitute trading, then Capital Gains Tax treatment should apply.

In the case of an individual, CGT will be levied at 33% on any cryptocurrency gains arising in a tax year after any prior year and current year capital losses are offset, and the individual's personal CGT exemption of €1,270 is utilised.

Where the individual is not resident in Ireland or is not domiciled in Ireland it is possible for a tax planning exercise to be carried out ahead of realising any gain. Assuming the crypto-exchange used is based outside of Ireland, then non-resident individuals may not be within the scope of Irish CGT. Non-Domiciled individuals may benefit from the remittance basis of taxation.

In the case of companies any profits realised on non-trading cryptocurrency transactions should be taxable as a chargeable gain for Corporation Tax purposes and included in the company's CT1 for the relevant period.

In either case, Revenue now appear to have accepted that non-trading cryptocurrency losses can be allowable for CT and CGT purposes.

Unincorporated & Incorporated Cryptocurrency Traders and Miners

Taxpayers which are trading in cryptocurrency will be taxed on their profits once these are realised from each transaction; i.e. the aggregated profits of all the sales transactions in an accounting period are taxable, where applicable, without reference to the current market values of any cryptocurrency currently held but not sold in that period.

Revenue regards cryptocurrency as a "negotiable instrument" for VAT purposes. Paragraphs 6(1)(c) and (d) of Schedule 1 to the VATCA 2010 exempt transactions in cryptocurrencies from VAT. This means that traders and miners would not normally be entitled to claim back any VAT incurred on their input costs. However, in cases where sales of cryptocurrencies can be verified as being made



outside of the EU, these are qualifying activities for VAT recovery purposes and VAT may be recovered on any direct costs, and a suitable apportionment of the indirect costs.

Instances where taxpayers are actively “mining” cryptocurrency will likely be regarded as trading where they are switching between mining different cryptocurrencies to maximise profit and continuously managing their operations. In these cases costs such as the power used may be deductible against the profits arising. The equipment bought and used for same will also likely qualify for capital allowances treatment. This would allow 12.5% of the cost of the equipment being deductible in each year against trading profits, for an 8 year period.

For unincorporated businesses Income Tax would arise on the profits from the business at each taxpayer’s marginal rate. Losses should be available for use against total income in the year.

For incorporated businesses Corporation Tax would arise on the profits of the business. In an actively managed trade these profits would be taxed at 12.5%. Any losses should be allowable against trading profits in the standard manner.

Retailers accepting Cryptocurrency for Goods or Services

Retailers and business owners who accept cryptocurrencies in consideration for the standard goods and services they provide should view that transaction in the same way as if they were receiving cash of the equivalent value at the moment of purchase. The fact that consideration is paid for in a cryptocurrency does not alter when revenue is recognised or how taxable profits should be calculated.

VAT will continue to apply to the supply of goods and services at their prescribed rates. Where payments are received in cryptocurrency, these should be regarded to be the gross consideration at their euro equivalent value at the time of the payment. The net and VAT amounts should then be worked out from this valuation and included in the business’s VAT3 for the period as appropriate.

It should be noted that the location of the purchasers and any suppliers will still need to be ascertained to ensure correct VAT rates, Intrastat, VIES, and self-accounting requirements are met. Where a non-VAT registered business starts providing VATable goods and services a VAT registration should be sought when the relevant registration threshold is exceeded, or likely to be exceeded, regardless of whether any of the value of the consideration received is in cryptocurrency.

Where inputs for the business are bought in cryptocurrency no VAT on the inputs can be recovered unless a valid VAT invoice with all the required information is received including the suppliers VAT number and a breakdown of the Gross, Net, and VAT amounts. In the same vein VAT must be self-accounted for on purchases from the EU and services from abroad, despite the fact a business may be operating wholly online and using digital currencies.

As with a business accepting foreign currency, any profit or loss on the disposal of cryptocurrencies received as consideration (i.e. incidental to trading profits) would ordinarily be taxable as a chargeable gain or allowable as a capital loss for Corporation Tax or CGT purposes. Unincorporated businesses would be within the scope to CGT on these transactions. Whereas incorporated businesses would be subject to Corporation Tax on chargeable gains.

All records should be kept for a minimum of 6 years. This includes records relating to the receipts and disposals of the cryptocurrencies corresponding to each sale or purchase of goods and services, together with the capital transactions.

Considerations affecting both Traders and Retailers

There are a certain number of considerations which will be applicable to all businesses operating with cryptocurrency regardless of whether they are trading in cryptocurrency like a commodity or accepting it as a means of payment.

Businesses will generally prepare their accounts in the most relevant “functional currency” for the business. The functional currency will be by reference to the currency of the primary economic environment in which the business operates when all circumstances

are considered. This will need to be a fiat (non-digital) currency. Cryptocurrencies are not recognised as currencies despite their usage as a means of payment. Therefore, when recording profits and losses from business activities the same accounting methods must be undertaken as when accepting foreign currencies. Valuation of cryptocurrency is therefore an important factor for both the preparation of accounts and for satisfying the various tax points arising across all applicable tax heads. Revenue recognise there is not always a single exchange rate which applies to cryptocurrencies, due to the variances which occur between different exchanges. Therefore, a “reasonable effort” is expected to use an appropriate valuation for each transaction. This should comprise of a fair and consistent approach; i.e. always valuing by reference to the same nominated exchange, or in cases where the invoices state figures in both fiat and cryptocurrency figures, it may be appropriate to use this as the exchange rate for the transaction.

Any staff that businesses may have should always be subject to PAYE on their employment income. The payment of wages in cryptocurrency would not be sufficient to demonstrate a worker is a contractor to which the PAYE system does not apply. As with other tax heads, where the employees are paid in cryptocurrency the value of all emoluments should be converted to euro amounts at the time the payment is made. The payroll returns should then state the euro amounts and all remittances for payroll taxes withheld should be made to Revenue in euro.

OTHER TAX CONSIDERATIONS ON THE USE OF CRYPTOCURRENCIES

Outlined below are further considerations on the use of cryptocurrency on which there have, as yet, been no Revenue Guidance. However, they remain general taxation principals and obligations regardless of the nature of the transactions consideration.

Stamp Duty

The transfer of ownership, sale, or purchase of cryptocurrency should not give rise to a charge to Stamp Duty unless a physical contract or document

is created to facilitate same. Given the digital nature of the technology this seems unlikely, but should be borne in mind when preparing any transactional documentation.

Contracts and transactions which would usually be within the charge to Irish Stamp Duty, such as property conveyances, will not have this treatment altered by virtue of the consideration being paid digitally in cryptocurrency.

Withholding Taxes

Subject to certain exemptions there are withholding tax obligations on Irish companies on payments of dividends and interest. This is particularly relevant where value is being transferred from companies to individuals or where value is being transferred overseas.

Distributions paid in cryptocurrency would require DWT returns to be made to Revenue with the euro equivalent figures used. Should there be a withholding obligation the payment to Revenue of the corresponding amount needs to be paid in euro. Interest payments on loans (whether the payment or underlying loan amount be in fiat or digital currency) may be deemed to be distribution depending on the circumstances. In these cases a withholding obligation may apply.

Transfer Pricing Provisions

These regulations mean “arm’s length” pricing must be imposed on transactions between companies under common beneficial ownership. This is designed to limit profit shifting, and may become increasingly relevant to borderless cryptocurrency transactions. However, at the current time these rules do not apply to companies in a group with turnover of €50 million or less, total assets (regardless of liabilities) of €43 million or less, and fewer than 250 employees in total. Therefore the applicability of these regulations to companies dealing in or with cryptocurrency are restricted to

larger corporates.

As the use of cryptocurrency becomes more widespread, and / or the applicability of transfer pricing regulations becomes refined, this may become a larger area of focus.

Conclusion

Whilst the recent Revenue Guidance is welcome and has clarified Revenue’s opinion on the applicability of certain tax treatments to cryptocurrency, it is clear that if the adoption and use of cryptocurrency as a means of payment continues to emerge, then further targeted guidance and possibly new regulations will be required and introduced. Cryptocurrency transactions already appear to be an area of increasing Revenue scrutiny, and as new uses and technology platforms are developed it can be expected that correspondingly regulation and legislation will develop in response to this.

We would be happy to assist you with any aspect of tax planning, treatment, or compliance you have relating to cryptocurrency transactions or operations. Please feel free to contact a member of our team and we can arrange a convenient time to discuss your circumstances and requirements

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