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IBA 8th Annual IBA Finance and Capital Markets Tax Conference

Cryptocurrency

January 29, 2019

Moderator

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Speakers

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Jonathan Cooklin

Davis Polk & Wardwell, London, UK



Jonathan Cooklin is a UK tax partner in Davis Polk's Tax Department, practising in the London office. He joined Davis Polk in 2012, having been a tax partner at Freshfields Bruckhaus Deringer for many years. He concentrates on corporate tax and corporate tax planning, including tax aspects of corporate finance and private equity work, public and private mergers and acquisitions, demergers, joint ventures, reconstructions, equity and debt capital markets transactions, and cross-border transactions. He also has considerable experience of advising insurance groups and on restructuring of distressed groups. He is a dual-qualified lawyer and chartered accountant.



Nils Harbeke

Pestalozzi, Zurich, Switzerland



Nils Harbeke is head of Pestalozzi's Tax Practice Group. Nils Harbeke has a particular strength in cross-border tax work and tax work for international clients, both inbound and outbound. Prior to becoming a partner with Pestalozzi, Nils Harbeke led a team of tax advisors at PwC.

Nils Harbeke has gained special experience and knowledge in tax work for the financial services industry and related to financial products. Nils Harbeke frequently works for leading Swiss and international financial institutions. Nils Harbeke's tax practice covers areas like cross-border private banking, bonds, commodities, collective investment funds, syndicated loans & structured finance, investment vehicles for institutional investors, insurance linked products, real estate.



Raquel Novais

Machado Meyer Sendacz e Opice Advogados, São Paulo, Brazil



Raquel Novais is a tax partner at Machado Meyer Sendacz e Opice Advogados in São Paulo, Brazil.

She has a large experience in both domestic and international taxation, as well as tax controversy.

Raquel's consultancy practice involves assisting clients in domestic and cross-border taxation, as well as structuring deals and projects, including development and financing. Raquel is a leading lawyer in transfer pricing.

Raquel's practice is also devoted to high complexity technical tax conflicts settlement. Her practice also includes the taxation of regulated industries, such as natural resources and energy.



Rebeca Rodriguez

Cuatrecasas, Madrid, Spain



Ms. Rodríguez advises on all kinds of restructuring transactions, financing, issues, and financial agreements and transactions.

She has provided advice on securitization (Spanish and Pan-European transactions) and has participated in many debt instrument issues (bonds, notes, subordinate debt) and derivative transactions. In recent years she has been involved in many corporate and high-yield bond issues. She has extensive experience in advising on tax, both through syndicated and bilateral loans (financing businesses, projects, leasing, and leveraged and structured acquisitions). Recently, she has advised on acquiring bad debt and non-performing guaranteed loans (NPLs), in participations, corporate loan portfolios, and guaranteed debt restructuring transactions. She also specializes in insurance company taxation, and in social welfare, providing both institutional and product-related advice. In recent years she has participated in several merger and acquisition transactions of Spanish and international insurance companies.



Lisa Zarlenga

Steptoe & Johnson LLP, Washington, D.C.



Lisa Zarlenga represents public and private companies on a wide range of corporate transactional and tax policy issues. She advises clients on structuring tax-free and taxable acquisitions and dispositions, tax-free spin-offs, and internal restructurings, including the special rules governing consolidated groups. Lisa also advises clients on tax policy issues before the Treasury Department and Internal Revenue Service involving regulations and other administrative guidance, and before Congress involving legislation.

Lisa also advises clients on tax issues relating to blockchain and digital currency, including conducting digital currency transactions and conversions, token offerings, and different investment and entity structures.

Lisa previously served as Tax Legislative Counsel at the US Treasury Department's Office of Tax Policy.



Agenda

- Blockchain and Cryptocurrency Primer
- Tax Treatment of Cryptocurrency
- Tax Treatment of Forks and Airdrops
- Tax Treatment Initial Coin/Token Offerings
- State of the Tax Law Governing Cryptoassets

What is Blockchain?



Key Characteristics of Blockchain Technology

A **peer-to-peer network** of “nodes” for conducting transactions without an intermediary



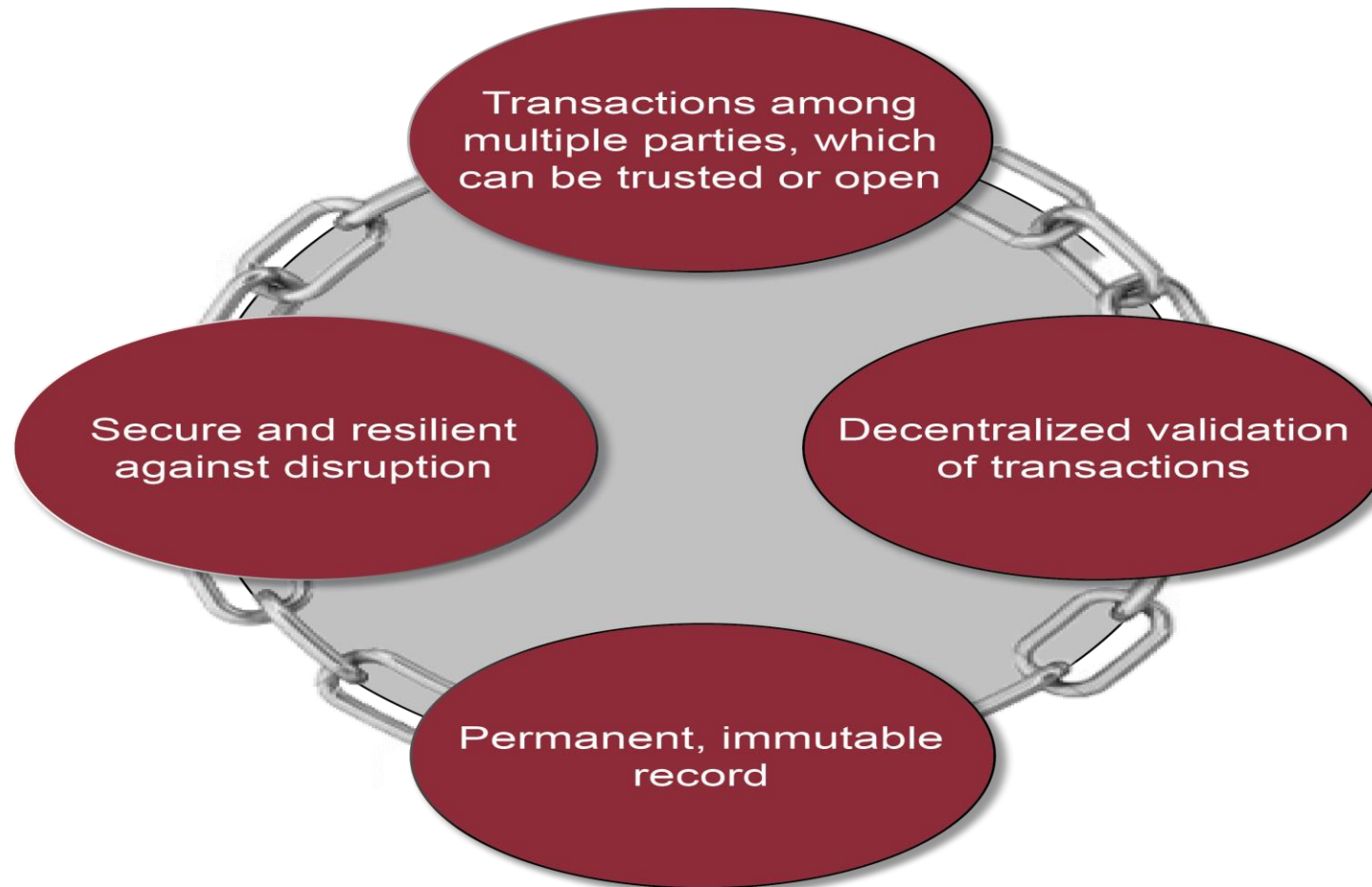
A **data store or append-only database** for recording those transactions



A **consensus mechanism** for **validating transactions** and preventing fraudulent or false transactions.



Key Characteristics of Blockchain Technology



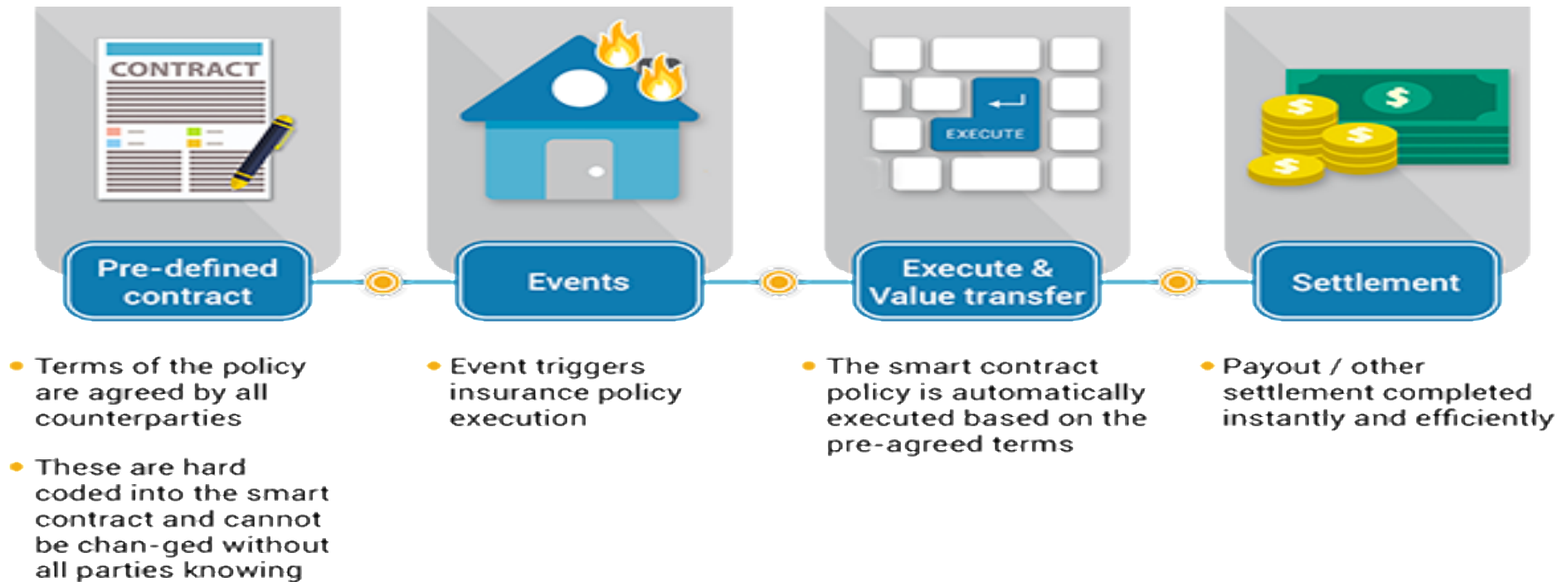
What is a Private or Permissioned Blockchain?

- Public (Permissionless) blockchains: access to read blockchain information, transact, and participate in the consensus process is open to anyone in the world
 - E.g., Bitcoin, Ethereum
- Private (Permissioned) blockchains: access to read blockchain information, transact, and participate in the consensus process is controlled or limited
 - Can set permissions for specific users, a whole company, or even a consortium
 - Useful for database management and auditing where public readability is not necessary
 - E.g., Hyperledger, Ripple

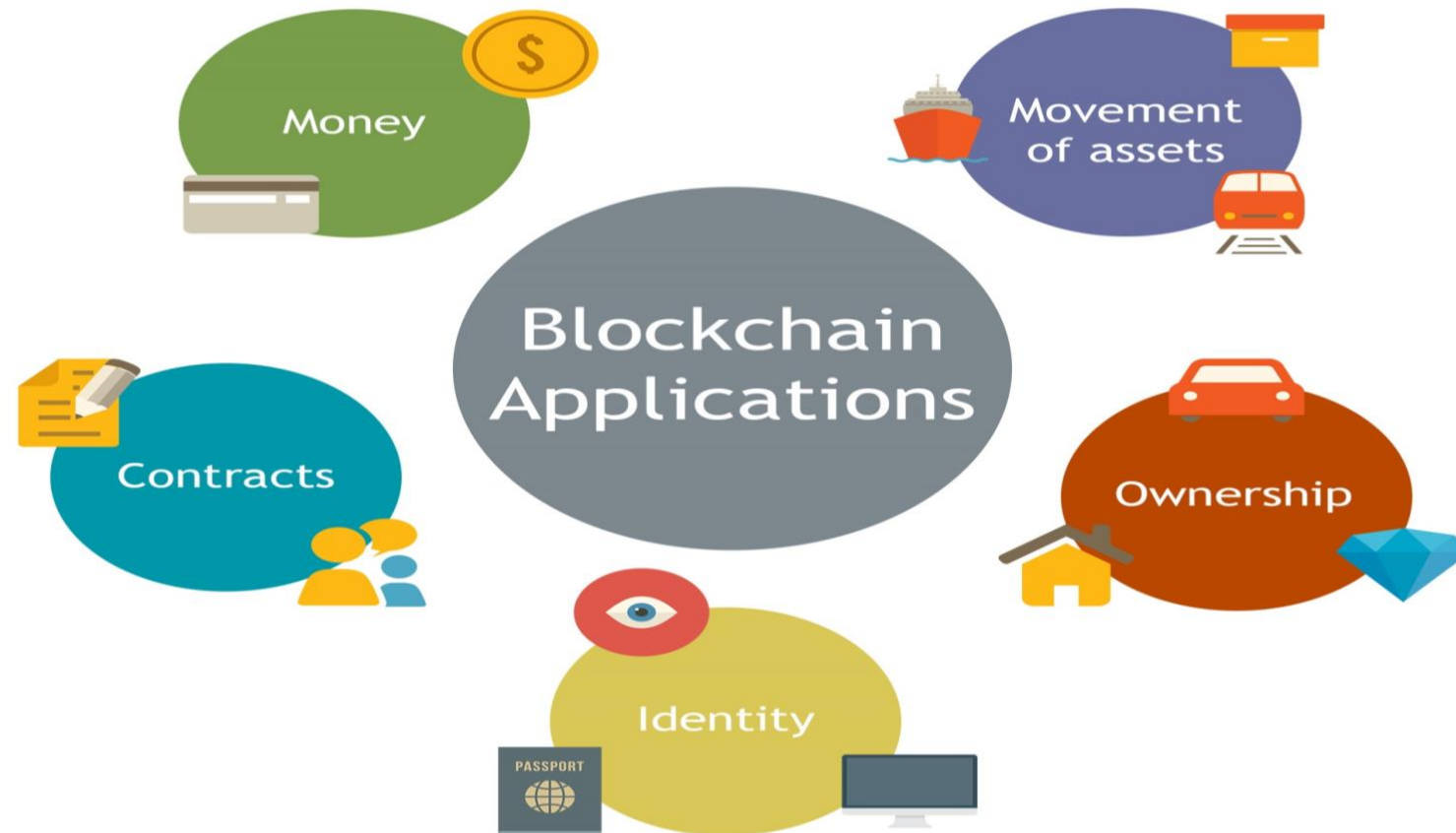


What is a Smart Contract?

- Most efficient for simple “if-then” statements (e.g., automatic payments, life insurance, smart meters)



Blockchain Applications



Enterprise Applications

- Supply/Inventory Management
 - Reduce fraud and tampering
 - Identification of source
 - Enhances auditability
 - Customs compliance and information reporting
- Financial Services
 - Payment processing
 - Trade settlement and clearing
 - Smart contracts for leasing
- Energy
 - Trading excess capacity
- Insurance
 - Smart insurance policies

What is Cryptocurrency?



What is Cryptocurrency?

A type of digital or virtual currency that uses cryptography for security

Hundreds of Cryptocurrencies

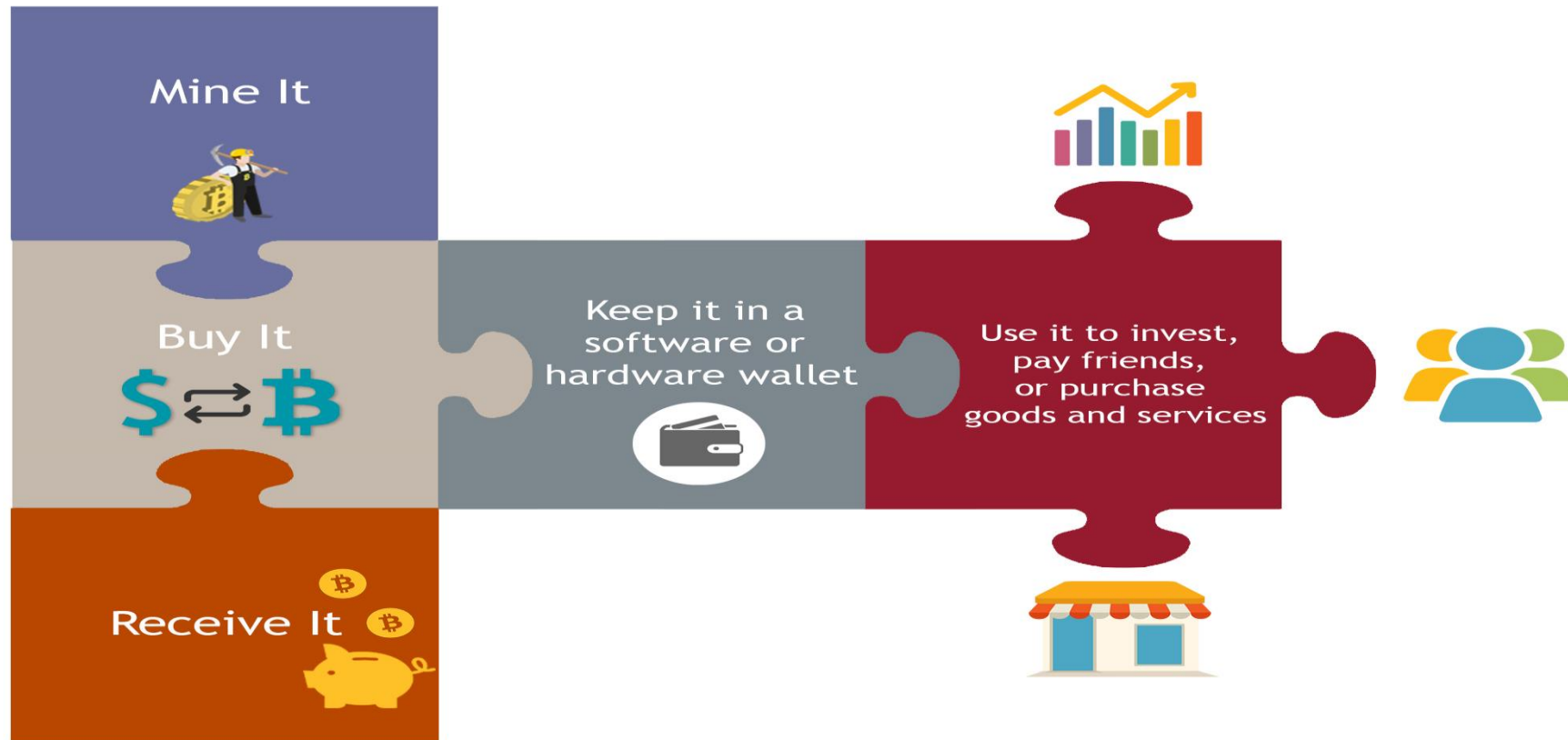


What is Bitcoin?

- Bitcoin is a **form of digital currency**, created and held electronically
- White Paper, “Bitcoin: A Peer-to-Peer Electronic Cash System,” by Satoshi Nakamoto laid out the **principles of bitcoin**, including its underlying technology, the blockchain
 - Meant to **solve problems associated with the digital transfer of value**, including the double-spend problem and the Byzantine Generals computing problem
 - As such, bitcoin is the **first blockchain application**
- It is **decentralized** - no one central authority (e.g., a bank) or governance body (e.g., a foundation or board of directors) controls it



How Do You Get and Use Bitcoin?



Proof-of-Work vs. Proof-of-Stake

- Prominent, early cryptocurrencies, such as Bitcoin, are based on proof of work
 - Transactions are verified by “miners” who compete to complete a resource-intensive computer calculation to verify cryptocurrency transactions
 - Miners are rewarded with new cryptocurrency to incentivize verification of transactions
- Proof of stake is a different way to validate transactions
 - All cryptocurrency is “minted” prior to the launch of the currency
 - Instead of having separate miners, holders of proof-of-stake cryptocurrencies can voluntarily “stake” (i.e., deposit) their currency by joining a validation pool that verifies transactions
 - If a member of the validation pool is found to have violated the rules (e.g., incorrectly verifying a transaction), their stake is confiscated
 - Currency holders receive transaction fees (a percentage of each transaction) in exchange for staking their cryptocurrency



Tax Treatment of Cryptocurrency



Cryptocurrencies Tax Treatment – Key Drivers:

- Legal nature of the cryptocurrency holder
- Legal nature of the cryptocurrency under each legislation
- Use possibilities

Legal Nature of the Cryptocurrency Holder

- Legal entities (corporations, companies, unincorporated joint ventures, etc.)
- Individuals
- Investment Funds

Legal Nature of the Cryptocurrency Under Each Legislation

Financial investment?

Intangible asset?

Civil asset?

Commodity?

Simple Property?

Security?

Digital money?

Legal currency?

Virtual currency?

Use possibilities

- Conversion into traditional currencies and vice-versa
- Acquisition of goods and services
- Investment
- Loan
- Purchase of other cryptocurrencies

Conversion into Traditional Currencies and Vice-Versa

- Is this conversion or sale?
 - Distinct tax consequences – exemption / capital gains
- How to establish the pricing of the cryptocurrency?
- How to deal with high volatility?

Acquisition of goods and services

- Is it qualified as currency, asset, or barter?
- Tax considerations - Criteria to assess gains or losses?
 - Accounting cost of the cryptocurrency?
 - Market value? Use of a price index?
 - How to deal with volatility?
- Deductibility of losses?

Investment

- Taxation on the variations of the cryptocurrencies' market value without realization?
- Does the criteria change for corporations / individuals?
 - Is it obliged to reassess the value of the cryptocurrency (mark to market)?

Loan

- Loan or taxable exchange of property?
- Treatment of interest payments?

Acquisition of Other Cryptocurrencies

- Is this conversion, sale, or barter?
- How to establish the pricing/quotation of both cryptocurrencies?
- How to deal with high volatility?

Tax Treatment of Forks and Airdrops



Cryptocurrency Forks

- **Cryptocurrency Fork:** Open-source code modification
 - **Hard Fork** – Change to a protocol that renders older versions invalid. Second branch of a cryptocurrency using the same basic code (e.g., Bitcoin Cash/Ethereum Classic). It is a new asset with similar (but not equal) characteristics as the original
 - **Soft Fork** – Can still work with older versions, similar to a software upgrade (e.g., introduction of the block size limit)



Cryptocurrency Airdrops

- **Airdrops:** Delivery of a cryptocurrency to a certain group of investors either for free (as a promotional activity) or in exchange for performing small tasks
 - Airdrops do not create two iterations of the same cryptocurrency



Tax Implications of Forks and Airdrops

- **Cryptocurrency Fork:**

- ✓ Income subject to taxation?
- ✓ Tax acquisition value of the assets? Application of FIFO rules, if any?
- ✓ Is there any difference on the hard fork vs the soft fork?

- **Airdrops:**

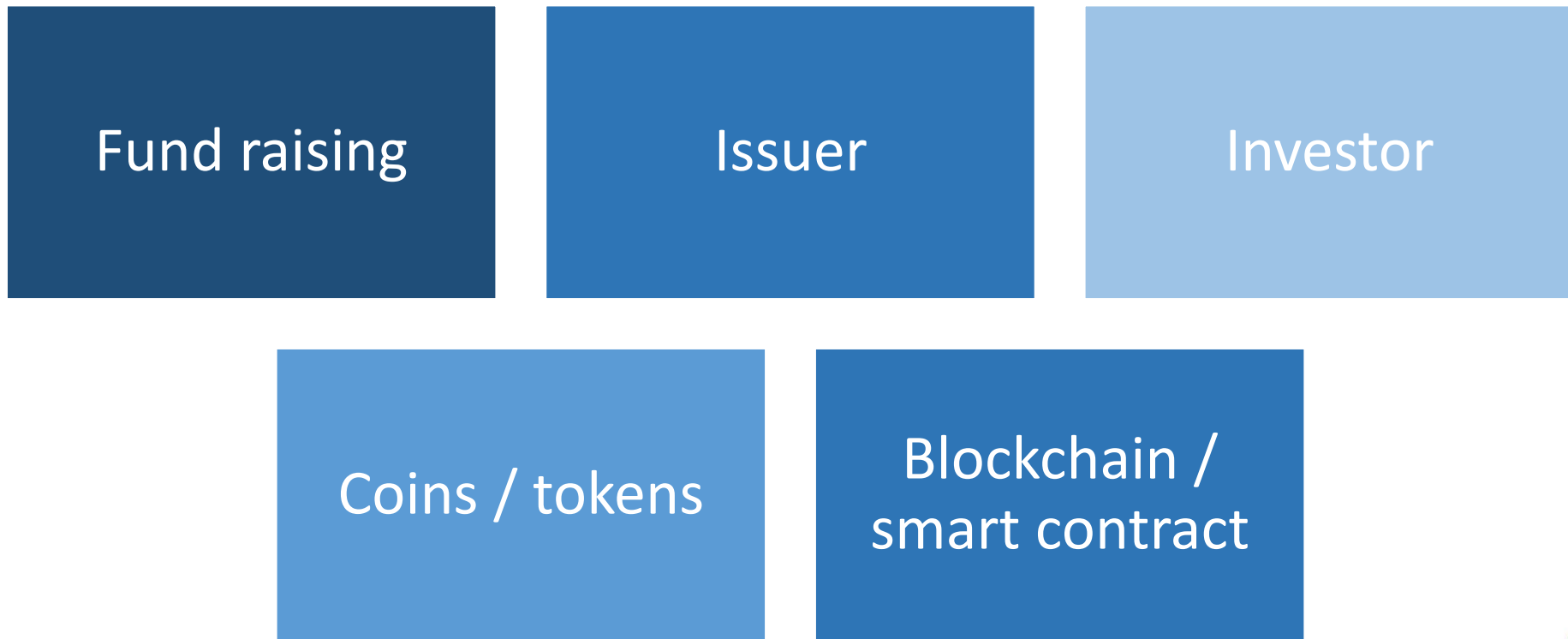
- ✓ Income subject to taxation?

Tax Treatment of Initial Coin/Token Offerings (ICO/ITO)



ICO (ITO) – Fact Pattern

- Is there a definition of «ICO» in your jurisdiction?



ICO – Characterization of Coins

- Does tax treatment depend on characterization of coins / tokens?



Taxes

- Income / capital gains
- Deductible cost
- Transfer taxes / VAT
- Withholding taxes

Taxpayers

- Issuer
 - Investor
- Corporate
Individuals

ICO – Timeline of Coin Issue

- Does tax treatment depend on the timeline of coin issue?



«Presale»

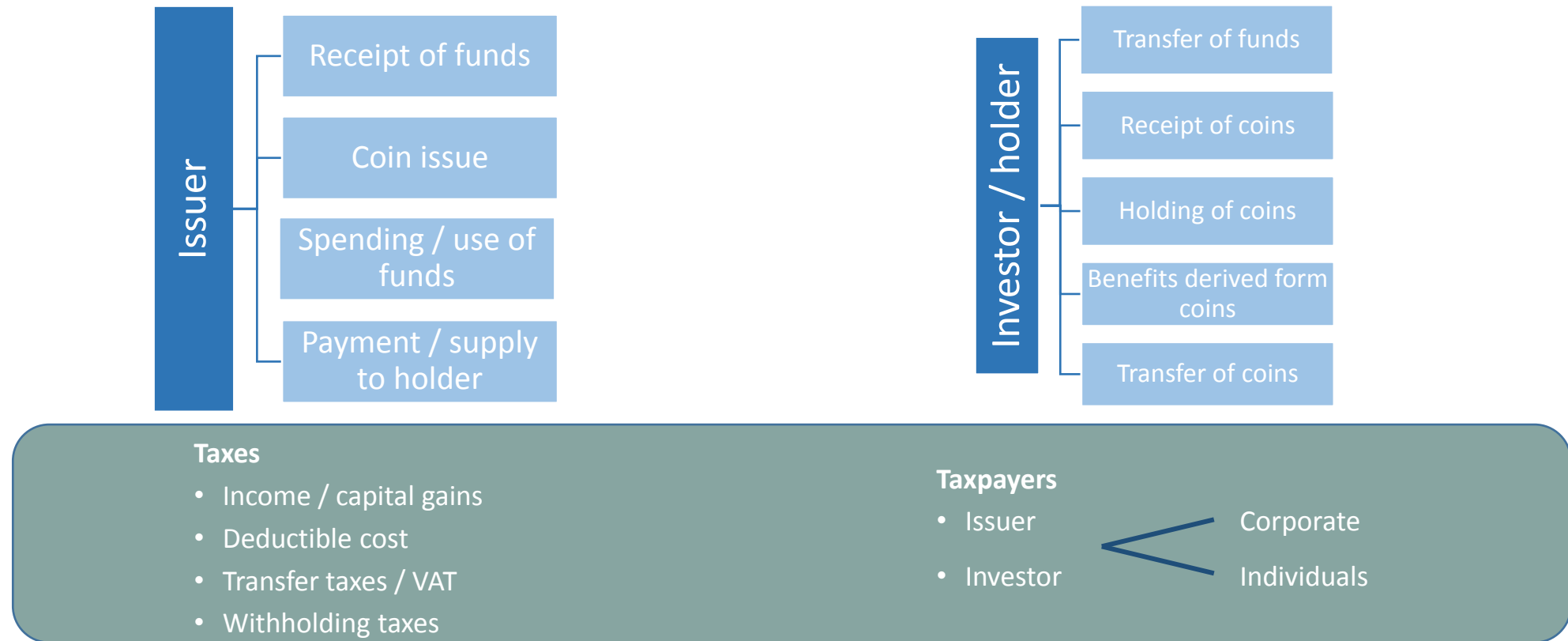
Simple Agreement for Future Tokens (SAFT)

Issue of coins which may be exchanged against

«final» / other coins at a later time

ICO – Taxable Events






- Which are the tax issues associated with ICOs in your jurisdiction?



State of the Tax Law Governing Cryptoassets



Cryptoassets: Where are the Tax Rules?

					
Specific Legislation	X	X (Draft anti-avoidance legislation)	X	X	Introduced but not enacted
Domestic Tax Case Law	X	✓ (tax rulings)	✓ (advance tax rulings)	X	X
European Tax Case Law	n/a	✓ (VAT)	n/a	✓ (VAT)	n/a
Tax Authority Guidance	✓ (Individuals)	✓	✓ (statements at IFA congress; draft VAT guidelines;)	✓	✓
Enforcement Activities	Plans to introduce	✓	✓ (tax authorities aware and asking questions)	✓ (tax authorities aware and asking questions)	✓ (concerted effort by tax authorities to find noncompliance)

Cryptoassets: Where are the Brazil Tax Rules?



- No specific legislation on the matter
- Brazilian Revenue Service (RFB) guidance
 - Individual Income Tax - “Can be equated to a financial asset” – no specific legal qualification Shall be disclosed as “other assets” - by its acquisition value in Brazilian currency.
 - Attracts capital gains tax treatment (15%-22.5%)
 - Intention to introduce mandatory disclosure of every “purchase/sale” transaction
 - Applicable to Brazilian resident (individuals/legal entities) that negotiate cryptoassets and Brazilian exchanges
 - Cryptoasset: representation of value not issued by Brazilian Central Bank. No formal quotation as formal currencies
 - Public consultation procedure in 2018 – No rule yet

Cryptoassets: Where are the Brazil Tax Rules?



- Brazilian Securities Commission (CVM) manifestations
 - Utility tokens are not qualified as securities
 - The qualification as securities depends on the features of the cryptoasset (*i.e.*, if it is publicly offered and generates a participation, partnership or remuneration right)
 - Risk warning – fraud, low liquidity/volatility, non-regulation/cross-border, cybernetic, etc.
 - Investment funds cannot invest directly in cryptocurrencies, but they can invest via foreign funds that invest in cryptocurrencies and derivatives
 - Concerns in connection with pricing – no consensus regarding the appropriate method to assess the fair value of cryptoassets

Cryptoassets: Where are the Brazil Tax Rules?



- Central Bank of Brazil (BACEN) manifestations
 - Cryptocurrencies should not qualify as electronic currencies – not backed by a Central Bank
 - Transactions with cryptoassets that imply international transfers based on foreign currencies must obey the applicable foreign exchange regulations
 - How to apply foreign exchange controls?
- Current (lack of) legal framework – qualification as an intangible asset:
 - No physical existence
 - Property rights recognized
 - Economic value
 - Transference by means of an agreement between the parties

Cryptoassets: Where are the Spain Tax Rules?



- Tax rulings
 - Personal Income Tax
 - Net Wealth Tax
 - Local Tax on business activities
 - VAT
- Draft of anti-avoidance legislation
- Regulatory
 - Guidance CNMV and Bank of Spain

Cryptoassets: Where are the Swiss Tax Rules?



- Advance tax rulings
 - In particular: Swiss tax authorities have confirmed VAT and income tax treatment of ICOs/ITOs on a case-by-case basis in advance tax ruling confirmations (not public)
- VAT
 - Draft administrative guidelines on VAT implications of cryptocurrency and ICOs (e.g., use/payment, mining, assessment base, invoicing)
- Regulatory
 - Swiss financial markets supervisory authority (FINMA) has issued guidance on regulatory framework for ICOs. Characterization of coins/tokens in this regulatory guidance is also used by tax authorities (functionality: payment vs. utility vs. asset)

Cryptoassets: Where are the UK Tax Rules?



- HMRC Manuals
 - Very limited guidance
 - Relates only to bitcoin and similar cryptocurrencies
- HMRC VAT Manual
 - VATFIN 2330
 - *Hedquist* (c-264/14)
 - *First National Bank of Chicago* (c-172/96)
- HMRC Capital Gains Manual
 - CG 12100
 - Nature of transaction: gambling/investment/trading/barter
 - “Pooling” rules
 - Forks

Cryptoassets: Where are the UK Tax Rules?



- Revenue & Customs Brief 9/2014
 - Largely superseded
- HMRC Policy Paper (19 December 2018)
 - Cryptoassets for individuals
- HMRC “Task Based” Guidance (19 December 2018)
 - Check if you need to pay tax when you receive cryptoassets
 - Check if you need to pay tax when you sell cryptoassets
 - Paying employees in shares, commodities or other non-cash pay (updated)
- HMRC Guidance on tax treatment of cryptoasset transactions involving businesses and companies expected in (early?) 2019

Cryptoassets: Where are the US Tax Rules?



- IRS Guidance - Notice 2014-21
 - “Convertible virtual currency” (e.g., bitcoin) is treated as property for tax purposes, not as foreign currency subject to foreign currency gain/loss rules
- Introduced Legislation
 - H.R. 7361 would exclude gain on exchanges of like-kind virtual currency (Dec. 20, 2018)
 - H.R. 6973 would provide relief from penalties for hard forks in absence of guidance (Sept. 28, 2018)
 - H.R. 3708 would exclude up to \$600 gain on exchanges of virtual currency (Sept. 7, 2017)
 - H.R. 4602 would treat virtual currency as foreign currency (May 7, 2014)
- Enforcement Activities
 - Summons against Coinbase
 - IRS compliance campaign regarding reporting of virtual currency transactions





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