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Perspectives on the Integration of Cryptocurrencies into National Tax Legislation

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ABSTRACT: The treatment of virtual currencies when it comes to income tax differs as much as the definitions of virtual currencies from country to country. It depends on this definition whether the existing laws corresponding to income tax can also include virtual currencies. Most commonly, virtual currencies fall under a certain category of income and thus are taxed accordingly. Many states have also published clarifying documents on how virtual currencies fit for tax purposes and how the existing legislative framework applies to them. Very few states consider cryptocurrencies as another type of currency, complementary to the usual one, whether we are talking about domestic or foreign markets, thus including them for tax purposes.

KEY WORDS: Tax system, Cryptocurrencies, legislation, regulation

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Introduction

At this point, one can distinguish a general lack of coherence in how virtual currencies are handled. An attempt was made to associate it with the conventional currencies, but technological peculiarities that favor increased anonymity, as well as the lack of intermediaries, have made regulating and standardizing the treatment of this financial instrument a real challenge for the authorities in almost all states (Saidov 2018). Only a few countries

place virtual coins in the same tax regime as the conventional currencies (Belgium, Poland and Italy). In many other countries, we are talking about a lot of uncertainty about how virtual coins are defined, resulting in different interpretations of their tax regime. Cryptocurrencies are usually considered a form of intangible property or a financial asset rather than a currency. Therefore, they are subject to property taxes and not income taxes. Currency regulations often contain provisions to minimize the tax consequences of taxation for individuals or minor traders, for example by capping transactions in individual accounts. On the other hand, income from transactions in property assets is taxed in various forms such as capital gains, profit from business, individuals or traders.

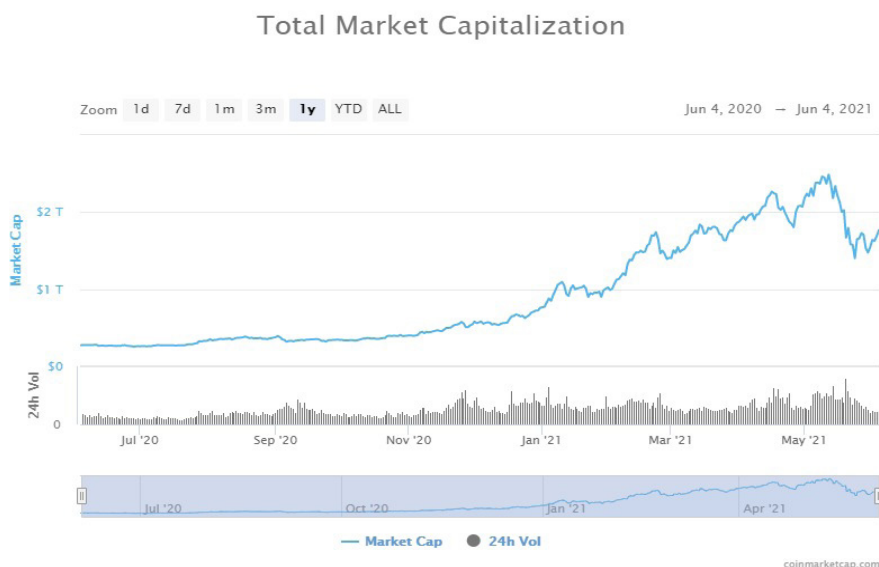

Figure 1. Virtual currencies market evolution (1 year) –
from 240 million $ to 2.4 trillion $
Source: https://coinmarketcap.com/charts (Last accessed 01.06.2021)

Research methodology

The problems analyzed in this research are both pressing and topical, therefore the international experts and academics are making important efforts to keep up the research closely connected to the dynamics of virtual currencies

related technologies. For this paper I have used the deductive method, while corroborating public data and information provided by European institutions, US government, think-thanks, official reports and reputable research centers. At the same time, the research represents a qualitative (synoptic) analysis concerning the lack of regulatory framework and how it impacts the national fiscal systems. The research also aims to highlight the degree to which inappropriate and anachronistic political decisions, have significantly contributed to the chaotic proliferation of virtual currencies with vast implications going as far as enhancing money laundering. Assessing the current regulatory framework, we can determine if the international actors or institutions have efficient levers at their disposal to solve the problem.

Taxation of cryptocurrencies in different stages

In the same time, we need to look at the prospect of charging virtual currencies in two different stages of their lives: the creation of a token through an ICO (Initial Coin Offering) in the block chain and the transfer of this token (Jiang, S.; Li, X.; Wang, S. 2020).

The first possibility of taxation appears at the time of its creation. Coins are created through a mining process, an airdrop marketing strategy or a new token (Zainuddin 2017). So far, the attention of the tax authorities has focused mainly on the currencies taxation in the mining process. First of all, we need to differentiate between new cryptocurrencies resulting from the mining process and the contributions received by miners to complete virtual transactions. Coins received from airdrop campaigns are of very low value, so the focus is not on them. Many states, moreover, do not turn their attention to taxation even when creating cryptocurrency via the mining process, although this is undoubtedly an event that determines this possibility (Natarajan, Krause and Gradstein 2017). The situation is not the same in the case of the transfer of the currency further on the chain, this being considered a "taxable event".

So, we are talking about a large number of states (Andorra, Argentina, Austria, Croatia, Estonia, Finland, Japan, Luxembourg, New Zealand, Norway, Slovenia, South Africa, the United States and the United Kingdom) that indicates the time of registration of new mined tokens as a possible

charge. If the time of receipt of the token is recorded on an invoice / fiscal receipt type document, the unit value of the virtual currency received is included in income tax / capital tax / other taxes and fees, and income tax is applied according to its income category, whether we are talking about tax for individuals or legal entities. The costs associated with this type of income are deductible.

There are other states considering that taxation must take place at the time of the transfer, either at the first exchange between the miners, or at the transfer of the final currency. Thus, the total value of the virtual currency at the date of disposal is included in taxable income (Rohr, J. and Wright, A. 2018). In most cases it is lower than the acquisition costs. These deductions generally involve the costs of the calculation technique in the mining process (Australia, Austria, Estonia), and sometimes the deductibility of these costs is unclear (as in Poland).

The time of the transfer of the token or currency is commonly treated as income from capital gains, and the taxation related to the regulations on capital gains applies. The tax treatment of capital gains in many countries involves tax rate reductions, partial exemptions or situations in which they are included in ordinary income, in which case a progressive tax rate applies. At the same time, there are states that apply exemptions to capital gains depending on the profitability of the holding period. In the field of virtual currencies, this would mean that mining revenues remain tax-free (Peláez-Repiso, Sánchez-Núñez and Calvente 2020).

Countries that consider that taxation should take place at the time of the transfer include Croatia, the Czech Republic, Denmark, Estonia, France, Latvia, Poland, Singapore or Slovakia. Last but not least, the states in which the taxable event is that of receiving a new virtual currency unit differ from case to case depending on the approach of the mining process. We are talking here about Australia, Canada, Germany, the Netherlands, Singapore, Sweden or Switzerland.

Short and medium perspectives on virtual currencies regulation

In the future, environmental policies will also play an important role in defining the fiscal policies of virtual currencies, since the basic calculation mechanisms can have important environmental consequences, especially in

areas where electricity comes from fossil fuels. Pollution costs are not reflected in the price of cryptocurrencies, therefore a tax treatment of electricity costs associated with the mining process would be applied in accordance with the tax treatment associated with virtual currencies.

Looking ahead, there are some areas that will develop rapidly and need to be considered. These areas will most likely need separate and constantly updated methodologies. A case in point is the treatment applied to new goods resulting from a cryptocurrency split, known as "fork". Very few countries apply specific legislation in this case, and a question that needs to be addressed is whether the taxpayer receiving the property should comply with tax laws. One approach could be to tax these assets when the taxpayer takes possession of the property or on first disposal, relative to a zero basis (Valente 2019). If the taxable event occurs upon receipt of a new token, lawmakers must consider how the taxpayer addresses liquidity issues, inability to access the asset, or how losses are treated if the value of the new asset decreases upon receipt.

Stable currencies and virtual currencies issued by central banks are the new forms of virtual currencies, with unique features that must also be adapted to specific crypto legislation. If the application of the virtual currency methodology for this type of new cryptocurrencies can create problems, specific methodologies can be developed. For example, their treatment as a fiat currency may be considered in the case of cryptocurrencies issued by central banks or securities in the case of stable currencies for tax purposes.

Another important aspect that will become more important in the future is the new types of tokens and their new features. The rapid evolution of tokens makes it very difficult for states to develop methodologies for tax treatment effectively implemented in the market, such as those generated by "proof of stake" protocols, or the use of virtual currencies as interest-bearing goods. Implementation in such ways is closer to application in the spirit of developing a new token. Although similar to the use of virtual currencies in kind, new token assets have rather specific characteristics than traditional financial or capital assets that generate profitability and are less similar to assets that depreciate over time. Thus, the question arises whether tax treatment similar to capital income should be applied rather than capital gains.

Conclusions

Virtual currencies are a rapidly evolving and challenging form of crypto assets for tax legislation. The challenges derive in particular from the nature of virtual currencies and their hybrid characteristics, their definition in the category of assets, lack of centralized control, cvasi-anonymity or difficulties in valuation. Other challenges may arise with the rapid evolution of technology, but also of currencies, taking into account recent developments resulting in the growth of stable currencies or virtual currencies issued by central banks (Witzig and Salomon 2018).

First, legislators need to ensure that they provide a very clear legislative framework and implementing rules to complement it. This legislative framework must start from the integration of cryptocurrencies in the current fiscal regime. Even if this happens in a tangential manner, under existing legislation on the taxation of goods or capital gains, implementing rules or implementing guidelines for their implementation would promote more clarity and certainty for taxpayers.

If existing laws behave unclearly or are not adapted to the special characteristics of virtual currencies, then policy makers may opt for specific legislation. This may consist of amendments to existing legal provisions, but both the legislation and the amendments and completions must be extremely clear and concise.

Another very important starting point can be a legal definition of virtual currencies. There is an urgent need for a comprehensive approach that addresses all taxable events and revenue formats associated with virtual currencies. Then, in terms of tax consequences, there are some key concepts of particular importance that need to be addressed, either under income tax, VAT or other property or transfer taxes, so that there is more clarity for taxpayers. These include the creation of virtual currencies and the costs associated with them; exchange with another virtual currency, fiduciary for goods and services: their transfer as a gift or inheritance; loss or theft; stable currencies, issued by banks, etc.

For a broader purpose, methodological rules may also include how other crypto assets are treated for tax purposes. Because methodologies for crypto assets or currencies are currently minimal in many countries, while

their parallel development could prove truly helpful. We must also take into account the need for their frequent revision and adaptation. In this constantly evolving field, any methodology must be constantly reviewed in order to remain relevant in comparison with technological developments. Other countries' approaches and international trends must also be incorporated.

In making any decision, beyond the inherent debates, decision-makers must clearly and unequivocally explain the rationale behind the tax treatment adopted or adapted to existing legislation. A clear logic behind the decision can make it much more explicit, transparent and flexible in the event of the emergence of new currencies.

Besides framing and updating the legislation, another important aspect is the follow-up on the implementation and compliance with it. The volatility and shifting value of cryptocurrencies can cause problems in ensuring compliance with legal requirements (Kiviat 2016). Other challenges may arise due to different exchange rates for the same virtual currency, the lack of evidence of trust currency translation in some cases and the need to maintain complex cash flow records and transaction data. Tax administrations will face problems in obtaining credible and timely information about these transactions. In this respect, a greater role in following up or stimulating intermediaries to provide information to tax authorities could simplify this process.

Also, in order to facilitate compliance with the legislation, especially in the case of small taxpayers, measures can be considered to reduce the need for valuation, possibly by amending the legislation on pooling assets or by facilitating compliance where trade is no longer treated barters according to VAT rules. Excluding exchanges between different types of virtual currency from income tax could also lead to simplification. Earnings can be taxed when the tokens are converted into fiat money or if they are used to purchase goods and services.

Given the multitude of small crypto traders, i.e., those who do not undertake this activity in a business capacity or enjoy a limited income, special attention should be paid to simplifying the legislation applied to them or occasional transactions. For this group of individuals, tax systems could apply exceptions for personal use, for example, depending on volume, transactions or value earned. Governments could also consider whether a simplified system applicable to small transactions or purchases would be

more effective in avoiding the consequences of taxes on capital gains from each if a transaction is completed.

Another aspect to be taken into account by decision makers is how the fiscal treatment of fiscal currencies is aligned or may undermine the political objectives assumed at national level. For example, governments' policies to stimulate the use of electronic means of payment and the decline in the use of cash could lead to the development of virtual currencies issued by central banks. The COVID-19 crisis also accelerates this process.

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