

THE FUTURE IS BRIGHT, THE FUTURE IS DECENTRALIZED

Fintech, Bitcoins, Blockchains, Decentralized autonomous
organization (DAOs)

TAX ASPECTS OF VIRTUAL CURRENCY AND DAO: IDENTIFICATION OF TAX RISKS UNDER SWISS LAW

Thierry Obrist

Professor of tax law at the University of Neuchâtel

Partner – LEAX Avocats

OVERVIEW

- **Taxation of individuals as investors**
 - Income tax
 - Wealth tax

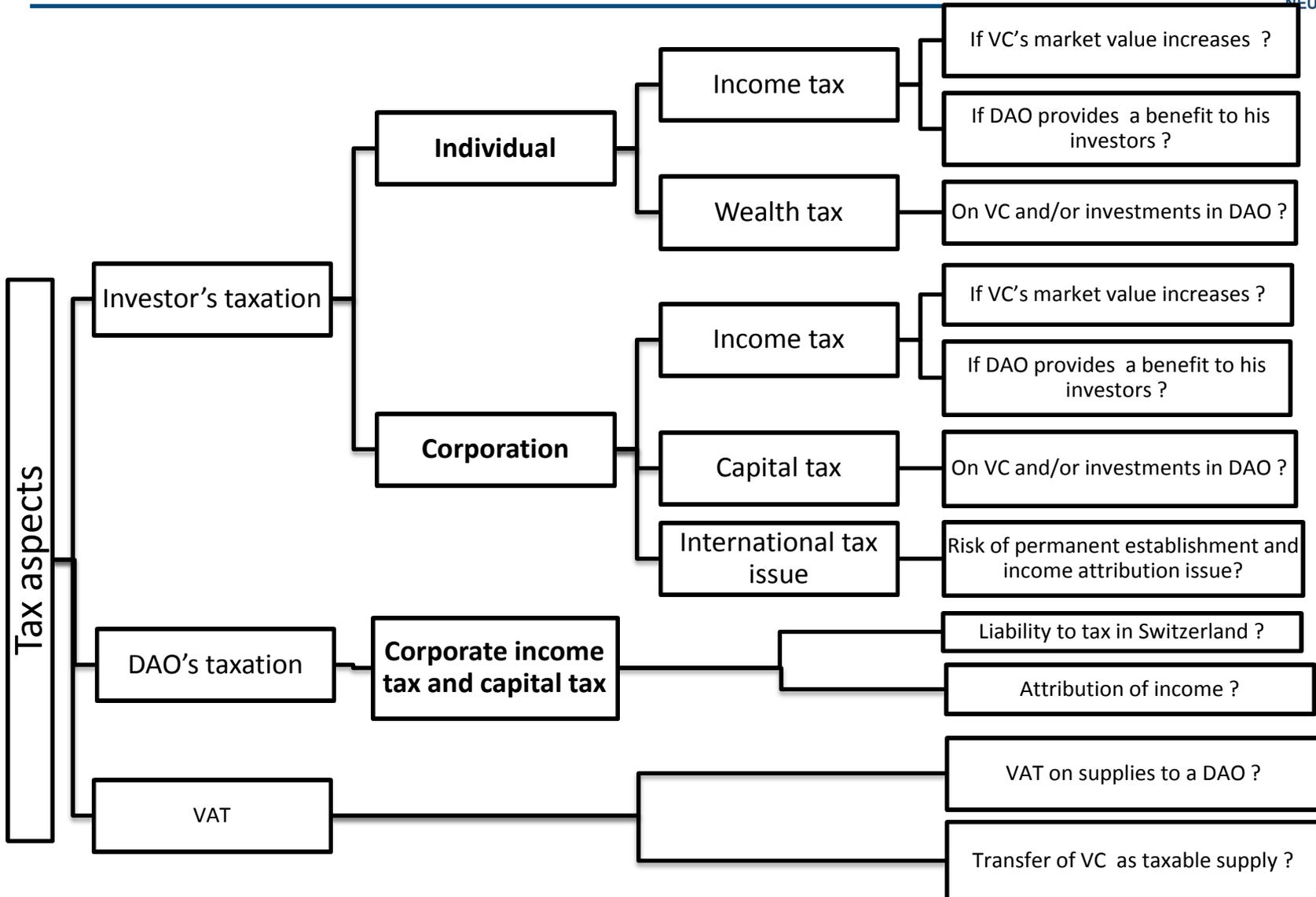
- **Taxation of corporations as investors**
 - Corporate income tax
 - Capital tax

- **Taxation of a DAO**
 - Corporate income tax
 - Capital tax

- **VAT**

- **Conclusion**

OVERVIEW



INTRODUCTION

DAO

- Decentralized autonomous organisations or decentralized autonomous corporation
- A Decentralized Autonomous Organization (DAO) is a computer program, running on a peer to peer network based on blockchain technology, incorporating governance and decision making rules. DAOs can be programmed to operate autonomously, without human involvement, or the code can provide for direct, real time control of the DAO and funds controlled by it.
- Best-known examples: The DAO (based on Ethereum blockchain) and Dash (based on X11)

Virtual currency (VC)

- Virtual currency is a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status in any jurisdiction (i.e., when tendered to a creditor, it is not a valid and legal offer of payment). It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within its community of users.

Taxation of individuals as investors

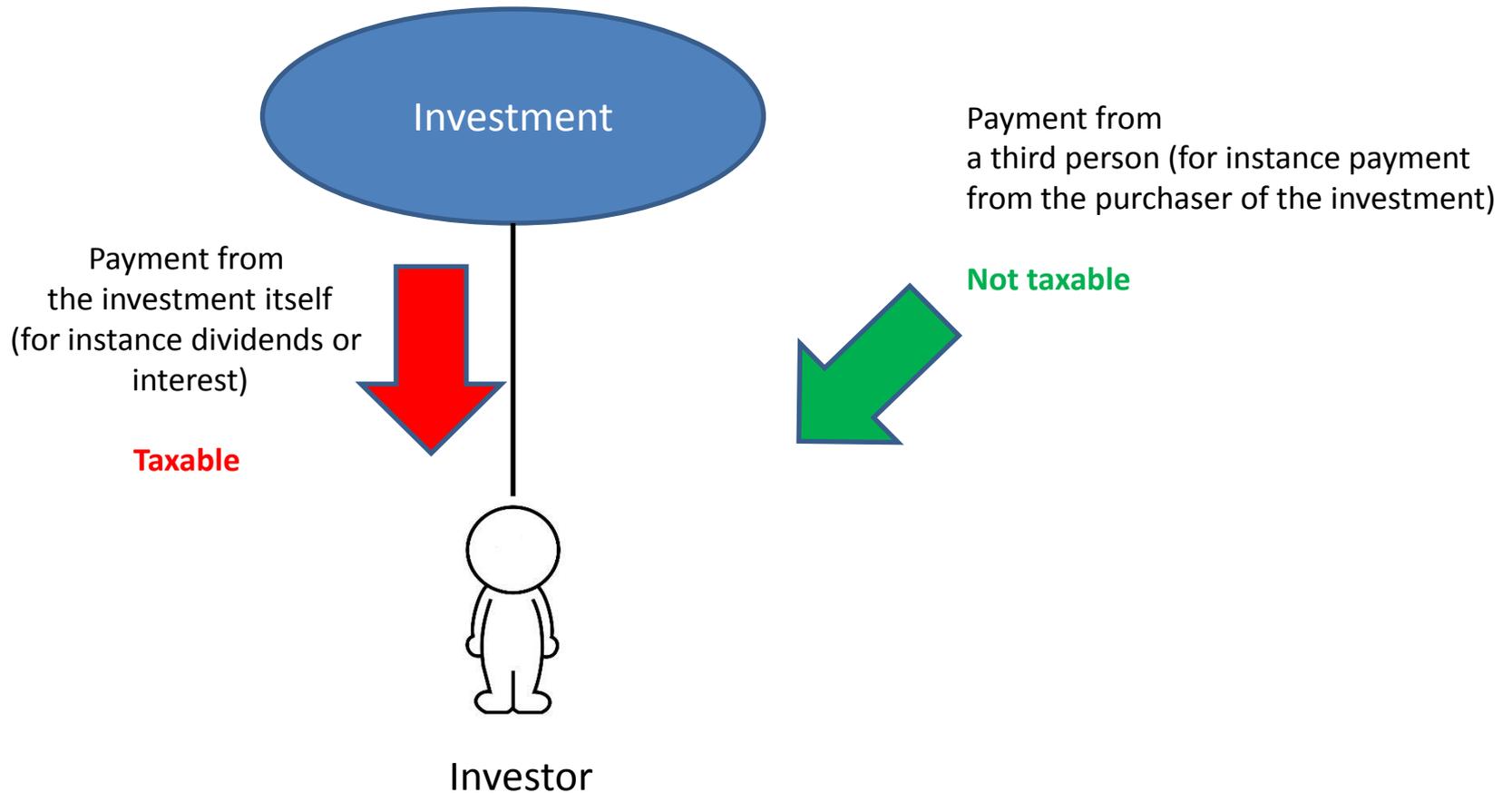
- Every increase of an individual's wealth qualifies as taxable income according to the principle of the net increase («*augmentation de la valeur nette du patrimoine*»)

However a few exceptions exist and such exception must be interpreted restrictively. One of the main exception exists for private capital gain:

↳ Gain realized on private assets are not taxed (art. 16 para. 3 FITA; gain realized on commercial assets are however taxed)

- For Swiss income tax law purposes, two situations must be distinguished :
 - Income from (movable) investments
 - Gain realized on investments
- In order to distinguished taxable distribution from exempted capital gain, the Federal Supreme Court applies (for movable assets) the principle of the origin (“*notion objective de rendement*”, “*principe de provenance subjective*” ; “*Subjektives Herkunftsprinzip*”).

– Principle of origin



– **How to qualify a VC's increases in value?**

- As long as not realised → no tax event
- If bitcoins are sold to a third party, the payment originates from a third person (and not from the investment itself) → exempted capital gain



A careful attention must be paid to the professional securities dealer issue (FTA Circular n° 36/2012)

- **Application of the FTA Circular n°36/2012**

- Application to VC / tokens in DAO ?
 - Application of the FTA Circular to traditional currency ?
 - Is VC a currency ?

- Disqualifying criteria (if cumulatively fulfilled = no security dealer)
 - Assets are held more than 6 months
 - Total yearly transaction volume is less than 5 times the total amount of assets
 - Total capital gain is less than 50% of the taxpayer's net income
 - Assets are not financed through third party
 - Derivative products are used only to hedge risks on assets

- If one criterion is missing : thorough exam of all circumstances

– How to qualify an “benefit” received from a DAO ?

- A. If it comes from a third person (price paid by the purchaser of tokens)
 - not taxable private capital gain (Art. 16 par. 3 FITA)

- B. If it comes from the DAO itself (benefit in kind for instance)
 - taxable but depends on whether the DAO has legal personality:
 - 1) If legal personality (rather unlikely)
 - Taxable participation income (Art. 20 FITA)
 - Partial taxation of the participation income if conditions are fulfilled (Art. 18b FITA (business assets), Art. 20 par. 1bis FITA (private assets))
 - 2) If no legal personality
 - Direct attribution of DAO’s income to the investor (Art. 10 FITA)
 - the DAO’s income keeps its qualification (dividend, capital gain, etc.)

WEALTH TAX

- **Wealth tax**
 - Cantonal tax levied on individuals
 - Fair market value is usually taken into consideration

- **Value for wealth tax purposes**
 - Listed companies are taken into consideration at their exchange price («valeur boursière»)
 - Not listed companies are taken into consideration at the value calculated according to a circular letter of the Swiss Tax Conference (CSI).
 - For VC ? Last exchange price or another observable market price in an active market ?
 - For investments in DAO ? Is there a market value ?

Taxation of corporations as investors

- **Linkage principle (“*principe de l’autorité du bilan commercial pour le droit fiscal*” “*Massgeblichkeitsprinzip*”)**
 - Taxation is levied on the basis of the commercial books (balance sheet and profit and loss account)
 - Taxation only if income is realised according to accounting law
 - No application of the principle of origin
- (Commercial) capital gains are taxed (but some relief exist on qualifying participation)

CORPORATE INCOME TAX

- **How to register VC according to Swiss accounting law**
 - VC is an asset that shall be booked
 - Booked as current asset / fixed asset / financial fixed asset / tangible fixed asset
 - not directly relevant for tax purposes
 - First book value: assets must be valued no higher than their acquisition or manufacturing costs
 - Amortisation and depreciation
 - VC = Assets with observable market prices ?
 - ↳ Stock exchange price or another observable market price in an active market (Art. 960b CO)
 - If yes, in the subsequent evaluation
 - assets may be valued at that price as of the balance sheet date, even if this price exceeds the nominal value or the acquisition value
 - creation of a fluctuation reserves
 - If no, in the subsequent evaluation
 - assets must not be valued higher than their acquisition or manufacturing costs

CORPORATE INCOME TAX

- **Any guidance on the way to register VC under foreign accounting rules ?
(not relevant for Swiss tax law purposes)**
 - Nothing in US GAAP
 - Nothing in IAS/IFRS
 - In determining the accounting for holdings VC with reference to the current IFRS varying views has been expressed.
 - VC = cash and cash equivalents
 - VC = financial instrument
 - VC = nonfinancial asset measured at the lower of cost and net realizable value
 - VC = intangible asset measured at fair value
 - VC = inventory measured at the lower of cost and net realizable value or at fair value less costs to sell.
- in May 2016 the International Accounting Standards Board (IASB) included VC as a potential new project to add to the IASB's agenda.

CORPORATE INCOME TAX

- **Risk of permanent establishment ?**

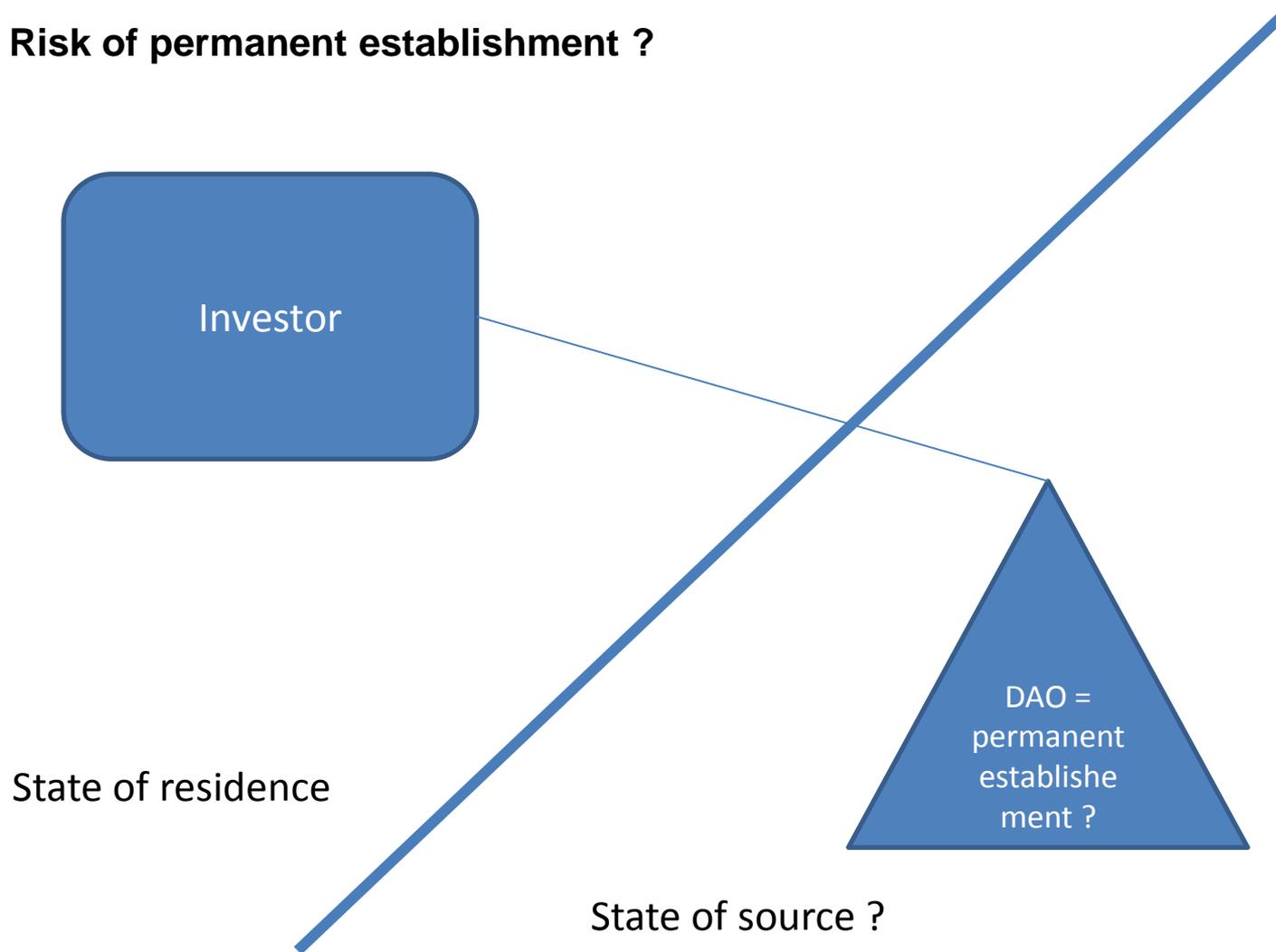
- In international situations (where double tax conventions apply) income realised by a company is taxed only in its State of residence unless the company carries on business in the other state through a permanent establishment (Art. 7 par. 1 MC OECD).

- The term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on (Art. 5 par. 1 MC OECD).

- There must be a
 - “fixed”
 - “place”
 - “at the disposal of the company”
 - “through which business is carried on”

CORPORATE INCOME TAX

- Risk of permanent establishment ?



- **Risk of permanent establishment ?**

- Application of the OECD's practice for server (in OECD Commentary, Update 2003, n. 42.1 ad art. 5), if
 - 1) DAO has a sever at its own disposal (examples: owned, leased or operated)

 - 2) Existence of a fixed place through which business is carried on

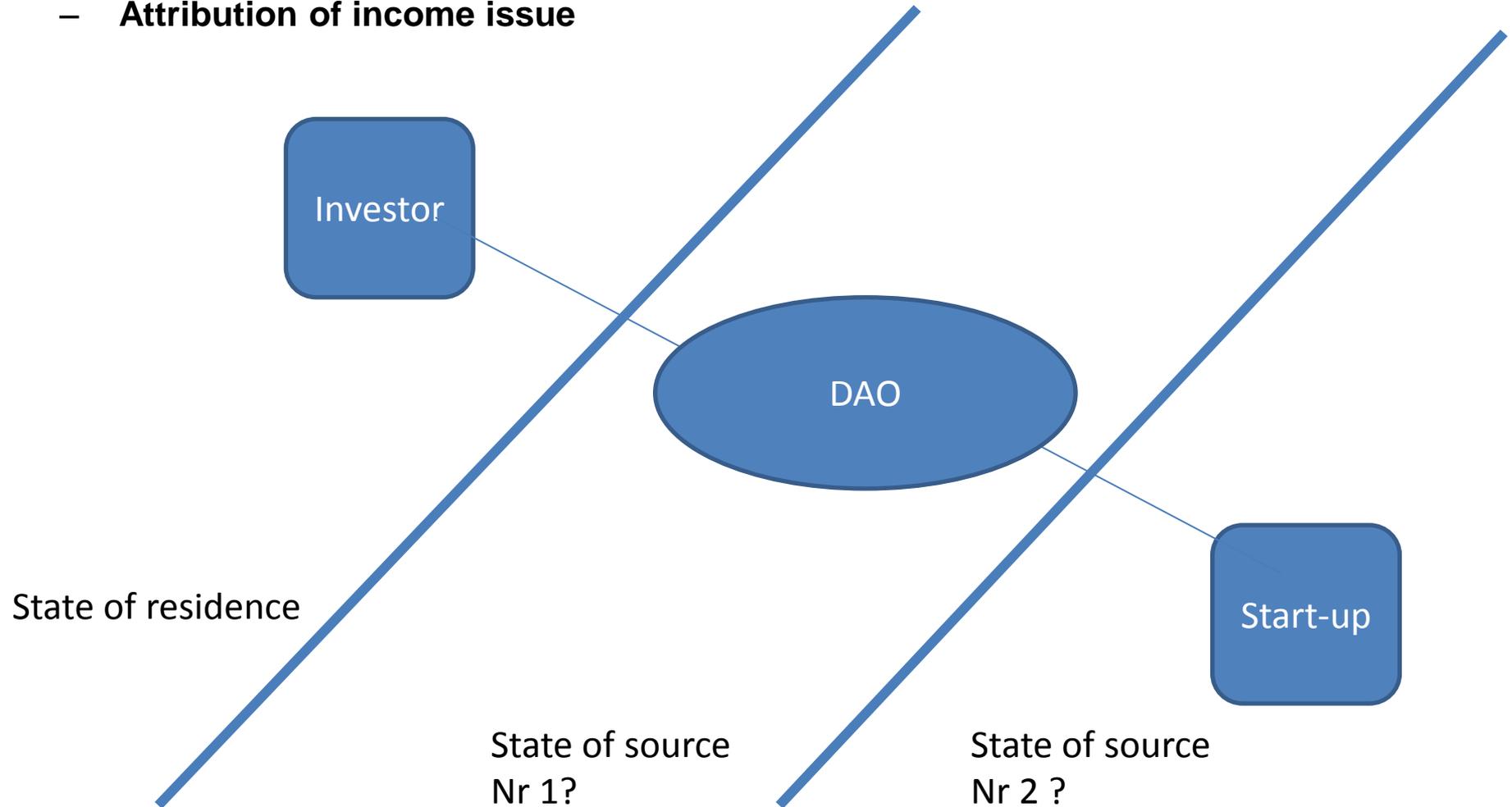
 - 3) Presence of personnel is not necessary

CORPORATE INCOME TAX

- **Attribution of income issue ?**
- In international situations a State of Source may levy a (withholding) tax on dividend, interest and royalties paid by one of its residents
- If a double tax treaty applies between the State of residence and the State of source, the right to levy a (withholding) tax is limited, e.g. for dividend the State of source may not levy more than 5 or 15 % (Art. 10 MC OECD) ; for interests 10 % (Art. 11 MC OECD) ; for royalties 0 % (Art. 12 MC OECD).
- 1st step: Is the DAO a person ?
- 2nd step : Identification of the State of residence and the State of source
- 3rd step : Qualification of the payment (as interest, dividend or royalties, etc.)
- 4st step : Avoidance of double taxation

CORPORATE INCOME TAX

– Attribution of income issue



CAPITAL TAX

- **Capital tax (tax on equity)**
 - Cantonal tax levied on legal persons
 - Based on the equity
- **Value for capital tax purposes**
 - Tax on equity where assets are taken into consideration at their book value

Taxation of the DAO itself

TAXATION OF THE DAO

- **DAO as a person ?**

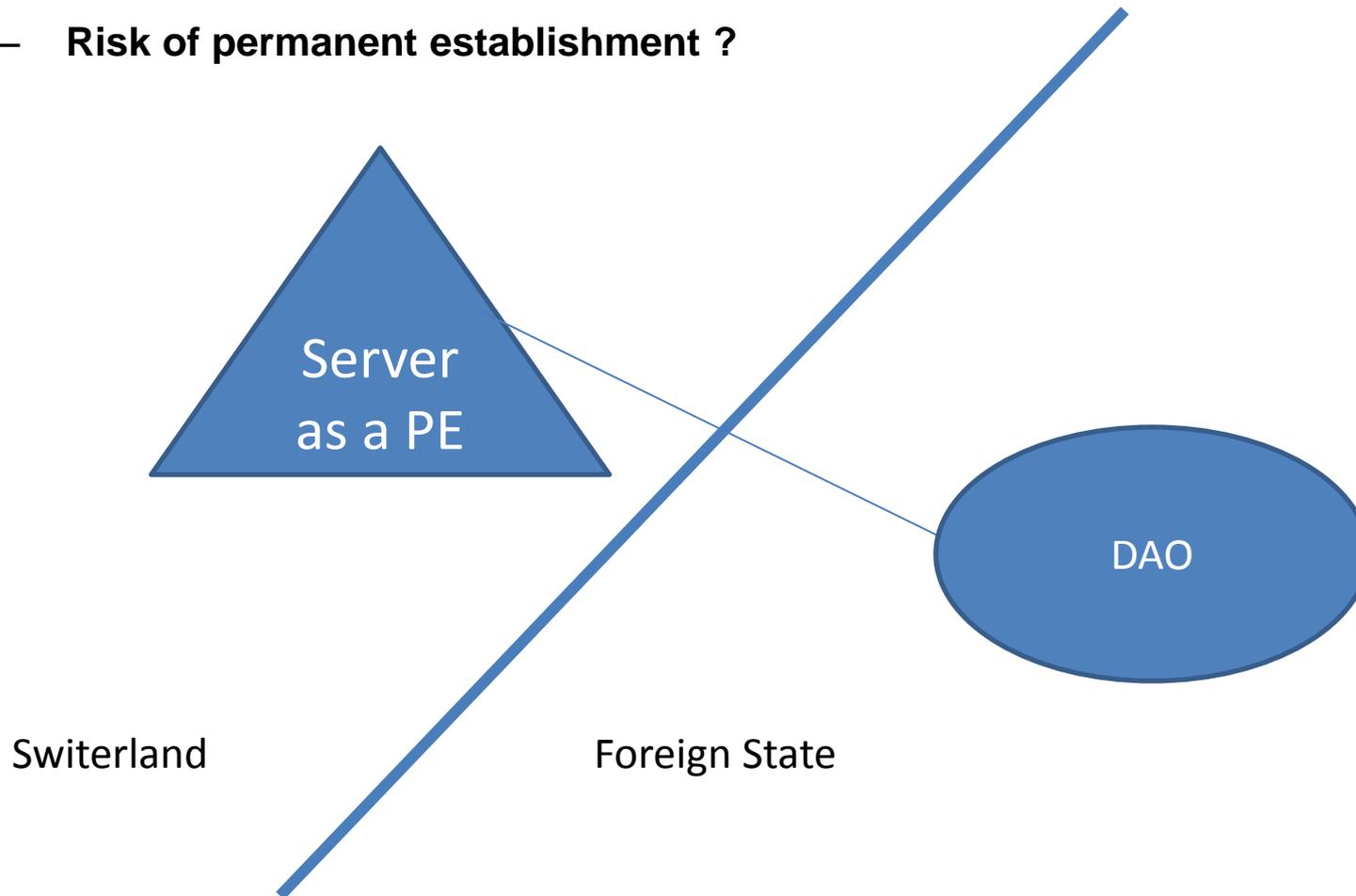
- **Art. 49 FITA**
 - Legal entities subject to tax are:
 - a. corporations (joint-stock companies, partnerships limited by shares, companies with limited liability) and cooperative companies;
 - b. associations, foundations and other legal entities.

- **Art. 49 para. 3 FITA**
 - Foreign legal entities as well as commercial companies and foreign communities of persons taxable in accordance with Art. 11 are treated in the same way as the Swiss legal entities they are closest to in their legal form or actual structure.

- **Art. 11 FITA**
 - Foreign partnerships and other foreign groups of persons lacking legal status who are subject to taxation on the basis of economic affiliation shall pay tax pursuant to the provisions applicable to legal entities.

TAXATION OF THE DAO

- Risk of permanent establishment ?



TAXATION OF THE DAO

- **DAO as a resident ?**
- **Art. 50 FITA**
 - Legal entities are liable for tax due to their personal affiliation with Switzerland when they have their head office or effective administration in Switzerland.

VAT

SWISS VAT

– **In a nutshell, Swiss VAT is levied on**

a) Supplies

- Concession of a usable economic asset to a third party in expectation of a consideration, even if it is required by law or based on an official order (Art. 3 lit. c FITA)
- It may be a supply of goods or supply of services

b) against consideration

- “An asset which the recipient or, in place of the recipient, a third party expends in return for receipt of a supply”, Art. 3 lit. f VATA

c) made by a Swiss VAT taxpayer

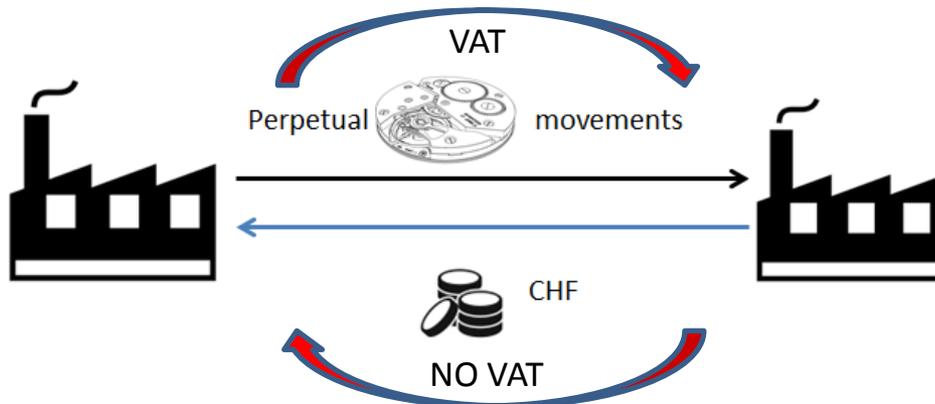
- “Any person, irrespective of legal form, objects and intention to make a profit, is liable to the tax if that person carries on a business and is not exempt from tax liability under paragraph 2”
- CHF 100'000 turnover threshold

a) the supply is located in the Swiss territory

- Supply of goods : where the good is remitted (Art. 7 VATA)
- Supply of services : where the recipient is located (Art. 8 VATA)

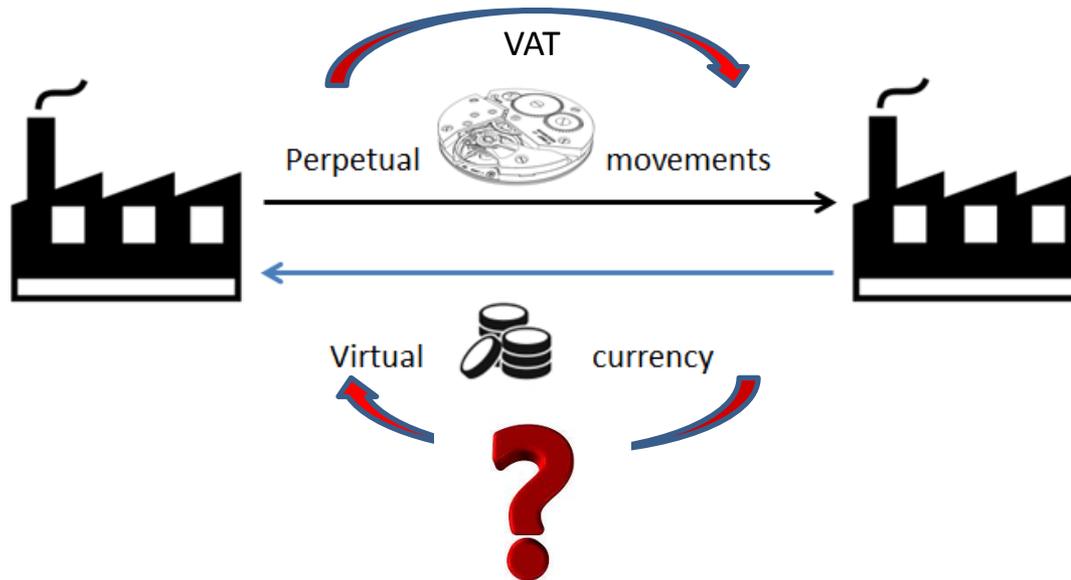
SWISS VAT

– Value added tax (VAT) – payments with VC



No VAT

soil and cash ≠ usable ≠ taxable supply



Option 1: VC = currency

→ not usable (no taxable supply)

→ no VAT

Option 2: VC ≠ currency

→ VAT

→ transfer of VC qualified as a taxable supply

- **Judgment of the Court of Justice of the European Union of the 22 October 2015, *Skatteverket vs David Hedqvist* (C-264/14)**
 - - “Article 135(1)(e) of the VAT Directive must be interpreted as meaning that the supply of services such as those at issue in the main proceedings, which consist of the exchange of traditional currencies for units of the ‘bitcoin’ virtual currency and vice versa, performed in return for payment of a sum equal to the difference between, on the one hand, the price paid by the operator to purchase the currency and, on the other hand, the price at which he sells that currency to his clients, are transactions exempt from VAT, within the meaning of that provision”
- ➔ VC trading qualifies as services exempted from EU VAT

- Opinion of advocate general Kokott delivered on 16 July 2015, in the case *Skatteverket vs David Hedqvist* (C-264/14)

“The judgment was based on the fact that the transfer of legal tender as such is accepted as not constituting a chargeable event for VAT purposes. Rather, such a transfer can in principle only constitute the consideration for a taxed supply, as VAT is a tax on the end consumption of goods. Currencies currently used as legal tender — unlike gold or cigarettes, for instance, which also are or have been used directly or indirectly as means of payment — have no other practical use than as a means of payment. Their function in a transaction is simply to facilitate trade in goods in an economy; as such, however, they are not consumed or used as goods.

That which applies for legal tender should also apply for other means of payment with no other function than to serve as such. Even though such pure means of payment are not guaranteed and supervised by law, for VAT purposes they perform the same function as legal tender and as such must, in accordance with the principle of fiscal neutrality in the form of the principle of equal treatment, be treated in the same way.”

→ Opinion expressed : VC is a currency for EU VAT purposes

SWISS VAT

- **Same treatment for Swiss VAT purposes ?**
- Art. 21 para. 1 n. 19 lit. d CH-VATA has approximately the same wording as Article 135(1)(e) of the VAT Directive. Therefore the same principle shall apply.
- According to the Swiss Federal Tax Administration the *Hedqvist* case law applies under Swiss law (cf. ruling obtained referred to in : MEIER CHRISTOPH/MEISSER LUZIUS, Bitcoin und Mehrwertsteuer, Mehrwertsteuerfragen für EU und Schweiz geklärt, EF 3/2016, p. 186ss)
 - VC is a currency for Swiss VAT purposes

- **Value added tax (VAT) – VAT on supplies to DAO**
- A Swiss company (VAT taxpayer) provides services to a DAO. Is VAT due on the amounts invoiced ?
- If the supply qualifies as supply of services it is located where the recipient is (recipient principle).
- Is the DAO located in Switzerland ?
 - If yes : Swiss VAT is due
 - If no : Swiss VAT is not due
- Application of the offshore companies praxis ? (info TVA concernant la branche 14: Finance chap. 7.1)
 - If the majority of investors are located in Switzerland, Swiss VAT is due

Concluding remarks

CONCLUDING REMARKS

- **Is the current tax system ready for VC?**
- **Is the current tax system ready for DAO ?**
- **Need for new principles or need for new rules ?**

MERCI DE VOTRE ATTENTION !

Prof. Thierry Obrist

Faculté de droit

Avenue du 1^{er} mars 26

CH-2000 Neuchâtel

+41 32 718 15 23

thierry.obrist@unine.ch

LEAX Avocats

Rue des Beaux-Arts 8

CH-2000 Neuchâtel

+ 41 32 730 20 00

thierry.obrist@leax.ch