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VALUE ADDED TAX TECHNICAL NOTE ON DIGITAL FINANCIAL ASSETS (CRYPTOCURRENCIES)





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This technical note was developed to help revenue authorities to articulate the basic VAT policy and administration considerations regarding cryptocurrencies. The technical note does not exhaust all the VAT issues that cryptocurrencies may present as it is a dynamic topic that continues to evolve; thus, future technical notes will be developed as the topic develops. For feedback, clarifications, or enquiries, please contact us through vat@ataftax.org



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1. Introduction

Cryptocurrencies[1] are virtual currencies that use cryptography to safeguard transactions that are recorded digitally on a decentralized ledger. Cryptocurrency transactions are recorded in a distributed ledger system like the blockchain which is a shared public database. The blockchain technology is based on a distributed ledger network which allows cryptocurrencies to be decentralised and operate via peer to peer network independent of any central authority or bank. All the procedures such as issuing, transaction processing and verification are managed collectively by this network.

Cryptocurrencies have not been granted the legal tender status in most jurisdictions; however, they are gaining general acceptance as means of payment for online transactions. Also, cryptocurrencies are held as assets for speculative purposes of making gains from the fluctuations in the value. In more recent times, entities use Initial Coin Offering (ICO) or Initial Token Offer (ITO) to raise capital. This is like Initial Public Offering (IPO) for stocks, but the difference is that investors are issued cryptocurrencies referred to as tokens.

The sources and uses of cryptocurrency give it various characteristics depending on the underlying transaction thus the VAT implications will depend on the substance of the transaction.

Examples of cryptocurrencies are: Bitcoin, Ethereum, etc.

[1] Digital Financial Assets (DFAs) is used by some literature to refer to cryptocurrencies and similar instruments.

[2] A block reward refers to the number of bitcoins you get if you successfully mine a block of the currency. The amount of the reward halves every 210,000 blocks, or roughly every four years. (Investopedia 2019)

[3] A Token is commonly used to describe a distributed ledger technology based on intangible asset that differs from cryptocurrency based on the basis of the rights it conveys e.g. they are usually security/debt instruments or utility based therefore may not be generally acceptable as a currency for non-specific transactions.

2. Sources of Cryptocurrencies

Cryptocurrencies are sourced in three major ways as summarised below:

Mining: Cryptocurrencies are backed by the blockchain technology. Therefore, the transactions are recorded on a distributed ledger after validation. Cryptocurrencies are produced by attaching a new block to the chain upon the solving of a cryptographic algorithm. Mining is the process where persons use specific equipment to validate cryptocurrency transactions i.e. solve cryptographic algorithm. Persons that perform these validations are known as “miners”. Miners are issued new cryptocurrencies called block rewards[2] for solving the algorithms. However, the issuer of the block reward may not be contractually identifiable except where there is a contract with identifiable parties.

Miners may also be paid a transaction fee for solving the algorithms. The transaction fees are usually paid by an identifiable party.

Received as Payment for Goods or Services: The ability to use cryptocurrencies as means of payment for goods and services is fast becoming common for both online and offline transactions. Many service providers accept it as means of payment.

Buy or Exchange: There are cryptocurrency exchange platforms where cryptocurrencies can be bought, sold or exchanged. The platforms match buyers and sellers making it possible for cryptocurrency to be bought with regular money (legal tender) or exchanged for another cryptocurrency.

Initial Coin or Token[3] Offering: An entity makes Initial Coin Offering to raise capital. The entity offers investors its cryptocurrency in exchange for money (legal tender) or other cryptocurrencies of value.

