KPMG

Crypto assets

tax issues that private investors should consider

Crypto assets have become a top agenda point for regulators, tax authorities and supra-national organizations around the world due to new developments in crypto technologies and the strong interest by individuals and corporates alike in digital assets. With the increased adoption of decentralized ledger technologies DLT (blockchains) for the creation, storage, investing, lending, and transfer of digital assets, regulators and tax authorities are finally starting to develop clear regulatory guidance for market participants.

While some jurisdictions are already quite advanced in the development of a comprehensive legal and tax framework for decentralized ledger technology others are in the process of drafting specific rules or adjusting existing ones for digital assets, while some countries are banning blockchain related business in total.

For private investors in crypto assets who want to be compliant with tax regulations, this means that the holding and trading of crypto assets can be quite challenging. From a tax perspective there is no one-size-fits-all solution to the taxation of crypto assets.

Crypto assets defined

Crypto assets can be segmented into three main categories: Assets used for payments, such as Bitcoin (Payment tokens)

Assets representing access to certain types of services or products (Utility tokens – often created to fund the development of a project)

Assets which represent full or fractional ownership of assets, profit distributions or voting rights (Securities tokens)

Recently a new kind of crypto asset known as non-fungible-tokens (NFTs) has emerged. NFTs are crypto assets that do not possess the property of fungibility. They are created on popular blockchain platforms such as Ethereum or Solana and are used to prove ownership and to carry out ownership exchange on digital or physical assets attached to them.

Taxation of transactions involving crypto assets

Limited tax authorities’ guidance on the taxation of crypto assets is available since these are a fairly recent phenomenon. For instance, while the tax consequences of buying and selling crypto currencies have generally been addressed, that is often not the case of income such as the reward derived from locking crypto on a Decentralized Finance (DeFi) exchange platform, or VAT implications of acquiring or selling utility tokens or NFTs. More generally, private investors holding digital or crypto assets should keep the following in mind:

- Governments worldwide observe the enormous amount of value creation involving crypto assets and are keen on ensuring that they will get their fair share through taxation.
- Applying existing tax legislation to digital and crypto asset investments can be complex. This often requires a case-by-case analysis based on the features or each specific investment.
- Crypto assets can be extremely volatile in value while eventually having a very low liquidity
- If taxes occur on crypto assets, they are due in FIAT. Crypto holders therefore need sufficient FIAT liquidity to settle tax bills
- Exchanging crypto into FIAT and finding banks that accept these FIAT funds might be challenging

Example

Richard wishes to invest in web 3.0 infrastructure and gaming projects. Intending to access Initial DEX Offering (IDO) opportunities, he purchases native tokens issued by a decentralized crowdfunding platform which he stakes. Within two years, Richard realizes a total of gains and staking reward of US$ 300,000. He then invests a good portion of this amount in the acquisition of art NFTs which he believes may significantly increase in value. The remainder is converted into Bitcoin for future spending. After two years, the value of his NFTs dramatically drops, so that Richard is now left with USD 80,000.

In light of his circumstances, Richard may need to consider, among other things, the following taxable events:

01

Acquisition of utility tokens

This may trigger VAT implications at the level of the buyer, depending on the characterization of the transaction (acquisition of a service vs. goods).

02

Staking reward

This type of income is likely to be subject to income tax in most jurisdictions or may trigger a taxable disposal in some others.

03

Selling utility tokens at a gain

This could trigger income and capital gains taxes or even social security contributions and VAT in certain circumstances.

04

Paying goods or services with cryptocurrencies

This may trigger tax consequences depending on how the crypto assets concerned are classified (typically “money” vs. “commodity”).

05

Holding crypto assets

A wealth tax would generally be imposed on the ownership of crypto assets in countries where such tax is levied. These assets may also be subject to inheritance tax upon the owner’s demise.

06

Crypto losing value

The losses incurred by private individuals may not be deductible (for example because gains are not taxable or due to losses not being realized in the same year as gains).

07

Buying and selling NFTs

This could trigger income and capital gains taxes or even social security contributions and VAT in certain circumstances.

How can KPMG help

With our global network and dedicated teams, KPMG is ideally placed to advice individual clients on such complex issues surrounding the tax consequences of investments in crypto assets. We closely monitor developments in all the jurisdictions where we are present and contribute to tax and regulatory policy work drawn up by governments and international organizations. This enables us to take a long term perspective when assisting our clients.

Ignoring potential tax consequences may expose investors to penalties and interest for late payments. Over time these accumulate and may at worst lead to shortage of cash to pay taxes due. Understanding tax consequences ahead of making investments is of paramount importance to avoid potentially significant financial losses.

We provide clients with our expertise in:

Analyzing and anticipating tax consequences resulting from specific crypto investments

Identifying and implementing the best legal structures, arrangements and jurisdictions to acquire, own and transfer crypto assets

Screening existing portfolios of crypto investments to assess tax risks

Complying with tax filing obligations and, where appropriate, facilitating the process of self-disclosure.

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