Germany

Tax Hurdles Thwart Virtual Currency Surge in Germany

By Jabeen Bhatti

Legal problems existing with the taxation and funding of virtual currency are staunching its growth in Germany, though the government is stepping toward full-scale integration, practitioners told Bloomberg Tax.

The exchange of bitcoin and other cryptocurrencies for fiat currency and vice versa isn't subject to VAT, according to a precedent-setting clarification from the Ministry of Finance. The tax authority also said it will consider bitcoin as legal tender when used as a means of payment.

The Feb. 27 clarification, which applies an October 2015 decision by the European Court of Justice on the matter (C-264/14), clears up some ambiguity surrounding the tax treatment of cryptocurrencies, which are normally taxed as specialty assets in Germany subject to income and capital gains tax. Implementing a clear VAT treatment for virtual currencies slightly elevates them to the level of officially recognized fiat currency, attorneys told Bloomberg Tax.

But expensive roadblocks persist for cryptocurrency and blockchain services trying to get off the ground, attorneys say, because of rules which are still in place and subject profits made on buying and selling cryptocurrencies to German income and capital gains tax. Germany is among myriad countries, such as the U.K. and Israel, that are setting rules for the tax treatment of cryptocurrency amid its rapid growth.

Snapshot

- Income tax on virtual currency can be as high as 45 percent
- Communication likely to increase between startups, financial authorities

"It's only clear and fixed that if you trade any type of cryptocurrency that there will be no VAT," said Istvan Cocron, a partner with CLLB law firm in Berlin specializing in virtual currencies and startups. "But on the other hand, if you're mining or if you're trading, then there's always tax."

"There has to be a regulation in some way because now there's such a gray area and there are so many coins around and it's costing people a lot of money," he told Bloomberg Tax March 8.

Hybrid Treatment

Cryptocurrencies gained legal recognition in Germany as specialty assets in 2013, at which time profits made from the buying and selling of tokens became subject to income and capital gains tax, according to Germany's Federal Supervisory Authority.

After the European Court of Justice's 2015 decision exempting virtual currency exchanges from VAT, many regimes in Europe did away with VAT for cryptocurrencies in line with the ruling, said Anka Hakert, an attorney with the Winheller law firm in Frankfurt who focuses on tax treatments for cryptocurrencies.

"However, there were exceptions, so it is to be welcomed that finally a clarification was made in the form of a binding letter," she told Bloomberg Tax in a March 12 email.

"The clarification will have a signal effect" for other regimes' treatments, she added.

Hybrid Status

The new regulation frees cryptocurrencies only from VAT when used in purchases and exchanges, meaning they now occupy a hybrid tax status in which coins are treated as currency when purchasing items, but reserve the status of an asset when coin owners buy and sell tokens.

"The use of Bitcoin will be deemed a conventional means of payment insofar as it serves no other purpose than that of a pure means of payment," according to the Ministry of Finance document.

That hybrid status still subjects owners of virtual currency to income tax, which can reach up to 45 percent in Germany for the highest earners, or capital gains tax which is set at 25 percent, Cocron said, in addition to Germany's 5.5-percent levy on income tax, capital gains and corporate tax known as the solidarity surcharge.

That makes trading cryptocurrency pricey in Germany, especially since the market can be so volatile.

“If you're mining or if you're trading, then there's always tax. That's a very, very big issue in Germany—how to tax the trading process of cryptocurrencies,” Cocron said.

High Barriers

Meanwhile, virtual currency startups exceedingly face high barriers to entry in Germany due to the fact that new techniques for raising capital for such offerings are hyper-regulated like banks or other traditional financial services, Cocron said.

According to Germany's Banking Act, initial coin offerings (ICO) are treated the same as if one is running a normal initial public offering (IPO), subjecting the offering to high levels of regulation. An ICO is a common means of crowdfunding vast sums of capital in which a quantity of virtual tokens are offered to investors in exchange for their financial backing.

That raises the barrier of entry for such startups due to high fees for licensing and regulatory rigmarole, preventing innovators from working to improve the blockchain technology to stabilize markets, Cocran said.

“Everything is so highly regulated, it doesn't fit to the ICO market,” Cocron said. “The consequence is that many investors in Germany and entrepreneurs building great projects on the blockchain basis aren't able to find a new way of funding.”

First Steps

Still, communication between financial authorities and virtual currency startups will likely increase in the future to correct the ills of current financial regulations and tax treatments to bring cryptocurrencies into mainstream practice, just like fiat currencies, Cocran said.

Various countries in Europe, such as Estonia and Switzerland,have already decreased barriers to entry for ICOs. They are also early adopters of newly proposed anti-money laundering guidelines from the European Union mandating that traders using an offering's blockchain must be properly identified, and have their information tracked and stored, attorneys said.

But given the fact that Germany's hybrid system of defining cryptocurrencies within the scope of existing laws for traditional currencies is still in place, Cocron advocates for passing new, crypto-tailored laws to meet market demand and unhinge innovation.

“The first step is already done—even in Germany,” Cocron said, referring to the nation's newly implemented tax treatments. “They shouldn't try to regulate the blockchain economic system with the laws you have for the old financial system because it simply wouldn't fit.”

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