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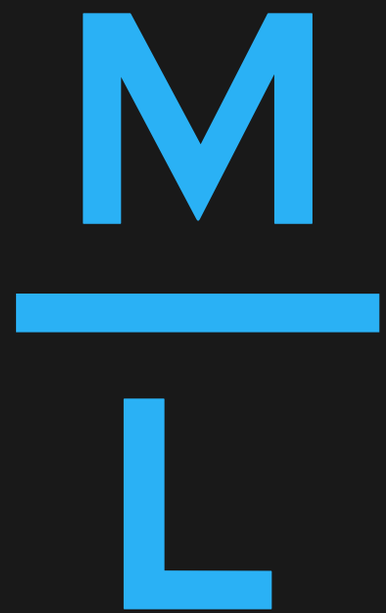
TAXATION OF CRYPTO ASSETS

Budget Proposal Law for 2023



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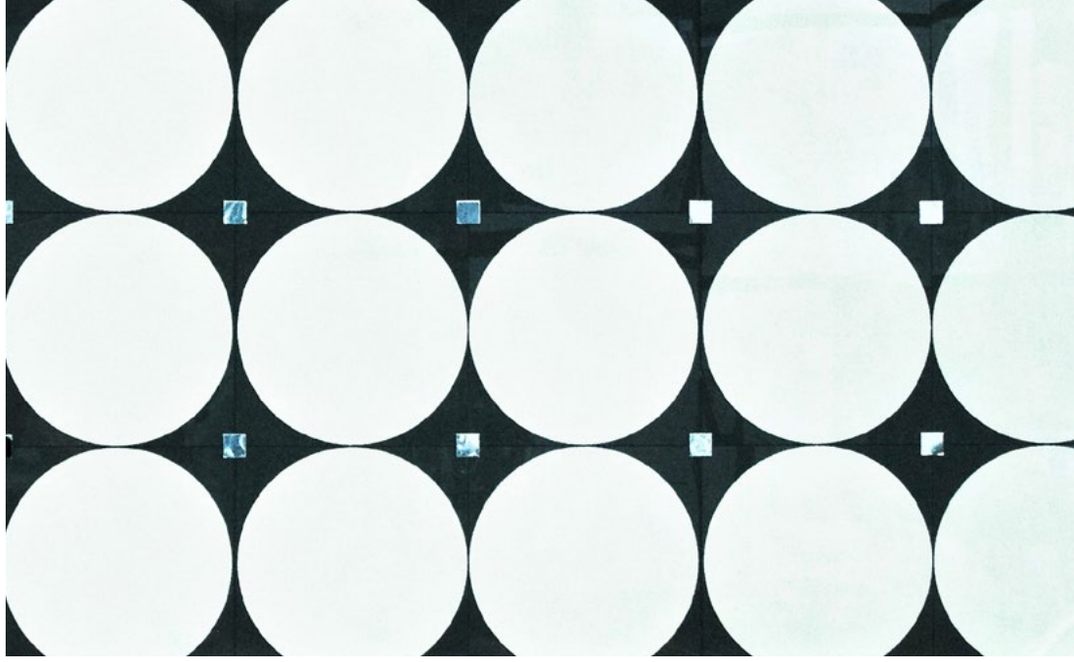


Introduction

It is common for the legislator to follow the new economic realities and alternative markets, in order to create the respective tax framework.

The recent Budget Proposal Law for 2023 (Budget Proposal Law) frames, for the first time for Portuguese tax purposes, most of the tax impacts arising from crypto asset related activities. Thus, it proposes to align the taxation of crypto assets with the standard taxation of other assets in terms of income categories, taxable base and applicable rates.

Without prejudice to a comprehensive description of the tax regime made below, in summary, we now have a multiplicity of proposed new rules that qualify and classify certain services related to crypto assets under commercial, industrial or agricultural income and, on the other hand, specific rules for the inclusion of income arising from the transfer of crypto assets in the category of capital gains, as well as rules related to Stamp Duty, which regulate the taxation of commissions derived from crypto assets providing services and its free transfers.

Additionally, we draw your attention to the clarification that transactions commonly referred to as *crypto for crypto* are considered taxable as income in kind earned by individuals. In our view, this change, although in line with the general rules for taxation of income in kind, may have a very relevant effect on investors who are tax resident in Portugal. In this regard, it is likely that difficulties will arise in relation to reporting and inspecting these transactions, but also in what regards the determination of the taxable value of crypto assets.

All in all, it seems that the Budget Proposal Law is ambitious in seeking to clarify the tax regime applicable to the various realities having a direct or indirect relationship with crypto assets.

Legal definition

A crypto asset, for taxation purposes, is defined as "any digital representation of value or rights that can be transferred or stored electronically using distributed ledger or similar technology", making clear use of the concepts of the agreement reached within the MiCA initiative (agreement reached on the European regulation of crypto assets). The definition put forward is quite broad, which is likely intended to cover the vast majority of crypto assets, including virtual currencies, most types of *tokens*, as well as NFTs (Non-Fungible Token).

Determination of value for tax purposes

The Budget Proposal Law includes a new rule to determine the relevant disposal value for purposes of crypto assets taxation, which foresees that when it comes to crypto assets the disposal value is presumed to be the market value at the date of disposal (which, even so, may prove particularly challenging in the case of exchange of one crypto asset for another crypto asset, taking into account the specificities of the sector and the decentralization typical of these investments).

Reporting obligation

A reporting obligation is proposed in relation to transactions with crypto assets. In fact, this reporting obligation is extremely comprehensive, applying to all natural or legal persons, bodies and other entities without legal personality (possibly intended to cover DAOs)[1] which provide crypto assets custody and administration services on behalf of third parties, or which manage one or more crypto assets trading platforms (possibly intended to cover most exchange platforms). These entities shall report to the Portuguese Tax Authorities (PTA) the transactions carried out with their intervention regarding crypto assets, in respect of each taxpayer. We note that the practical application of this compliance obligation will likely be quite onerous for the above-mentioned entities, considering that in practice, the necessary information on the identification of investors may not be readily available so as to allow for the fulfillment of this form – which may significantly affect the market in Portugal and the investment by Portuguese tax resident entities or individuals.

Taxation of services related to crypto assets

It is proposed to extend the concept of commercial activities to include "operations related to the issuance of crypto assets, including mining, or the validation of crypto assets transactions through consensus mechanisms". This extension is intended to cover realities directly linked to crypto assets such as mining and at least some forms of staking[2] (directly on the blockchain).

[1] Decentralized Autonomous Organizations, an organization constructed by rules encoded as computer program, controlled by the organization's members and not influenced by a central government.

[2] Staking refers to the deposit/lock-up of cryptocurrency for a fixed period of time, is used as a way of verifying cryptocurrencies transactions (in proof-of-stake protocols), and it allows participants to earn rewards on their holdings.

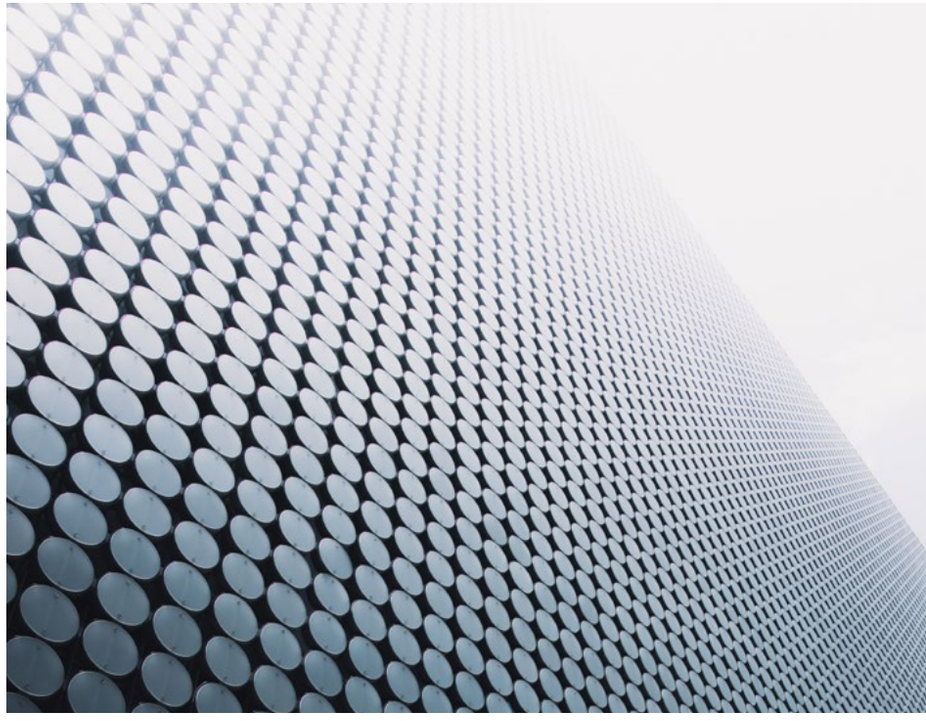
In parallel, the sale of crypto assets is also proposed to be included as professional activity for purposes of the simplified Personal Income Tax (PIT) regime, so as to benefit from the 0.15 coefficient (which means, in short, that for every EUR 100 of income only EUR 15 will be subject to PIT). This simplified PIT regime applies to taxpayers earning annual gross Category B income of less than or equal to EUR 200,000 (in the previous tax period).

Finally, a change is also proposed to the simplified regime applicable to CIT taxpayers (*i.e.* the regime applicable, by option, to entities that have earned, in the immediately preceding tax period, a gross annual income not exceeding EUR 200,000, whose balance sheet for the immediately preceding tax period does not exceed EUR 500,000 and are not legally obliged to have audited accounts). This regime, which functions as a mirror of the simplified regime applicable to PIT, has a new proposed 0.15 coefficient applicable to "income related to crypto assets that is not considered capital income, and which does not result from the positive balance of capital gains and losses and other asset increases".

These measures are aimed at individuals, tax residents in Portugal, who may develop professional activities related to crypto assets.

For PIT purposes, taxpayers who carry out a professional activity in Portugal related to crypto assets, which may include issuing crypto assets, mining, or validating crypto-related transactions through consensus mechanisms – and unlike the regime applicable to the sale of crypto assets –, it seems that the rules foreseen in the simplified IRS regime that already existed will apply to these activities, *i.e.* the coefficient of 0.75 will be applicable (meaning that in every EUR 100 of income only EUR 75 are subject to taxation).

The amendment to the simplified CIT regime applies to CIT taxpayers who opt for the simplified CIT regime and who may earn income from crypto assets.



It is important to propose specific rules for the taxation of crypto assets, responding to market requests for clarification of the tax impacts to be expected pursuant to activities developed within this sector of activity, thus eliminating uncertainty, to some degree. However, the various separate rules that make up the Budget Proposal Law also raise some questions, such as, for example, with regards to the concept of *staking* (it seems to us that types of *staking* related to the delivery of *tokens* on a platform and remuneration for their unavailability should be closer to the qualification as capital income rather than Category B).

Furthermore, the relationship between the two changes that are suggested in this context of professional activities, regarding PIT, raises some reservations. In this context, it should be noted that the new rule that makes "operations related to the issuance of crypto assets, including mining, or the validation of crypto-related transactions through consensus mechanisms" subject to taxation does not present itself as special rule in the scope of the coefficients of the simplified PIT regime. In this sense, it appears that the coefficients already provided for in the law should apply, except if any changes are made pursuant to the discussion of the Budget Proposal Law, and thus the application of a 0.75 coefficient to these activities shall apply.

On the other hand, we note that applying a 0.15 coefficient to the professional activity of selling crypto assets may be particularly advantageous for these investors. Combining the analysis of this regime with the PIT capital gains exemption regime on the sale of crypto assets (analyzed in detail below), and without prejudice of a case-by-case analysis which shall be made in any case, it follows that investors who prefer to adopt an exposure to sales of crypto assets held for less than 365 days may find the simplified regime a more efficient tax framework. Nevertheless, we admit that this difference in the coefficient applicable to the two activities related to crypto assets (*i.e.* sale of crypto assets *vs.* other activities such as mining) may have resulted from a clerical error, possibly to be corrected during the discussion of the Budget Proposal Law.

Finally, we also highlight the suggested change in the CIT law to the specific rules for determining taxable income under the simplified regime where reference is made to the application of the 0.15 coefficient for income related to crypto assets that are not considered capital income, nor that result from the positive balance of capital gains and losses.

This wording used for CIT purposes differs from that used in PIT law as the former refers to the application of the coefficient that, in PIT, is applicable to the sale of crypto assets and not to other *income related to crypto assets* (reinforcing the idea that the lack of articulation of the two rules mentioned above may have arisen from a clerical error).

Taxation of capital gains related to crypto assets

It is proposed that the disposal for consideration of crypto assets that do not constitute securities will qualify as capital gains subject to taxation at a rate of 28%.

This new incidence rule is accompanied by several specific rules relevant to the determination of the capital gain amount, where, among others it is clarified that the gain subject to PIT shall correspond to the difference between the realization value and the acquisition value, net of the part qualified as capital income. In determining the capital gain, the deduction of necessary and actually incurred expenses inherent to the acquisition and sale of crypto assets is allowed. Finally, it should be noted that whenever the taxpayer opts for aggregation of taxable income, carry forward of tax losses is allowed for the following five years.

Additionally, the Budget Proposal Law clarifies that gains obtained from the sale of crypto assets may be exempt from taxation if such assets were held for 365 days or more.

These measures are aimed at individuals who are tax residents in Portugal and currently hold crypto assets or plan to start such investment, insofar as this activity should not, in view of its regularity, constitute a professional or business activity, in which case it shall be classified as Category B (professional activity) for PIT purposes.

The regulation of the tax impact arising from the holding and sale of crypto assets is a positive sign given to the market and investors, although it is doubtful that, in a market as volatile as the crypto assets market, the application of the 28% rate to the entire capital gain (if the assets are held for less than 365 days) is the option that best considers the specifics of this particular sector.

In this context, the wording of the capital gains rule, which determines the taxation of transactions qualifying as a "disposal for consideration of crypto assets that do not constitute securities" is also not entirely clear. In fact, the rule raises interpretative doubts regarding the tax framework applying to crypto assets that may qualify otherwise, such as, for example, financial derivatives that allow a synthetic exposure to such crypto assets, or *security tokens* (crypto assets that may constitute securities).

Further, we must highlight the positive nature of the PIT exemption applying to sales of crypto assets if held for a period exceeding 365 days, which is, in fact, reinforced by the clarification – rightly so – that the holding period of crypto assets acquired before the entry into force of this rules should be taken into account.

Particularly relevant is the articulation between this capital gains taxation regime on gains from the sale of crypto assets with the professional activity of selling crypto assets (which is now clearer). In this context, it would be relevant to have a clearer view on what are the relevant factors to determine whether a taxpayer is developing a professional activity (subject to Category B rules) *vs.* acting as a casual investor (in which case Category G of the PIT rules shall apply).

Stamp Duty on free transfers of crypto assets

It is proposed that the gratuitous transfer of crypto assets, when occurring in Portugal, shall be subject to stamp duty.

It also establishes that the taxable value of crypto assets is preferably determined by reference to the specific rules provided for in the Stamp Duty Code, alternatively, by reference to the value of the official quotation (if any), and, lastly, by reference to the value declared by the administrator of the estate ("*cabeça-de-casal*") or beneficiary, and should, as much as possible, be close to the market value.

Furthermore, the PTA may determine the taxable value based on the market value, when it defensibly considers that there may be a divergence between the declared value and the market value.

Beneficiaries of free gifts and inheritances including crypto assets deposited in institutions with registered office, effective management, or permanent establishment in national territory, as well as, in the case of non-deposited crypto assets, in the case of succession due to death when the deceased was domiciled in national territory, and in the case of other free gifts the transferor is domiciled in national territory. In these situations, stamp duty may be levied at a rate of 10% on the taxable value of crypto assets, without prejudice to the application of the exemption foreseen to donations and inheritances taking place between spouses or civil partners, descendants and ascendants.

In the case of exempt free transfers, the Budget Proposal Law also provides that depositary entities will not be able to authorize the withdrawal of crypto assets entrusted to them without proof of payment of Stamp Duty or proof of submission of the required compliance obligations.

The inclusion of crypto assets as taxable in the context of free transfers and inheritances seems coherent with the changes introduced by the Budget Proposal Law, namely for PIT purposes.

The proposed rule for determining the taxable value may give rise to some interpretative doubts. One of the criteria to be observed, for this purpose, refers to the "value of the official quotation". It should be noted, however, that it remains unclear what an "official quotation" may be (*i.e.* if it is enough to determine the sale value of that asset on a single platform, on a given day, or if an average value should be calculated among several platforms providing that same crypto asset). The last criterion adopted resorts to the value declared by the spouse or beneficiary, which should be close to the market value.

Note, however, that while the market value of certain crypto assets should be easy to ascertain (*e.g.*, cryptocurrencies and some *tokens*), in other cases the market value may be much more difficult to define (as in the case of NFTs), which may give rise to disputes between the Tax Authority and taxpayers for the purpose of determining the relevant taxable value.

Taxation of commissions regarding crypto assets providing services

Commissions and fees charged by or through crypto asset service providers will now be taxed at a rate of 4% whenever the crypto asset service provider, or the client of such services, is domiciled in Portugal, domicile being considered to be the residence, head office, effective management, subsidiary, branch or permanent establishment. This will be a charge to be borne by the customer in connection with transactions carried out by or with the intermediation of a crypto asset service provider.

The entities obliged to declare these operations in the Stamp Tax Monthly Statement and to deliver the corresponding tax to the State, as taxpayers, will be:

- The crypto asset service provider when domiciled in the national territory; or
- The intermediary where the crypto asset service provider is not domiciled in the national territory and the transaction was intermediated by a crypto asset service provider domiciled in the national territory; or
- The representative mandatorily appointed in Portugal when the crypto asset service provider is not domiciled in the national territory and the transaction was not intermediated by a crypto asset service provider domiciled in the national territory.

Note that the entity to whom the crypto asset services are provided will be jointly and severally liable with the service provider for payment of Stamp Duty.

The practical application of this rule may prove challenging for the PTA, particularly for purposes of controlling the provision of services within the scope of the rules pursuant to the applicable territorial nexus, considering the number of platforms in operation, and the high volume of transactions taking place.

Further it appears as though the mandatory appointment of a representative in Portugal when the crypto asset service provider is not domiciled in this territory and the transaction has not been intermediated by a crypto asset service provider domiciled in Portugal, is liable to be challenged as a breach in EU law.

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Our team is available to clarify any specific questions and to provide assistance with any related subject.

The tax team.

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