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Taxation issues related to digital assets

Secretariat note

Summary

This paper provides background information on the topic of digital assets as a matter of growing importance due to the growing influence of such assets, as evidenced by market capitalization and trading patterns and the potential for base erosion and profit shifting in case of under-regulation. Evidence suggests that crypto-assets are of growing importance for developing countries. While crypto assets have shown to have tremendous potential for developing countries, it must be ensured that their tax treatment is in line with countries' efforts to mobilize domestic resources thereby contributing to sustainable development.

A decision is sought from the Committee if the topic of the tax treatment of crypto-currencies should be pursued by a smaller group of interested Committee members that would, in a first step, take stock of issues and challenges that tax administrations, especially those from developing countries, face with regards to crypto-assets and identify and define the most pressing tax issues where the Committee may most usefully assist developing countries. It is recommended that a smaller group of Committee members would prepare an initial report to the Committee on the proposed issues for work, including working arrangements (composition of Subcommittee / working groups) and a work plan to be presented at the 24th session of the Committee in April 2022.

Background

1. Blockchain and distributed ledger technology (DLT) has given rise to accounting tools that changed how assets can be issued and transferred digitally and, in turn, has enabled the creation of assets that only exist in digital form, oftentimes referred to as ‘crypto-assets’.¹
2. The term crypto-asset is not a homogenous concept but an umbrella term to describe an array of tokens. A helpful classification that is being used by some regulatory authorities is a token classification dividing crypto-assets into three broad categories, encompassing i) payment/exchange tokens that are used as a means of value exchange; ii) utility tokens that grant access to a digital platform or service and iii) security tokens that function as an investment instrument.² There are also so-called ‘stablecoins’ that are generally tied to a currency or a basket of currencies, with the goal to stabilize their value. A number of countries are considering the introduction of ‘central bank digital currency’ (CBDC), a crypto-asset backed by public authorities.³
3. Crypto-assets are gaining in relevance: In August 2021, there were more than 11,000 crypto-currencies in the market. The total market capitalization of these was around 2 trillion USD in August 2021, with the two largest currencies, Bitcoin and Ethereum, making up about 850 and 350 billion USD, respectively.⁴ The number of transactions of Bitcoin alone ranges between 200 and 300 thousand per day in 2021.⁵
4. Crypto-assets are more prevalent in developing countries according to surveys by Statista, which found that, for example, nearly one out of three respondents to Statista’s survey in Nigeria mentioned they either own or use a digital coin, as opposed to six out of 100 respondents in the United States.⁶ Crypto-assets may offer opportunities to companies in developing countries, where financial sectors may be inefficient, as they generally improve the efficiency and the cost of cross-border payments. They may also be beneficial to citizens in developing countries where banking services can be inaccessible to a large part of the population and / or where local currencies are perceived as unstable. The COVID-19 pandemic also underscored the growing role of digital technologies in all areas of the economy, as they helped maintain economic activity, thus giving crypto-assets a boost.⁷
5. Crypto-assets allow, through the use of blockchain technology, trust free interactions between trading parties without the use of an intermediary, generally resulting in lower transaction costs. They can be traded around the world at a high speed. Because they do not require high

¹ Cambridge Centre for Alternative Finance (2019). Global Cryptoasset Regulatory Landscape Study. Available from [2019-04-ccaf-global-cryptoasset-regulatory-landscape-study.pdf \(cam.ac.uk\)](https://www.cam.ac.uk/files/global-cryptoasset-regulatory-landscape-study)

² Ibid.

³ United Nations (2021). Report of the Secretary-General on the international financial system and development.

⁴ [Cryptocurrency Prices, Charts And Market Capitalizations | CoinMarketCap](https://www.coinmarketcap.com/price)

⁵ <https://www.blockchain.com/>

⁶ [• Cryptocurrency adoption by country 2020 | Statista](https://www.statista.com/chart/11111/cryptocurrency-adoption-by-country-2020)

⁷ United Nations (2021). Report of the Secretary-General on the international financial system and development.

technological standards besides having access to the internet and a digital device, crypto-assets are generally seen to support financial inclusion. In an increasingly digitalized economy and society, blockchain technology and crypto-assets are often described as a game-changer, with the potential to revolutionize banking and financing, thereby accelerating progress towards the achievement of the Sustainable Development Goals.

6. However, crypto-assets may also have potentially adverse unintended social and economic effects, as they tend to be less regulated and thus run the risk of being used to fund illegal activities. Due to large amounts of energy used in mining crypto-assets, they also have an environmental impact. Moreover, crypto-assets are generally volatile, which makes them less desirable as an investment and saving vehicle.⁸
7. Depending on the domestic tax environment, crypto-assets demand a tax policy response in the areas of income taxes, value-added taxes, property taxes as well as wealth and inheritance taxes. As their relevance increases, crypto-assets may also influence international tax cooperation in terms of what the appropriate treatment should be under double taxation treaties and for transfer pricing purposes.
8. The Committee's mandate specifies that the Committee should consider how new and emerging issues could affect international cooperation in tax matters and develop assessments, commentaries and appropriate recommendations and should do so with special consideration for developing countries.⁹ Accordingly, this note is intended to facilitate the decision of the Committee on whether, and if so how, it should play a part in practical responses to the taxation of crypto-assets for different types of taxes.
9. In presenting the issues for consideration, this paper draws on the work undertaken by other organizations such as the OECD, ATAF and CIAT. For example, the OECD has focused on identifying emerging tax policy issues¹⁰, ATAF has focused on the VAT-treatment of cryptocurrencies¹¹ and CIAT has scrutinized the influence of crypto-currencies on fiscal transparency.¹²

Issues

⁸ Ibid.

⁹ UN ECOSOC Resolution 2004/69

¹⁰ OECD (2020). *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues*. OECD: Paris. Available from <https://www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.pdf>

¹¹ ATAF (2020). *Value Added Tax Technical Note on Digital Financial Assets (Cryptocurrencies)*. Available from [ATAF Admin \(ataftax.org\)](https://ataftax.org/)

¹² CIAT (2015). *Cryptocurrencies, a New Obstacle in the Path Toward International Fiscal Transparency*. Available from [Cryptocurrencies, a New Obstacle in the Path Toward Int... | OPAC - CIAT](https://www.opac-ciat.org/)

10. The taxation of crypto-assets is a matter of growing importance – because of their growing influence as evidenced by market capitalization and trading patterns and the potential for base erosion and profit shifting in case of under-regulation. Evidence suggests that crypto assets are of growing importance for developing countries. While crypto assets have shown to have tremendous potential for developing countries, it must be ensured that their tax treatment is in line with countries’ efforts to mobilize domestic resources thereby contributing to sustainable development. Accordingly, this section lists selected policy changes regarding the taxation of crypto-assets and presents a decision for the Committee on how the topic could be pursued going forward.
11. The issues to consider may differ between payment, utility and security tokens as well as between stablecoins and CBDC. Likewise, issues may differ between direct and indirect taxation. There are typical tax policy design questions that countries face when implementing tax laws for crypto currencies, or, alternatively, when they interpret existing tax laws to apply to crypto currencies (for example by publishing administrative guidance). For income taxes, these tax policy design questions are closely linked to the local tax accounting treatment of crypto currencies.
12. The following present selected policy changes regarding the taxation of crypto-assets but is by no means meant as an exhaustive list.
 - While some countries tax the creation of crypto-assets, which may take different forms (mining, air drops, initial token offering, forging)¹³, other countries focus on the disposal / transfer of crypto-assets or distinguish between occasional traders vs. larger traders and businesses. More broadly, countries will have to decide what constitutes a **taxable event** for crypto-currencies for tax purposes, and how far does this differ from the tax accounting treatment of crypto-currencies.
 - A contentious issue in this regard are so-called ‘**fork coins**’, i.e. when a token is split into more than one token with one or more additional token being generated, which poses the question of whether this constitutes a taxable event.
 - Another common challenge is the **valuation** of crypto-assets due to the volatility of crypto-assets, which in turn is essential to establish tax consequences under income taxes, value-added taxes and property taxes. In case of existing valuation rules, for example for income or transfer tax purposes, countries will have to decide if they can be applied / interpreted to crypto-currencies or if dedicated valuation rules will be necessary.
 - Another common challenge is how to **document** crypto-currencies and their value for tax purposes.

¹³ Mining refers to the process of verifying and adding transactions to the distributed-ledger. Airdrops refers to the distribution of free tokens with the goal to increase awareness. Initial token offerings are the issuance of new tokens, often in exchange for a known token such as Bitcoin. Forging is the process through which transactions are verified.

13. The tax treatment of crypto-assets would not only be a new topic for the Committee, but it is also a new topic for tax administrations and taxpayers. Moreover, the policy environment around crypto-assets is changing fast, and new topics emerge frequently.

Recommendation

14. It is recommended that the Committee consider engaging in the topic of crypto-assets given their growing importance, especially for developing countries. A decision is sought from the Committee on whether to establish a smaller group of Committee members to perform the following next steps:
 - Take stock of issues and challenges faced by tax administrations, especially those from developing countries, with regards to crypto-assets, by liaising with representatives from tax administrations and other experts in the field, including from other international and regional organizations;
 - Identify and define the most pressing tax issues where the Committee may most usefully assist developing countries and where guidance can be produced over the tenure of the Committee;
 - Prepare an initial report to the Committee on the proposed issues for work, including working arrangements (composition of Subcommittee / working groups) and a work plan to be presented at the 24th session of the Committee in April 2022.