Distr.: General
13 March 2023

Original: English

Committee of Experts on International Cooperation in Tax Matters
Twenty-sixth session
New York, 27-30 March 2023
Item 3(j) of the provisional agenda
Taxation of crypto-assets

Secretariat Note

Summary

This note and (in particular) the appended consultant's report analyzes the risk and challenges that crypto-assets pose for tax systems and outlines some proposals on how to manage them. Based on the information provided, this note also examines the role that the Committee could play in providing countries with guidance regarding the taxation of crypto-assets and makes two specific recommendations for work to be undertaken.

A decision is sought from the Committee on whether to do further work on the taxation of crypto-assets and if so, whether to form a Working Group or a Subcommittee to take that work forward.

Background Information

1. At the Twenty-third Session of the Committee of Experts on International Cooperation in Tax Matters (the Committee), the Secretariat presented a conference room paper on taxation issues related to digital / crypto-assets (E/C.18/2021/CRP.29). The relevance of digital / crypto-assets for developing countries were highlighted as they facilitate low-cost transactions and work well in environments where banking services may be difficult to access. At the same time, it was pointed out that digital / crypto-assets pose some specific tax challenges that may erode a country's tax base.

2. Several Committee members and observers noted the issue's significance, while recognizing its complexity. Some Committee members were cautious about taking on the topic owing to the Committee's limited time and resources. Other members noted the Committee's mandate to consider how new and emerging issues could affect international cooperation in tax matters and develop assessments, commentaries and appropriate recommendations, especially as they relate to developing countries. Ultimately, the Committee decided that a paper on the issues and challenges faced by tax administrations, especially those from developing countries, with regard to the taxation of crypto-assets should be prepared outlining possible ways forward.

3. At the Twenty-fourth and Twenty-fifth Session the Secretariat provided updates to the Committee on the work undertaken. The preparation of a paper for consideration by the Committee was scheduled to be presented to the Committee at the Twenty-sixth Session to properly take into account new developments in the crypto-asset landscape, resulting from market turbulences and resulting losses taking place in 2022. Accordingly, a report on the challenges which crypto-assets pose for tax systems with a special focus on developing countries was prepared by Vincent Ooi as a consultant to UN-DESA and is appended to this Secretariat note.

4. The report is divided into two main sections and contains additional Annexes that provide further (technical) information. Section A deals with risks and challenges faced by tax systems. Within Section A, Chapter 2 describes the various risks that crypto-assets pose for tax systems. Chapter 3 then discusses the various challenges as far as substantive tax law and policy is concerned. Technical aspects of tax law such as those in domestic and international taxation, transfer pricing, as well as valuation and accounting are discussed. Chapter 4 covers procedural tax administration and enforcement. Section B deals with proposals to manage risks and challenges. Accordingly, Chapter 5 emphasizes the need for basic guidance on a variety of important issues relating to crypto-assets taxation. The chapter also explores how training and assistance can assist tax authorities with ensuring that they have a sound technical foundation in crypto-assets taxation and the accompanying procedural matters such as tax administration and enforcement.

5. Chapter 6 contains desk research of legislative approaches taken by jurisdictions. It summarizes the findings and then presents examples of challenges faced by tax authorities and examples of tax policy approaches taken by developing countries. Chapter 7 suggests concrete steps which the Committee may wish to consider in moving forward to assist developing countries in dealing with crypto-assets taxation. The Annexes contain technical information that is referenced throughout the report. Annex A1 provides a comprehensive overview of digital assets and their taxation, while Annex A2 describes

the methodology of the cross-jurisdictional desk research on legislative approaches and lays out the data collected.

6. The report concludes that crypto-assets have a wide-ranging impact on tax systems, making it difficult for tax authorities to ignore them, especially as the impact of crypto-assets is often not limited to 'purely crypto-asset' transactions. Instead, they act as functional substitutes for traditional transactions, creating a risk of revenue loss in at least three situations: where 1) tax authorities do not tax crypto-assets and transactions; 2) 'functionally equivalent' crypto-assets and transactions attract a more favorable tax treatment than their traditional counterparts; 3) tax authorities incorrectly apply tax law to crypto-assets and transactions. The impact on the tax system may be felt in the tax revenue relating to the crypto-asset transaction itself, and potentially in the forgone revenue from traditional transactions that would have taken place instead. Additionally, crypto-assets can also influence tax systems through what has been termed 'crypto contagion', i.e. when crypto-asset values plunge other asset classes and financial institutions will also be affected, even those with more limited exposure to crypto assets. Without proper safeguards to 'ringfence' these losses, taxpayers may use them to offset income from other sources, eroding the tax base.

7. Due to the technology that is used to create crypto-assets, the record of (potentially taxable) transactions is available in the public domain. However, this fact is of little assistance to tax authorities if it is not possible to identify the individuals or companies behind the 'wallets' in which these assets are commonly held. Due to this concept, called pseudonymity, crypto-assets give taxpayers the opportunity to conduct transactions outside of the traditional banking system which, in turn, poses the risk of tax evasion, both premeditated and incidental. Jurisdictions that are resource-constrained and face issues in taxpayer compliance and audits will find it especially difficult to trace these transactions.

Recommendations for a Role for the Committee

8. International tax cooperation responses on taxation of crypto-assets currently focus on bringing these assets into the scope of reporting and exchange of information initiatives[1], and the identification of emerging tax policy risks.[2] There are, however, no tax cooperation initiatives that aid countries in identifying risks specific to their tax system and how to respond to these risks that, as outlined in this note and the appended report, constitute new and emerging tax issues that have a wide-ranging impact on tax systems.

9. The purpose of this note is to seek views of Members of the Committee on the substantive issues outlined in this note and the appended report with a view to deciding on a possible role for the Committee. Due to the diversity of technical experiences and

[1] In August 2022, the OECD approved the Crypto-Asset Reporting Framework (CARF) which provides for the reporting of tax information on transactions in crypto-assets in a standardized manner, with a view to automatically exchanging such information. Another example is the update of the European Commission's Directive on Administrative Cooperation (DAC).

[2] See for example, the OECD's report on Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues. ATAF has analyzed the VAT-treatment of crypto-assets and CIAT has scrutinized the influence of crypto-assets on fiscal transparency.

the special attention to developing countries and countries with economies in transition, the Committee is well suited to take up work on this issue and could – due to the convening power of the United Nations – draw on subject matter experts in this area. If the Committee consider that such a role exists, the appended report outlines two distinct recommendations (noted below) that the Committee, through a dedicated Working Group or Subcommittee, may want to commence work on. It should be noted that any work pursued would need to be closely focused and completed on an 'accelerated' timeline in view of the term of the current Committee membership. This argues for identifying the highest priority issues where the Committee can make a value-added contribution to assist countries, especially developing countries, potentially in combination with capacity building initiatives. Such guidance would also assist other stakeholders.

Recommendation 1: Developing a Toolkit for the Evaluation and Mitigation of Tax Risks

10. The report suggests that the Committee may wish to consider developing a toolkit that could assist countries with evaluating the tax risks from crypto-assets which their tax systems face. The toolkit could be limited in scope but would contain questions and background that would guide an analysis of the four classes of tax risks discussed in the appended report: 1) crypto-asset substitution of 'functionally equivalent transactions', 2) deduction of tax losses; 3) loss of opportunities to tax new transactions; and 4) tax evasion. Countries could use the toolkit to analyze their tax legislation and identify the extent to which such risks manifest themselves across different kinds of taxes (income tax, capital gains tax, VAT, etc.) and in their tax administration procedures. As such, the toolkit could form the basis of how countries could determine challenges in their substantive and procedural tax law as a first step to effectively address them.

Recommendation 2: Drafting of Model Guidance for Internal Tax Authority Use

11. The report further suggests that the Committee may wish to consider drafting high level model guidance on crypto-asset taxation to facilitate the preparation of internal guidance for tax authorities. The idea is for such guidance to assist tax authorities in understanding how crypto-asset taxation fits into their existing tax system so that they can then produce their own guidance which is tailored to the local context. Fundamental crypto concepts apply uniformly to all jurisdictions and can simply be factually presented. Tax administration guidance will also cover many common issues across jurisdictions, such as staff management and international initiatives to support tax enforcement.

12. While tax systems differ widely, high-level guidance can still be drafted in such a way as to be useful to tax authorities. For example, the guidance can state that generally, crypto trading should be classified as an activity akin to gambling due to the extremely volatile nature of the assets in question. Thus, losses from crypto trading will not generally be deductible. The reasoning for this position can be set out in detail. The guidance can then provide a few examples of tax systems where this is the case, such as in systems following the UK tax model (as in the UK and many former colonies), or civil law systems (as in France). If experts from tax authorities agree that this is an accurate representation of the tax law in their countries, they can adopt this as part of the guidance that they will eventually issue for internal use. The high-level guidance provided will

naturally have to be presented at a broad level of generality but would serve as a starting point for tax authorities in each jurisdiction to draft and issue their own guidance.

Decision Sought by the Committee

13. As noted above, the purpose of this note is to seek views of Members of the Committee on whether to pursue further work on the taxation of crypto-assets and if so, whether to form a Working Group or a Subcommittee to take that work forward.[3] Should a decision be taken to continue work on this topic, the Members of the Committee may indicate at this juncture if (one of) the recommendations as presented above should be prioritized. In light of the timeline and providing practical benefits in an area with a high degree of (technical) innovation and change, recommendation one could offer practical benefits to countries in identifying risks for their tax systems.

[3] A possible mandate for a Working Group / Subcommittee could focus on taking stock of the issues and challenges presented at the Twenty-sixth Session with a view to proposing a work plan, including working arrangements (composition of Working Group / Subcommittee) at the Twenty-seventh Session of the Committee or through written procedure.