



# Taxation of blockchain and crypto currency – a case study

## I. Introduction

So called Initial Coin Offerings ("ICO") as a new fundraising mechanism in which new projects sell their underlying crypto tokens in exchange for e.g. Bitcoin or Ether, have often been discussed in recent months. In order to contribute our part in this dialogue we would like to discuss a fictional case of a company intending to finance the development and fabrication of its product through an ICO. In this connection we observe the different stages of a planned ICO from a Swiss tax perspective and provide an overview of the different tax issues relating to this topic.

## II. Fictional Case

Robo Nurse Ltd. based in Zug, Switzerland plans to develop, produce and sell a robot for the nursing industry which will facilitate the daily care of the elderly. Apart from the development and the production of the nursing robot, the corporation plans to create a platform on which customers will have access to the "Nurse Robo Education Program" and further services of Robo Nurse Ltd. in connection with the nurse robot.

In order to finance the robot and the platform, Robo Nurse Ltd. will firstly launch a pre-ICO round to a limited number of

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investors who can purchase a pre-emptive right on a certain amount of "Robo Coins". Secondly Robo Coins will be issued in the course of the ICO and allow its owners to access the platform, to buy the Nurse Robot with the Robo Coin on the platform and to participate in 10% of future gains of Robo Nurse Ltd. .

### **III. Token Definition**

#### ***3.1 Legal background***

The analysis of tax issues regarding an ICO requires that the token or coin is firstly qualified from a legal point of view. At the moment there exists no binding legal qualification of tokens. However, on 16 February 2018 the Swiss Financial Market Supervisory Authority ("FINMA") published guidelines for enquiries regarding the regulatory framework for ICOs. FINMA categorized tokens according to the underlying economic function of a coin into: payment tokens, utility tokens and asset tokens.

FINMA qualified payment tokens as tokens which are intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer. Cryptocurrencies give rise to no claims on their issuer.

Utility tokens were defined as tokens which are intended to provide digital access to an application or service by means of a blockchain-based infrastructure.

Finally, asset tokens were described as tokens which represent assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function these tokens are analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the blockchain also fall into this category.

However, FINMA pointed out that the individual token classifications are not mutually exclusive. Asset and utility tokens can also be classified as payment tokens (referred to as 'hybrid tokens'). In these cases, the requirements are cumulative; in other words, the tokens are deemed to be both securities and means of payment.

#### ***3.2 Categorization of Robo-Coin***

According to the token definitions of FINMA, Robo Coins entail characteristics of payment (purchase of Nurse Robo), utility (access to the Robo Nurse platform) as well as asset tokens (10% participation on future gains) and are, therefore, considerably hybrid tokens.

### **IV. Tax 'life cycle'**

The following description of the tax 'life cycle' of the ICO of Robo Nurse Ltd. will follow the same pattern and outlines the tax implications of the income tax, the stamp duties, the withholding tax ("WHT") and the value added tax ("VAT"). It should be noted that for editorial reasons we will only analyze the tax implications from the perspective of Robo Nurse Ltd. in this newsletter but not of other involved parties (e.g. investors, managers).

#### ***4.1 Phase 1: Pre ICO***

##### **4.1.1 Income tax**

The income generated by the private sale will be subject to corporate taxes. However, the payment of the token holders to Robo Nurse Ltd. can normally be booked as accruals according to the estimated budget for the development and production of the nurse robot. As a consequence, in the token generating income year, the payment of the investors have generally limited income tax implications for Robo Nurse Ltd.

#### 4.1.2. Stamp duties

The purchase of the pre-emptive right of the Robo Coin should not be subject to the one-time capital duty (1%) or the securities transfer tax (0.15%), since at that point in time the investor has neither equity rights nor debt claims against Robo Nurse Ltd. as she or he only acquires a pre-emptive right on the Robo Coin.

#### 4.1.3. WHT

The sale of the pre-emptive rights should not entail any WHT consequences as the generated income is not considered a corporate right for withholding tax purposes.

#### 4.1.4. VAT

At the time of the pre ICO, Robo Nurse Ltd. will not be subject to VAT since the income relating to the sale of the pre-emptive rights is considered as a turnover in the field of money and capital transactions and should, therefore, be exempt from VAT.

### **4.2 Phase 2: ICO**

#### 4.2.1. Income tax

The income generated by the ICO will again be subject to corporate taxes but can be booked as reasonable accruals. This again should entail immediate income tax consequences for Robo Nurse Ltd. Future development expenses can be off-set against the release of the provision.

#### 4.2.2. Stamp duties

The issuance of Robo Coin should not be subject to the one-time capital duty. At this point in time, Robo Nurse Ltd. will not qualify as Swiss security dealer. Hence, no securities transfer tax should become due as consequence of the ICO.

#### 4.2.3. WHT

Although Robo Coin entitles its holder to participate on 10% of future gains of Robo Nurse Ltd., it seems to be a fair position to state that payments based on Robo Coins which were issued during the ICO should neither be considered as dividends nor as interest payments. This should not change under the situation that the payment to the investors depends on whether Robo Nurse Ltd. is profitable or not.

#### 4.2.4. VAT

The VAT classification of a coin or token is currently quite challenging as no respective guidelines exist in Switzerland. However, if an ICO is undertaken in Swiss territory, the VAT implications of the ICO must be analysed according to the transaction and the legal relationship which are subject to Robo Coins in order to determine, whether the ICO may entail any VAT liabilities. Given that there is a relation to Swiss territory, the payment and asset token character of Robo Coin should not entail any VAT liabilities as they are again to be classified as a turnover in the field of money and capital transactions and therefore exempt from Swiss VAT. However, the utility token character of Robo Coin could entail VAT implications for Robo Nurse Ltd. as the company provides various services and rights to the token holder such as the access to the Robo Nurse platform and the right to use the Nurse Robo Education Program as well as further services of Robo Nurse Ltd. These services could be considered a taxable supply of goods or of services.

### **4.3 Phase 3: Going live and sale of good**

#### 4.3.1. Income tax

Running research and development costs ("R&D costs) have to be accounted

against the accruals relating to the ICO. Provided that the R&D costs of the Nurse Robot are within the scope of the planned budget, the accruals relating to the ICO should dissolve completely. If the R&D costs are lower than the projected budget, the release of the remaining part of the booked accruals would generally be subject to income tax. A potential loss may be considered as a tax loss carried forward.

Potential conversion gains associated with the exchange of Robo Coins into fiat currency would also be subject to income tax.

Assuming the sale of the Nurse Robot is highly profitable, all generated income will be subject to income tax. However, further R&D and operational costs could be deducted from the taxable income as business expenditures.

#### 4.3.2. VAT

Regarding the VAT implications in this phase we refer to para. 4.2.4. above.

## V. Conclusion

This high-level case study of Robo Nurse Ltd.'s ICO displays the various tax issues arising in connection with this new way of corporate financing. Although the crypto-technology is rather new in Switzerland's jurisdiction, Swiss tax law already offers numerous solutions regarding such tax implications. Therefore, Swiss tax law must not be adopted significantly to this new technology. It is rather the technology which must be incorporated in our existing (tax) law. Relevant tax aspects should be subject to upfront tax rulings with the Swiss tax administration. Normally such rulings will be responded within 2-8 weeks. Should you plan to make an ICO or should you have any questions regarding crypto technology and Swiss tax law, please do not hesitate to contact us.



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