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NEWSLETTER

BITCOINS: THE PERSONAL INCOME TAX TREATMENT OF BITCOIN EARNINGS

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SUMMARY

Created in 2009 as a form of crypto-currency, *Bitcoin* has gained increasing relevance in the international financial milieu, serving investors as a refuge to protect their financial assets. A recently published piece of information by the Tax Administration now clarifies the fiscal treatment of earnings obtained from Bitcoin in what concerns IRS. This grants tax payers greater legal security, not excluding the possibility of a later regulation of *Bitcoin*, (namely as a transferable security) or a review of its legal framework.



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INTRODUCTION

Created in 2009 as a form of crypto-currency, Bitcoin has gained increasing relevance in the international financial scene, serving as a refuge to protect investors' financial assets.

The reason for this choice is nonetheless also its problem: just as it is a digital value not subject to the constraints of exchange or monetary policies controlled by central banks, the absence of regulatory control enables its volatility and manipulation.

FRAMEWORK

The very nature of currency has evolved through time, from commodity-money (made of materials with market value), to scriptural-money (bank notes capable of being traded for gold or silver), all the way to fiat-money (which does not bear any intrinsic value, yet is declared to be of legal usage and is issued by a central bank which keeps its value stable).

Modern currency can also exist without physical representation in a bank account, in the form of computer record, or be deposited in a savings account. This digital or electronic currency consists in a registered monetary value, for instance, in a pre-paid card or a *smartphone*. However, other forms of digital money are

not under the supervision of a centralized instance of control, such as a central bank. From a legal standpoint, these forms of currency cannot be considered *money*, such as crypto-currencies and especially *Bitcoin*.

In practice, crypto-currencies are lines of computer code to which a certain value is ascribed and that save a permanent record of transactions, with *blockchain* functioning as a vast public ledger, controlled by an interconnected system of databases (peer-to-peer network). This protects crypto-currencies from forgery or theft, as well as the owner's identity.

INCOME TAX ISSUE

Considering its characteristics, doubts arise about their taxation in Portugal, especially when there is not a concrete legal framework. The use of crypto-currencies is only starting to be regulated e.g. in Japan, and it should be noted that there is a growing tendency for regulation (or adaptation of regulations) in this context.

TAX ADMINISTRATION'S FISCAL FRAMEWORK

According to a recent binding ruling from the Portuguese tax administration

(5717/2015, of 27/12/2016, in Portuguese), income earned through the sale of crypto-currency are not taxed in Portugal, unless the individual taxpayer carries on a business or professional activity and earns said income in that context (profit). The tax administration acknowledges that this sale is not taxable as personal income, particularly as capital income (income-type E) or capital gains (income-type G).

Thus, unless the taxpayer carries on an active trade or business concerning crypto-currencies, income from the sale or purchase of crypto-currency is not liable to tax in the context of the Personal Income Tax (PIT) code. Taxation may only take place when its regularity constitutes a business or professional activity for the tax payer (income-type B).

The ruling also mentions, but does not address, questions concerning the tax framework applicable to the rendering of services related to the acquisition or common exchange of crypto-currency, as well as on financial gains derived from the sale of products or services in crypto-currency, and also in what concerns the conversion of fiat-money into crypto currency.

The binding ruling was published as part of the Portuguese tax administration policy

to publish all individual binding rulings, but may be referred to, with some caution, by other interested individuals.

FINAL COMMENTS

Although it might seem advisable for taxpayers to keep a record capable of justifying the origin of their income, especially in the case of certain expenses with particular assets that are taken as “displays of wealth” by the tax lawmaker in the framework of the PIT, crypto-currencies are mostly utilized as a form of investment and not of payment and/or purchase of goods and services.

In the short-term, the tax framework for crypto-currencies in Portugal might encompass their regulation as financial assets, as well as their classification as a transferable securities of by-products – not as currency for the transactions of sales and purchases – followed by a consequent alteration of the definition of “transferable security” provided in article 1 of the CMVM.

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