

# **GUIDELINES**

**on the**

# **Income Tax Treatment**

**of transactions or arrangements involving**

# **DLT assets**

**Issued on: 01/11/2018**

These guidelines, issued under article 96(2) of the Income Tax Act, set out the Commissioner for Revenue's (CfR) position on the income tax treatment of transactions involving the use of distributed ledger technology (DLT) assets specifically for income tax purposes. For the avoidance of doubt, these guidelines do not cover electronic transactions in fiat currency. These guidelines are applicable solely to the purposes of the Income Tax Acts (including any rules or regulations issued thereunder) and have no bearing on any other law.

## **A. Types of DLT Assets for Income Tax Purposes**

For the purposes of these guidelines, DLT assets are categorised as follows:

### **1. Coins**

This category refers to DLT assets, that do not have any of the characteristics of a security that have no connection with any project or equity in the issuer, and whose utility, value or application is in no way directly related to the redemption of goods or services. These are cryptocurrencies that are designed to be used as a means of payment or medium of exchange, or function as a store of value: functionally they constitute the cryptographic equivalent of fiat currencies.

### **2. Tokens**

#### **a) Financial tokens**

This category refers to DLT Assets exhibiting qualities that are similar to equities, debentures, units in collective investment schemes, or derivatives and including Financial Instruments. Generally, they might be known as security, asset or asset backed tokens. These tokens would be analogous to equities, debentures, units in collective investment schemes, or derivatives, where they grant rights to dividends in a similar fashion as equities/shares, or to interest payments like bonds, or to payments from units in collective investment schemes, or payments linked with the performance of a specific asset like derivatives, respectively. Alternatively, they could grant rewards based on performance, or voting rights, or represent ownership in assets, or rights secured by an asset as in asset-backed tokens, or a combination of the foregoing.

## b) Utility tokens

This category refers to DLT Assets whose utility, value or application is restricted solely to the acquisition of goods or services either solely within the DLT platform on, or in relation to which they are issued or within a limited network of DLT platforms. This category also includes all other DLT Assets that are tokens whose utility is restricted solely to the acquisition of goods or services, i.e. whether or not listed on any DLT exchange, may be transferred on a peer to peer basis, or may be converted into another type of DLT Asset but only until such time as it is so converted. They do not have any connection with the equity of the issuer and do not have the characteristics of a security.

It may also be possible for tokens to contain the features of both financial and utility tokens, depending on the terms and conditions of the said tokens, such that in practice they are referred to as 'hybrids'.

Where a hybrid token is used in a particular case as a utility token then it is to be treated as such, while if in another occasion the same token is used as a coin, then it needs to be treated as such.

Ultimately, the tax treatment of any type of DLT asset will not necessarily be determined by its categorisation, but will depend on the purpose for and context in which it is used.

## **B. General Approach to Income Tax treatment**

The income tax treatment in relation to any transaction involving DLT assets is regulated by the current provisions of the Income Tax Acts, taking into account jurisprudence and established principles. Each transaction needs to be analysed in the same way as any other transaction, i.e. by reference to the nature of the activities, the status of the parties and the specific facts and circumstances of the particular case.

### **Value**

The amount of profits, value of transferred assets, value of the consideration and any other tax-relevant value in transactions that involve DLT assets will be determined by reference to the market value of the DLT asset in question. The market value may be determined by reference to the rate established by the relevant Maltese authority, and where such is not available by reference to the average quoted price on reputable exchanges, on the date of the relevant transaction or event, or such other methodology to the satisfaction of the CfR.

### **Records**

Any obligation under the Income Tax Acts to keep proper records applies to transactions involving DLT assets. Values expressed in a cryptocurrency will need to be translated to the reporting currency in which the taxpayer presents its financial statements. Applicable sanctions in terms of the said Acts shall apply where proper records are not kept and where there is failure to report and pay any liability to tax.

### **Payments**

When a payment is made or received in a cryptocurrency, it is treated like a payment in any other currency for income tax purposes. Accordingly, for businesses which accept payment for goods or services in cryptocurrency, there is no change to when revenue is recognised or the manner in which taxable profits are calculated. The same applies to payments of remuneration, such as salaries or wages, and therefore such should be regarded as taxable in terms of the general principles. When a payment is made by means of the transfer of a financial or a utility token, it will be treated like any other payment in kind.

The following are some examples of the application of the general tax principles to transactions involving DLT assets.

### **1. Transactions in *COINS***

The tax treatment of transactions involving coins is identical to the tax treatment of transactions involving fiat currency. The profits realised from the business of exchanging coins are treated like the profits derived from the business of exchange of fiat currency. Also, proceeds from the sale of coins held as trading stock in a business are ordinary income. Gains or profits on revenue account from mining of cryptocurrency represent income. Coins fall outside the scope of the taxation of capital gains.

### **2. Return on *FINANCIAL tokens***

The return derived by the owner of financial tokens on his holdings, such as payments equivalent to dividends, interest, premiums etc., in a cryptocurrency or in another currency, or in kind, is treated as income.

### **3. Transfers of *FINANCIAL and UTILITY tokens***

The tax treatment of a transfer of a financial or utility token depends mainly on whether the transfer is a trading transaction or a transfer of a capital asset.

If the transfer is a trading transaction, the consideration will be treated as a receipt on revenue account. Consequently, transfers that are made in the ordinary course of business are taxed as trading transactions. The trading / non-trading nature of a transaction may not always be immediately evident. The ordinary income tax rules apply and, accordingly, profits from the sale of tokens which would have been acquired with the intention of resale at a

profit, or from a profit-making undertaking or scheme, are to be treated as trading profits. The badges of trade tests may need to be used for this purpose.

If the transfer of financial tokens is not a trading transaction, one must see if it falls within the scope of the provisions on capital gains under article 5 of the Income Tax Act. An analysis will have to be made to determine whether such tokens meet the definition of “securities” under that article, and particularly if they participate in any way in the profits of the company and their return is not limited to a fixed rate of return, or if they are units in a collective investment scheme or units and such like instruments relating to linked long term business of insurance. Transfers of financial tokens that qualify as “securities” are governed by the provisions on the tax on capital gains under article 5. Transfers of tokens that do not fall within the definition of “securities”, such as transfers of utility tokens, fall outside the scope of the tax on capital gains. The same applies to transfers of convertible tokens (not being financial tokens at the time of issue) until such time as they are converted into securities.

#### **4. Treatment of *Initial Offerings***

An initial offering (or token generation event) of financial tokens typically will involve raising capital. The proceeds of such issue are not treated as income of the issuer and the issue of new tokens is not treated as a transfer for the purposes of taxation of capital gains.

An initial offering of utility tokens entails an obligation of the issuer to perform a service or to supply goods or benefits to the token holder. Gains or profits realised from the provision of the services or the supply of the goods will represent income.