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Is Finland the Next Crypto Tax Super Power?

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Introduction

The taxation of cryptocurrencies has managed to attract strong interest even among the general Finnish population. A key reason has been the perceived unfairness of crypto taxation, because a private person pays taxes on crypto gains but has been unable to deduct losses. Luckily, recent case law brought change to this asymmetry.

For the rest, there is little case law. The Tax Administration strived to fill in legislative gaps through its 2013 and 2018 guidances focusing on income tax and VAT aspects and its guidance on valuation of cryptocurrency for gift and inheritance tax purposes. Blockchain technology has also attracted the interest of other authorities. The Prime Minister's Office, for example, has conducted studies on the applicability of blockchain technology to wage tax and to social and health care services.

Below, I briefly discuss selected recent developments in Finnish crypto taxation, namely, the deductibility of losses for private persons, crypto-crypto trades and initial coin offerings (ICOs).

Deductibility of Loss for Private Persons

Whereas gains have been treated as taxable from day one, the most important topic so far has been the right to deduct losses on cryptocurrencies. On a general level and somewhat simplified, a private person may deduct a loss only if the sold item qualifies as an "asset" under the Income Tax Act. Hence, a loss on e.g. a contractual obligation would typically not be deductible.

In its 2013 guidance, the Tax Administration took the view that losses on cryptocurrency are not deductible. The Tax Administration based its conclusion on a comparison of cryptocurrency to contracts for difference (CFD) for which the Supreme Administrative Court had already denied deductions in a 2010 ruling. A similar conclusion was reached by the Central Tax Board in its 2017 ruling and by the Tax Administration in the updated 2018 guidance.

The wind changed only few days after publication of the 2018 guidance. The Administrative Court of Helsinki ruled that cryptocurrency is an asset under the Income Tax Act and, in November 2018, the Administrative Court of Eastern Finland followed suit. However, none of the mentioned Central Tax Board or Administrative Court rulings were final at this stage, because they had all been appealed to the Supreme Administrative Court.

In March 2019, the Supreme Administrative Court finally confirmed that cryptocurrency is an asset in two rulings: upon appeal from the Central Tax Board and Administrative Court of Helsinki rulings (the appeal on the Administrative Court of Eastern Finland ruling is still pending). The Tax Administration reacted promptly by stating in a short bulletin that, contrary to earlier guidance, most losses on cryptocurrency would be deductible (even retroactively).

With reference to the wording of the bulletin, it may not be entirely clear if losses on all cryptocurrencies would be deductible as the final rulings concerned only the more mainstream cryptocurrencies: Ether and Bitcoin. The Supreme Administrative Court is still to rule on the asset characterization of certain altcoins (OmiseGO, Metal, Chainlink and districtOx) upon appeal from the Administrative Court of Eastern Finland. In the author's view, also altcoins should be treated as assets apart from very exceptional circumstances such as very concentrated ownership or low trading volumes.

It should be noted that the above-mentioned asset characterization has implications besides loss deductibility. For example, the possibility to apply the so-called presumptive acquisition cost to calculate the amount of taxable gain, i.e. apply 20% of the sales price as acquisition cost (or 40% for assets held at least 10 years), is very beneficial in cases of steep value increase. The taxpayer could also benefit from a tax exemption for small disposals (with corresponding limitations on deductions for small disposals at a loss) as long as the total sales prices from all sold assets do not exceed EUR 1,000 during a tax year.

Crypto-crypto Trades

The March 2019 Supreme Administrative Court rulings confirm that a trade of one cryptocurrency for another constitutes a taxable event. The tax treatment follows that of barters, i.e. with the fair market value (in euros) of the received cryptocurrency treated as taxable income from which the acquisition cost or the above-mentioned presumptive acquisition cost is deducted. Tax treatment of barters applies also when crypto is used as payment to participate in an ICO or to purchase goods or services.

As a background, the Tax Administration had in its 2013 guidance taken the view that crypto-crypto trades would not constitute taxable events, i.e. that only trades from crypto to fiat currency would trigger taxation. In the 2018 guidance, this view changed for no apparent reason attracting wide criticism.

One point of criticism related to retroactive guidance. Guidances generally apply already from their date, but it had taken the Tax Administration one month to publish the guidance. In addition, the Tax Administration had stated in an interview before the change that its interpretation on crypto-crypto trades would not change. Another point of criticism was the practical concern that it would be a daunting task for a private person to keep track of and separately report each crypto trade and that it could be difficult to understand the tax principles applicable to barters. Luckily, the Tax Administration's guidance provides plenty of practical examples on barters and a practical relief for situations where it is not possible to determine a euro value for the traded cryptocurrencies. The guidance also states that gains are calculated in accordance with the first in, first out (FIFO) method, unless the taxpayer establishes otherwise.

ICO Income

The Tax Administration's guidance contains a general mention that the terms of ICOs may vary significantly and that the tax treatment of ICOs follows the actual features of the investment. In the author's knowledge, the Tax Administration has also issued non-public advance rulings on ICO income that indeed emphasize the features of the token.

In the author's view, it is correct to take into account the token's features with regard to technology neutrality. It is, however, interesting to note that the token's features are currently given importance only in the taxation of ICO income, whereas in the taxation of capital gains all tokens are treated as assets regardless of their features (as discussed above).

In the taxation of ICO income, it could be difficult to determine how tokens should be classified (acknowledging that there is a wide range of papers on token classification) and what the tax treatment of ICO income should be within each category. A tiebreaker rule would be needed for the numerous cases in which a token has features of multiple categories and would therefore fit into more than one category – or no category at all. The tiebreaker rule could provide for treatment in accordance with, for instance, the token's principal nature.

One very general categorization could be in utility tokens, securities tokens and actual cryptocurrency (currency tokens). For utility tokens, which provide utility on a network by, for instance, entitling to a discount or services or goods, tax treatment similar to prepayments for goods or services could be motivated. Therefore, ICO income should be subject to income tax and VAT. For securities tokens, tax treatment similar to traditional equity and debt investments could be motivated, although it could in practice be difficult to follow procedures according to the Companies Act that would be needed to reach comparability with equity investment. The related ICO income should be exempt from income tax and VAT as injection of equity or debt capital. For currency tokens (actual crypto currency), which bear no resemblance to equity or debt investments but are rather comparable to sale at a gain of fiat currencies, tax treatment with income tax but no VAT could be more suitable.

Conclusions and Future Outlooks

It is good to note that there are no outright impediments from a tax perspective to carry out an ICO in Finland. In fact, at least one has been carried out in Finland and the Tax Administration has issued advance rulings on more. From an issuer perspective, it could often be desirable that no taxes would be triggered already at the moment of the ICO.

In the author's view, also the characterization of cryptocurrency as an asset and the consequential deductibility of loss, taxability of gain and treatment of crypto-crypto trades as taxable events are elegant and well in line with the general Finnish tax system. It is clear that taxpayers will have difficulties in separately reporting each crypto-crypto trade according to the tax rules on barters, but fortunately there are technical solutions available that could help in the calculations.

At the same time, it is clear that the barter treatment confirmed by the Supreme Administrative Court discourages the use of cryptocurrency as payment (the exemption applicable to small disposals may not be of great help). A hypothetical alternative could have been to create a distinction between different types of crypto and to treat pure cryptocurrencies (currency tokens) as currency and other crypto as assets, which could certainly have encouraged the use of crypto for payment but even such alternative would have been bad as losses on currency are not deductible.

Partly for this reason, crypto enthusiasts have demanded introduction of favourable crypto tax regimes modelled after e.g. the general German tax system, which de facto exempts gains on crypto held for at least one year and also up to a set annual threshold. However, special regimes could be difficult to fit into the general Finnish tax system and, as it seems now, there are no plans to introduce special regimes or even general crypto tax legislation.

Nevertheless, the Tax Administration's guidance and the recent rulings on crypto taxation provide much wanted clarity to many of the questions concerning crypto taxation in Finland. In the unclear cases that remain, advance discussions with the Tax Administration or advance ruling proceedings may be feasible ways to obtain tax comfort.

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