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Highlights & Insights on European Taxation

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– European Parliament resolution on the impact of new technologies on taxation: crypto and blockchain. European Parliament

(comments by **Claudio Cipollini**) (H&I 2022/324)

Facts and background

On 4 October 2022, the European Parliament (EP) adopted, by a large majority, a non-binding resolution to approve the report issued by the Committee on Economic and Monetary Affairs addressing the impact of new technologies on taxation. During the debate, the member-rapporteur, Lídia Pereira, underlined the importance of the initiative by insisting that it is ‘important to be visionary’ and ‘we have a duty to make European legislation more innovation-friendly’.

The report highlights the leading role of the EU institutions in ensuring coordination and cooperation between the Member States ‘to avoid barriers to the interoperability of national technical platforms’ and ‘to tax crypto-assets in a fair and transparent way’. It recommends that Member States implement blockchain technology in their tax systems. According to the document, blockchain represents an opportunity for tax administrations to ‘better serve the needs of taxpayers, to exchange information between jurisdictions for various types of record-keeping, and to deter and/or address corruption’. Furthermore, the market of crypto-assets shows that there is a need to create ‘a clear, stable and transparent legal framework’ to guarantee fair competition and a level playing field with uniform definitions of crypto-assets across the EU aligned with international standards.

The EP resolution has been adopted based on a procedure for an own-initiative report as provided by Article 225 of the Treaty on the Functioning of the European Union (TFEU) and Articles 45, 46, and 52 of the EP rules of procedure. In this case, the Committee on Economic and Monetary Affairs issued a report on the impact of new technologies on taxation on 11 July 2022. By voting in favour of the own-initiative report on 4 October 2022, the EP adopted a resolution calling on the European Commission to put forward a legislative proposal on the issue. The Commission, having received an own-initiative report adopted by an EP resolution, will now have three months to decide whether to take legislative action. The Commission will not be obliged to follow the Parliament’s suggestions given that the right of initiative is its exclusive prerogative. However, such requests by Parliament may be hard to ignore due to political reasons.

The EP initiative finds its background in the previous and ongoing work of the OECD and the EU on the impact of new technologies on taxation. As far as crypto-assets are concerned, it is worth mentioning the OECD report released in October 2020 on taxing virtual currencies, which provides a cross-jurisdictional overview of the tax treatment and emerging tax policy issues. More recently, in August 2022, the OECD also approved the Crypto-Asset Reporting Framework (CARF), which provides for the reporting of tax information on transactions in crypto-assets in a standardised manner to automatically exchange such information, as well as amendments to the Common Reporting Standards (CRS) to bring certain electronic money products and Central Bank Digital Currencies into scope. Also, the EU has taken important steps in the field by developing the Markets in Crypto-Assets (MiCA) proposal: this regulation will bring crypto-assets, crypto-asset issuers, and crypto-asset service providers (CASPs) under an EU-wide regulatory framework intended to protect investors and preserve financial stability.

Besides crypto-assets, blockchain technologies have also recently been at the centre of the policy agenda of international organizations. The OECD has issued a recommendation on ‘blockchain and other distributed ledger technologies’ to provide guidance for actors in the blockchain ecosystem, addressing a series of relevant issues and formulating policy recommendations for governments. The EU Blockchain Observatory and Forum has published a report on Decentralized Finance (DeFi) to define the main principles and provide details about the DeFi market size, the concepts of decentralized lending and borrowing as well as decentralized exchanges and other notable DeFi Concepts. Furthermore, the European Blockchain Services Infrastructure (EBS), which is a peer-to-peer network of interconnected nodes running blockchain-based services infrastructure, is contributing to enabling national tax authorities to exchange tax information in a safe manner. To complete the framework at EU level, it is also necessary to remember the proposal for an amendment of the Directive on Administrative Cooperation, to be known as ‘DAC8,’ which is intended to extend the scope of exchange of information to crypto assets.

The EP resolution

Based on the above background, the resolution adopted by the EP is structured in three different sections: the first section on the potential of new technologies including blockchain in tax matters, the second section on the taxation challenges regarding crypto-assets, and the third section on the development of an effective regulatory and legal framework.

In the first section, the EP endorses the use of distributed ledger technologies such as blockchain to foster effective and efficient tax and administrative procedures, automate tax collection, deter and limit corruption and fraud, facilitate tax compliance by citizens and businesses, and increase the traceability of taxable transactions and ownership of tangible and intangible assets. According to the EP, the implementation of blockchain in the tax field can create opportunities for better and more fairly designed tax systems to tax both mobile taxpayers and assets. In particular, it is necessary to opt for permissioned blockchain, with restricted permissions granted to intermediaries, to guarantee a high standard of privacy and data protection and improve the integrity of the system. Based on these considerations, the EP calls on the Members States to commit to making sufficient investments in human resources, digital infrastructures, and equipment to facilitate efficient tax collection through distributed ledger technologies. Furthermore, it calls on the Commission to evaluate the opportunity to integrate blockchain-based solutions on information exchange platforms to promote real-time auditing and exchange of information. In this regard, the EP calls on the Commission to support national tax administrations in the design of a special training program for their staff and explore all the opportunities created by the European Blockchain Services Infrastructure (EBSI) for national tax authorities.

The second section of the report puts in evidence the need for a clear, broadly accepted definition of crypto-assets for tax purposes aligned with that of the MiCA Regulation, as well as the need to adapt the concept of permanent establishment by developing a clear definition of a virtual permanent establishment in line with international standards. Furthermore, the report highlights the need to find a coherent definition of the taxable event to ensure an adequate level of taxation, while avoiding instances of double taxation. In this regard, the EP calls on the Commission to present an assessment on the conversion of one type of crypto-asset into a different kind of crypto-asset and present options for defining the taxable event, bearing in mind the risk of considerably increasing the number of taxable events.

In the third section of the report, the EP underlines the need for a common approach to the taxation of crypto-assets to ensure the integration of the EU single market. To this scope, it calls on the Council to initiate a structured dialogue with Parliament on this matter. Furthermore, the EP calls on the Commission to include in its future revision of the Directive on Administrative Cooperation the OECD recommendations on crypto-asset reporting and revisions of the CRS, so that the exchange of information framework in the field of taxation includes crypto-assets and e-money. In this direction, the declared objective of the EP is to safeguard a systematic coherence that provides legal certainty to operators and technical guidance to national tax authorities.

Discussion

The resolution represents a major step forward of the EU institutions in leading the process of digitalization of tax administrations and addressing the impact of new technologies on taxation. Although this is a non-binding legal instrument, the EP is clearly suggesting a line of action. The endorsement of blockchain technology gives an impulse to reconsider how tax audit and tax collection activities are performed, while the idea of a common approach to the taxation of crypto-assets opens up room for new legislative initiatives at the EU level.

The statements contained in the document reflect the recent literature debate on blockchain for tax. Scholars have already discussed the advantages and disadvantages of blockchain in the tax field assuming various positions (S.K. Bilaney, From value chain to blockchain: transfer pricing 2.0, 25 Intl. Transfer Pricing J. 4, pp. 294-296, 2018; D. Post & C. Cipollini, Fundamental Elements of a Blockchain-Based Tax System – When to Use Blockchain for Tax?, 14 World Tax Journal 4, 2022; C. Cipollini, Blockchain and smart contracts: a look at the future of transfer pricing control, 49 Intertax 4, pp. 313-330, 2021). While they generally agree that blockchain could improve the efficiency of tax administration and collection, they also caution on the risks associated with privacy and taxpayers’ rights (J.P. Owens & J. Jong, Taxation on the blockchain: opportunities and challenges, 87 Tax Notes Intl. 6, pp. 601-612, 2017). By adopting this resolution, the EP demonstrates its capability to evaluate all these aspects and finally concludes that, to implement blockchain, it is also necessary to fully respect the highest standards of data protection and privacy.

As far as crypto-assets are concerned, the EP focuses on the need for a systematic approach to the taxation of crypto-assets, including a broad definition. This is an evident alignment with the recent work of the scholars in the field (A.M. Bal, Developing a regulatory framework for the taxation of virtual currencies, 47 Intertax 2, pp. 219-233, 2019; C. Brummer, Cryptoassets: legal, regulatory, and monetary perspectives, Oxford University Press 2019). Furthermore, the EP puts in evidence a fundamental issue: the assessment and identification of taxable events. Also in this case, scholars have scrutinized the substance of the events and transactions referring to crypto-assets to define systematic and coherent solutions for taxation (S. Parsons, Developing a foundation for a globally coordinated approach to the taxation of crypto-asset transactions, 2022).

Therefore, the EP resolution does not introduce anything new from the point of view of the theoretical debate on the topic. It collects the outcome of previous studies in the field to give them political value and open new horizons for legislative actions at EU level. This is evident also for what regards the statement on the opportunity of a permissioned blockchain with restricted permissions granted to intermediaries. When dealing with a tax use case, some studies have already recommended setting the governance structures in such a way as to create a permissioned blockchain (M.R. Hoffman, Can blockchains and linked data advance taxation, Companion Proceedings of The Web Conference 2018, p. 1180, 2018). This involves limiting blockchain rights and network users in a selective manner. In all these cases, the objective is to replicate the governance structures of real-world taxation where data access is granted only to participants that are party to a transaction, as well as to tax authorities for audit and monitoring purposes.

From a systematic perspective, the EP resolution also demonstrates an approach to taxation which is clearly intended to comply with the principles of tax efficiency and tax fairness. The reference to efficient tax collection and compliance is a constant throughout the document; it thus represents a fundamental goal to be pursued in the context of the EP initiative on the impact of new technologies on taxation. Based on the principle of tax efficiency, the EP gives special emphasis to the opportunities of blockchain technology. Then, as far as tax fairness is concerned, the resolution stresses several times the need to use new technologies to ensure fair tax treatment and fair tax competition. Furthermore, when dealing with crypto-assets, the EP underlines that to preserve the internal market, it is necessary to develop a uniform legal framework for crypto-asset taxation. In other words, the EP is justifying its initiative in the context of EU primary law by referring to the internal market as one of the fundamental pillars of the Union. How to concretely develop such a framework is not yet clear.

However, the related model rules should be carefully designed to ensure compatibility with EU legislation. For instance, it will be necessary to ensure the proportionality of the measures and compliance with fundamental freedoms. To this scope, the framework for crypto-asset taxation should also consider that a large amount of tax information will already be available under the CARF and DAC8 provisions. Therefore, the new framework should ensure a proportionate approach to the taxation of crypto-assets at EU level by also avoiding the duplication of burdensome obligations on taxpayers and minimizing the risks associated with legal uncertainty and double (non)taxation. Besides these theoretical considerations, what emerges from this document is the first attempt of the EP to support the development of the blockchain culture within tax administrations. There is the idea to focus on the design of special training programs for tax administration staff on the use of new technologies including interoperability of tax systems, standardisation of data, and automatic real-time data sharing in a cross-border context. This reflects an awareness of the EU institutions of the current limits of the resources of the national tax administrations and the fact that such limits are now impeding the full exploitation of the opportunities offered by new technologies for tax collection and compliance. Therefore, having adequately trained staff in tax administration becomes crucial, also to responding to the EP call and exploring the new possibilities of the European Blockchain Services Infrastructure.

Conclusion

In conclusion, while the EP resolution does not add anything new to the ongoing theoretical debate dealing with the interplay between blockchain, crypto-assets and taxation, it assumes a strong political value by framing a clear line of action. In the EP's view, the EU should play a leading role in addressing the impact of new technologies in taxation, both for blockchain applications and for the development of a crypto-asset common framework. In this direction, the phenomenon of the digital economy with its new opportunities and challenges could offer more possibilities for harmonizing legislation in the Member States also in the area of direct taxation, thus supporting the perspective of common tax policies beyond the divergences of the Member States. Nonetheless, as this decision is a non-binding instrument, the realization of such an ambitious project will depend on the European Commission’s future actions.

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