



Tax Newsletter – December 2017

Taxation of Initial Coin Offerings in Switzerland

Be it in the Zug "Crypto Valley" or elsewhere, various large-scale Initial Coin Offerings or ICOs have recently been conducted in or from Switzerland. ICOs are a new instrument of raising capital for the financing of commercial projects, which includes an issuance of (diverse) legal claims by digital means. Those so-called (crypto) tokens can, for example, be used to access a platform, participate in a project or give a right to participate in a share of the returns provided by the project. Despite conceptual and legal differences, ICOs can basically be compared to the Initial Public Offering or IPO but without accompanying flotation.

According to the ICO Alert website, there are over 40 ICO offerings worldwide as at the end of December 2017. Notwithstanding the unprecedented surge of ICO activity, tax considerations remain vital to both ICO investors and providers (those organizing the ICO fund raising campaign). For this very reason Prager Dreifuss wants to take the opportunity to provide an overview of the most significant instances of ICO taxation in Switzerland.

Sequence of ICOs

ICOs have in common that so-called crypto tokens are issued (hence frequently also referred to as Token Generating Event or TGE). The issuer can freely decide upon the design of the specific crypto tokens, i.e. the rights or claims he undertakes to grant to the investors through the tokens. One can cite, by way of example, tokens that define a share in a company with rewards depending on the profit of the company (i.e. dividends) thereby making it essentially comparable to an IPO (equity token). In addition, the token may also refer to payment/repayment obligations (debt token), the usage of future products, services or platforms (utility token), the periodical reward based on the success of a company in the form of revenue incl. voting/membership rights (participation rights token), as well as – more frequently – tokens, which simply represent a new cryptocurrency such as Bitcoin or Ethereum.

The implementation of an ICO does not require a particular type of company or actual business operation. Even individuals who do not run a business are technically capable to offer tokens as long as they have sophisticated coding skills (or engage somebody with such skill set). Mostly however, the provider or issuer of a token is a blockchain technology start-up company looking for seed capital to finance future projects. In a Swiss TGE where the issuer looking for project funding does not have its headquarters in Switzerland, it will usually rely on a foundation structure or a special purpose vehicle in a corporate structure (e.g. stock company or a limited liability company) as an intermediary platform for managing the funds received from the investors and for allocating the tokens customary to an ICO. The funds, i.e. the purchase price for the token is usually paid – often in advance – by the investor in virtual, sometimes also in legal (fiat) currency.

The providers describe their project intentions and the functioning of the offered tokens in a so-called whitepaper (occasionally they also publish contract terms and conditions). In contrast to the prospectuses of a share issue, the contents of the whitepaper are neither prescribed by law nor checked for completeness by a supervisory authority. The generated tokens are usually sold to interested investors in an unregulated public bidding process (token sale). Together with the relative flexibility in the set-up of the implementation structure this means that the costs of an ICO issue are negligible as compared to the costs of a share issue.

Taxation of ICOs

Generally, ambiguity reigns at the moment as ICO and cryptocurrency taxation is very much a work-in-progress for tax authorities and legislators in Switzerland (as elsewhere in the world). Since there is at present no waterproof common ground in relation to ICO taxation, it is imperative to assess potential tax implications on a case-specific basis. An ICO will actually raise tax implications at the level of the blockchain investor and at the level of the provider or issuer of the tokens, which will be summarized below.

ICO issuer

Since it is not uncommon that the ICO issuer is a stock company, the issuance of an equity token, i.e. the creation and increase of the nominal value of equity securities (i.e. shares, common shares, and participation certificates) as well as other capital contributions of the shareholders, may be subject to one-time capital duty of 1% (there is a tax exempt amount of CHF 1 million). The issuance of a debt token, i.e. a payment/repayment obligation on the other hand, is not subject to one-time capital duty.

In the case of an issuance of utility tokens the situation and, in particular, the technical and conceptual design of the token must be considered in more detail for a qualification. In any case, tokens for which the usage function is still undefined at the time of issue must be treated in the same way as bitcoins. However, if the token actually embodies the right to a specific and precisely defined (or definable) service or delivery at the time of issue, this constitutes an advance payment. In this case, the first sale of the tokens is already subject to Swiss VAT (at the rate of 7.7% as of 1/1/2018). A VAT liability can only be assumed if the token is valid with regard to the purchase of the service or if delivery was offered and purchased.

During the term of validity, any distribution of profits on shares or participation certificates in a company (e.g. dividends) made by the issuer is subject to Swiss withholding tax at a rate of 35%. Income derived from a payment or repayment obligation (e.g. interest payments) distributed by a Swiss issuer is also subject to 35% withholding tax. The same might apply to participation rights tokens, depending on the details of the instrument.

Transacting in tokens that qualify as securities (e.g. derivatives) may give rise to securities transfer tax duties for domestic instruments at a rate of 0.15% (or 0.30% for non-domestic instruments) in case a Swiss securities dealer was involved in the transaction.

The ongoing taxation of the ICO issuer depends on its tax status; generally, a stock company pays corporate income tax at a rate of between 12% and 23%, depending on the domicile. Some ICO issuers have been structured via foundation or associations, but each for very particular reasons. Depending on the final corporate structure different corporate tax rates may apply.

ICO investor

In order to qualify the tokens issued in a TGE under Swiss tax law, it is necessary to analyse the individual rights to which the investor is entitled. If the individual rights are constrained to rights *in rem* in the digital object and if no further rights are granted, the tokens will have to be treated in the same way as Bitcoins. In this relation, tokens issued as new cryptocurrency (e.g. Bitcoin) are subject to wealth tax for the ICO investor. As regards the filing in the tax return, monetary rights to an item, such as Bitcoin, must not be listed in the list of securities, but under the heading "other assets" (such as jewellery, paintings, etc.) at the respective daily closing price. The user can prove ownership of Bitcoin by printing out the year-end stocks of the wallet, i.e. the digital wallet. For the valuation of year-end stocks, the Federal Tax Administration will determine the average value for Bitcoin. If the tax authorities do not set a year-end exchange rate due to the lack of trading, a cryptocurrency must be declared at the purchase price. If necessary, a discount may be justified due to lack of trading.

However, if the tokens grant certain additional rights to the investor, the fiscal assessment may differ considerably. There are other forms of digital tokens that may constitute liability or equity of the issuer and would as a consequence have to be filed as part of the list of securities in the ICO investor's tax return (*Wertschriftenverzeichnis*). For instance, where the ICO investor is entitled to a dividend, voting or liquidation rights in equity, the token is comparable to a digital share, which will then have to be filed as part of the list of securities in the tax return. Corresponding investment income is subject to income tax. An important dynamic to consider is that capital gains from the sale of movable private assets remain basically tax-free in Switzerland. Only if an investor qualifies as a professional trader, the profits from trading in cryptocurrencies are taxable as income from self-employment. Digital interest and claim rights to assets and loans are also to be filed in the list of securities of the tax

declaration as well as the corresponding liabilities in the debt register (*Schuldenverzeichnis*). Investment income derived from interest or claim rights is taxable as income.

Implications for ICO entrepreneurs and investors

Switzerland has long been a global center for the wealth management industry but the country is also developing as a prospective global hub for virtual currencies. Despite the multitude of successful ICO campaigns in Switzerland lately and the widespread perception of ICOs as disruptive innovative tools in the digital era, both entrepreneurs and investors should always be aware of the Swiss tax consequences of token transactions as well as their corresponding rights and obligations. At this stage there are no established legal guidelines or best practice standards with respect to the Swiss taxation of ICO investors and issuers. The difficulty of an ICO funding campaign lies in the fact that different tax consequences have to be taken into account depending on the specific token design. In addition, countless combinations of cross-border issues are conceivable, which may further complicate the situation. That is why a precise Swiss tax analysis of the TGE drawing on the support of experts is indispensable before making an ICO investment or initiating a blockchain funding campaign. To the extent sensible upfront tax rulings should be obtained.

We are at your disposal for any queries concerning this rapidly evolving digital sphere.



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