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GMS Flash Alert

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Germany - Circular Indicates Opinion of Tax Administration on Taxing Crypto-Assets

On 10 May 2022, the German Ministry of Finance issued a 24-page circular[1] on the taxation of cryptocurrency assets.

For the first time, the German tax administration has stated its opinion on the tax treatment of cryptocurrency assets[2] for individuals. The circular provides a useful overview and explanations of the "new" asset class and reduces legal uncertainties.

In this *GMS Flash Alert*, we highlight some of the main topics from the private investors'[3] "perspective."

WHY THIS MATTERS

The tax guidelines stated in the German circular now summarise the current position of the German tax authorities and provide a helpful guidance to all cryptocurrency investors. The principles are to be applied to all open tax assessments. Therefore, all individual investors and tax practitioners are recommended to consider the tax principles set by the German tax authorities carefully and to review the positions taken in their individual tax returns and subsequent tax assessments.

Context

Over the last decade, the cryptocurrency asset class has become more and more important on a global scale. The global crypto-market cap is now estimated at more than 1 trillion U.S. dollars.[4] The adoption of blockchain-based technology and cryptocurrencies, especially and primarily Bitcoin,[5] is continuing.

As a new asset class, cryptocurrency assets are currently not explicitly governed in German tax legislation. The taxation of investments in this new asset class – whether at all and if so, up to what amount – has therefore been controversial in recent years.

Taxable Income from Sales

According to the German tax authorities, cryptocurrencies are to be regarded as an asset[6] for tax purposes. As such, the gain from selling cryptocurrencies is taxable as "other income" and is subject to the individual taxpayer's progressive income tax rate.[7]

A sale for tax purposes is not only triggered by the exchange of crypto units into state currencies (in this context often called "fiat[8] money"), but also by exchanging the crypto units into other crypto units or even for simply buying goods or services.

Tax Exemption Available

The sale of cryptocurrencies is tax exempt in Germany if the private investor has held the crypto assets for more than one year. Otherwise, the law provides for a tax exemption limit of only €600 per year. If the overall gain from crypto assets exceeds the annual exemption limit of €600,[9] the entire gains are taxable.

Determination of Taxable Gains (Order of Use)

In order to determine which amount of cryptocurrency assets are sold, the German tax authorities allow the first-in-first-out method (FIFO); i.e., the units acquired first are deemed to be sold first for purposes of the one-year holding period. For the determination of the acquisition costs of the remaining units acquired within 12 months prior to the sale, the average method is to be applied. For reasons of simplification, though, the German tax authorities also allow/recognise the FIFO principle for valuation purposes of historic acquisition costs.

Further, a strict wallet-based approach applies, i.e., crypto assets from different wallets must not be mixed in order to determine a capital gain/loss for tax purposes.

Crypto-Based Exchange Trade Notes (ETN)

The aforementioned tax principles might also apply to specific crypto-related Exchange Traded Notes (ETN)[10] as the German tax authorities draw parallels to (exchange-traded) gold bearer bonds[11] and "Gold-Bullion-Securities" where the bond/note conveys a claim to delivery of the underlying assets (here, gold). In other words, these gold notes do not constitute a capital claim (or a receivable) but rather a claim to payment in-kind and – as such – are tax exempt after holding these notes for more than one year (i.e., like a direct investment in gold).

KPMG NOTE

At the moment, it is held possible that the sale of crypto-based ETN can be tax exempt after holding the ETN for more than one year. This is if the ETN investor has a claim to delivery of the underlying crypto assets against the ETN's issuer (or a claim to payment of the proceeds from the sale of the crypto assets). However, it remains to be seen whether and under which (further) criteria the German tax authorities will grant the tax exemption after one year of holding the crypto-based ETNs.

Taxable Income from Mining, Forging, Staking, and Lending

In addition to gains on disposition of cryptocurrency, revenues[12] in connection with the creation of new blocks either based on the proof-of-work mechanism ("mining") or proof-of-stake mechanism ("forging") are taxable.

Furthermore, income generated by crypto holders from providing and transferring their crypto units to other market participants for a period of time (“staking” and/or “lending”) is also taxable.

The income from “mining,” “forging,” “staking,” and “lending” is deemed as “other income” and subject to progressive income tax rates.

Tax Allowance for Mining, Forging, Staking, and Lending

There is a tax exemption limit of €256 per year. If the total income from mining, forging, staking, and lending exceeds the aforementioned threshold, the entire income from these activities is taxable.

KPMG NOTE

The determination of taxable gains (or losses) from cryptocurrencies can be very complex and time consuming, depending on each individual case. Although there are still some uncertainties on the taxation of cryptocurrency[13] (including its “taxability as such”), all taxpayers in Germany should be aware of the existing reporting obligations in their German income tax returns. Needless to say, we will closely follow future developments in this field and keep readers of *GMS Flash Alert* informed.

The German Ministry of Finance announced[14] that it will issue a further circular on cryptocurrencies that will focus on both record-keeping requirements and increased cooperation requirements.

FOOTNOTES:

1 Soon to be published in *Bundessteuerblatt*, the German Federal Tax Gazette; but already available (in German) at the Ministry’s official Web Site – please click here.

2 Cryptocurrency assets are not issued by the central bank or any public body and typically do not have the legal status of a currency or money; however, they are increasingly accepted by persons.

3 IMPORTANT NOTE: Income generated from cryptocurrency assets can be classified as business income, e.g., if block-creating activities are sustainable and/or if cryptocurrency assets are repeatedly bought and sold. This may lead to other tax implications and requires a detailed analysis on an individual basis.

4 At the time of writing, the global market cap amounted to $1.2 trillion; see "Today's Cryptocurrency Prices by Market Cap" at: https://coinmarketcap.com/ . (*By clicking on this link, you are leaving the KPMG website for an external site, that KPMG is not affiliated with nor is it endorsed by KPMG. The use of the external site and its content may be subject to the terms of use and/or privacy policies of its owner or operator.*)

5 Meanwhile, El Salvador and the Central African Republic have adopted Bitcoin as a legal currency.

6 Note that there is a case pending with the German Federal Fiscal Court under file number IX R 3/22; the lower court ruled that cryptocurrencies are regarded as assets for tax purposes.

7 As opposed to investment income (e.g., dividends, interests, sale of shares/securities) which is subject to a flat tax of 25% plus solidarity surcharge of 5.5% and church tax (where applicable).

8 Derived from Latin phrase in the Bible: “fiat lux!”, meaning that the creation of (fiat) money is not backed or tied to the amount of gold that a government owns and is therefore regarded at risk from inflation.

9 The tax exemption limit of €600 also includes the sale of other taxable assets (e.g., precious metals or properties) and is not only granted for cryptocurrencies.

10 Crypto-related ETNs can be bought and traded via an ordinary stock exchange/broker. Hence, the advantage from a practical point of view is that investors can benefit from the asset’s price development and neither a crypto exchange registration nor a crypto wallet is required. On the other hand, the issuer of the crypto-based ETN charges administration fees.

11 So called "Xetra-Gold-Inhaberschuldverschreibung.“

12 E.g., Block rewards and transaction fees.

13 See footnote 6.

14 See "Bundesministerium der Finanzen veröffentlicht BMF-Schreiben zur Ertragsbesteuerung von virtuellen Währungen und sonstigen Token," Press release (in German) at the Ministry’s official website (please click here).

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