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NEWSLETTER

THE PORTUGUESE INCOME TAX TREATMENT OF CRYPTOCURRENCY INCOME

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IBFD Tax Correspondent Angola, Mozambique and East-Timor, 2013, 2014, 2015, 2016, 2017, 2018, 2019

Summary:

Cryptocurrencies have been gaining prominence in the international financial plan, being an option for investors seeking high return and protection for their assets. These "currencies" have not yet been subject to specific regulation in Portugal, and the tax framework of the income derived therefrom is still uncertain.

The Portuguese Tax Authorities have already clarified their position on the tax treatment of income from cryptocurrencies within Personal Income Tax. However, some doubts persist, as the definitive applicable tax framework to income derived from cryptocurrencies is still to be determined, due to the lack of a specific taxation standard or an express exclusion.



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INTRODUCTION

The nature of currency has evolved over time, passing through the scriptural currency – banknotes, liable to exchange for gold or silver – to the fiduciary currency – which has no intrinsic value, but is declared as having legal tender and issued by a Central bank, ensuring its value stable.

The current currency may also exist without a physical representation: in a bank account in the form of a computer register or deposited in a savings account. This currency, digital or electronic, consists of a monetary value recorded, for example, on a prepaid card or on a smartphone.

However, other digital currencies are not under the jurisdiction of a centralized control entity, such as a Central Bank and, from a legal point of view, these currencies are not considered legal tender, and this is precisely the case for cryptocurrencies.

Cryptocurrencies are, in practice, computer code lines, to which a certain value is assigned and controlled by an interconnected database system (*peer-to-peer network*) keeping a permanent

transaction log (*blockchain*), which protects the cryptocurrency of falsification or theft, as well as the identity of its holder.

In a nutshell, in terms of a definition disclosed by the European Central Bank, cryptocurrencies are a type of digital money, not yet regulated or linked to any Central Bank, which is issued and generally controlled by its developers and used and accepted among members of a specific virtual community.

Recently, major players have shown interested in entering the cryptocurrency segment (the case of Facebook's Libra), which has found resistance from State and financial entities.

ISSUES AT STAKE

Bitcoin, one type of cryptocurrency, with high popularity grown all over the world, was the currency that valued the most in 2016 and 2017, is already worth more than gold. In fact, cryptocurrencies have been gaining prominence in the international financial plan, being used as an option for investors seeking high return and protection for their assets.

However, the reason for its choice also constitutes its biggest problem: being a digital value not subject to the constraints of monetary and exchange policies (defined and controlled by the Central banks), its volatility and manipulation have been high.

In the light of these characteristics, and because there is no concrete legal framework for cryptocurrencies, doubts have been raised concerning their legal framework, in particular regarding their taxation in Portugal.

TAX FRAMEWORK

According to a first binding information issued by the Portuguese Tax Authorities on this subject, the profits obtained from the sale of cryptocurrencies are not taxed in Portugal, as long as these are not obtained within a professional or business activity developed by the taxpayer. According to such information, income resulting from the sale of cryptocurrencies is not taxable within Personal Income Tax ("PIT"), particularly within category E (investment income) or G (capital gains), regardless of the value of the profits attained.

Thus, unless the taxpayer develops a professional or business activity to

mine or exchange cryptocurrency, no taxation shall be due within PIT for profits relating to the purchase or sale of virtual currencies. These profits will only be taxed "*when, by its habituality, it constitutes a professional or business activity of the taxpayer, in which case it will be taxed in category B*".

Conversely, through an e-mail answer to a question posed by a taxpayer through the Tax Authorities' website, the Tax Authorities stated that "*despite the fact that the current Portuguese tax legislation does not specifically contemplate this type of activity, we understand that such income constitutes a distribution of profits, in proportion to their participation (investment)*", concluding that "*in these terms, such distribution would fall under the qualification of income from capital, as provided in article 5 of the PIT code*".

However, such e-mail information has not been disclosed in a generic or official manner by the Tax Authorities, therefore it should not be understood as an official position. In any case, the lack of consensus is clear, even within the Tax Authorities, with the matter remaining controversial.

In another binding information provided by the Tax Authorities on this topic, focusing not on PIT, but rather on Value Added Tax (“VAT”), the position already assumed by the Court of Justice of the European Union was reiterated. This Court had already clarified that *“the Bitcoin, like traditional currencies that have liberator value, have no other purpose than to serve as a means of payment. ”*This means that *“in the case of means of payment whose function is exhausted in itself, its mere transfer does not constitute a [VAT] chargeable event”*.

On the other hand, transactions consisting on the exchange of this virtual currency by traditional currencies, or vice versa, in exchange for consideration, which are taxable in Portugal by means of the localization rules provided for in the VAT Code, shall be deemed exempt from tax under article 9 (27) (d) of the VAT Code.

Regarding Corporate Income Tax (“CIT”), there was not yet any position disclosed by the Tax Authorities, although, generally speaking, all income accrued in accordance with accounting standards should be considered as taxable income subject to CIT.

CONCLUSIONS

Cryptocurrencies are mostly used as investment or protection for investors, having had their role solidified in the financial world although not yet being used for payment and/or purchase of goods or services in Portugal.

The recent opinions issued by the Tax Authorities have not definitively solved doubts regarding the tax framework applicable to income and gains resulting from the investment in cryptocurrencies, to the extent that the applicable legislation has not undergone the necessary changes to adapt to this reality.

Thus, although it seems advisable that taxpayers keep a record capable of justifying the origin of their income (especially if they carry out certain expenses with certain assets, considered by Portuguese tax law as a “manifestation of wealth”), in the short-term the cryptocurrencies’ tax framework in Portugal shall remain as it is: no income derived from these currencies is subject to taxation (except if earned within the development of professional or business activity).

This will keep Portugal in the (increasingly short) list of countries that do not

tax income or gains from cryptocurrencies. Thus, our country consolidates its status as a desirable destination for cryptocurrency investors.

It is still expected that, in the medium-long term, cryptocurrencies will be regulated, and their tax regime specifically defined. However, its regulation may not imply taxation of income derived therefrom. In any case, it is expected that this may eventually involve the qualification of cryptocurrencies as a financial asset or a security – not as a currency for the purpose of buying and selling transactions. This being the case, the income obtained by the taxpayer who did not carry out an activity related to cryptocurrencies may eventually be taxed as passive income, within PIT's categories E (investment income) or G (capital gains).

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