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Paying with Bitcoins: How Your Business Can Gain Traction

What are Bitcoins?

Bitcoins (commonly abbreviated as BTC) are an internationally used cryptocurrency. They are created and transferred within a decentralized peer-to-peer computer network. New Bitcoins are created through the solution of complex arithmetical problems by computers in the Bitcoin network (so called mining). As the Bitcoin software is open-source, basically everybody can have access to it.

There is no single entity – like a central bank – controlling the network or generating the Bitcoins. And, unlike central bank money, there is a limitation in the total amount of Bitcoins that can be created. The program restricts the number of Bitcoins to 21 million. At the end of 2013, approximately 12 million Bitcoins were created. Because Bitcoins are divisible, it is possible to transfer smaller units than one Bitcoin. Several Bitcoin exchanges make it possible to buy and sell Bitcoins.

The software was made publicly available in 2009, but Bitcoins needed time to gain public interest. Now, more and more people are possessing and trading Bitcoins and the number of goods and services which can be purchased with Bitcoins is increasing.

Independence from a central bank and thus from politics, and the limitation to 21 million units in total are the most heard positive arguments in the ongoing discussion, while critics point out that there are also great risks at hand. For instance, unless Bitcoins have a broader acceptance as a method of payment, a high amount of speculation remains, resulting in a very high volatility.

For merchants, there are two interesting aspects in using Bitcoins as a method of payment. Firstly, transaction fees are optional and – by now – very low, especially compared to the fees of credit cards. Secondly, refunds are not possible in the Bitcoin system. Furthermore, due to the current media awareness, there is a significant marketing advantage.

Regulatory Issues in the Bitcoin Business

Before starting a Bitcoin related business, it is important to know the laws and regulations you must follow. Due to their increasing popularity, Bitcoins came under the scope of the financial authorities, who are now setting the rules for Bitcoin businesses. If people want to start a business in the German market or a business focusing on the German market, they should follow the opinion of the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin).

BaFin stated that Bitcoins are not e-money within the meaning of the German Payment Services Supervision Act because there is no central issuer who establishes claims against himself by issuing the Bitcoins.

Neither do Bitcoins qualify as a foreign currency nor as foreign banknotes and coins because they are not legal tender.



Anka Hakert



Eike Weerda

Anka Hakert practices tax law and the law of nonprofit organizations. With her special focus on value added tax matters, she regularly holds lectures concerning tax matters of Bitcoin businesses. Anka makes sure that clients interested in trading or using Bitcoins are well prepared when it comes to tax issues. She has more than 15 years of professional experience as a German attorney.

Eike Weerda practices banking and capital markets law. He advises clients regarding regulatory issues in banking and finance matters. He is an expert on Bitcoins and regulatory issues surrounding Bitcoin businesses. He also has extensive experience in the area of securities law where he counsels private and institutional investors.

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However, BaFin rates Bitcoins as a financial instrument in the form of units of account pursuant to the German Banking Act, i.e. as units of value not denominated for legal tender, which is at least comparable to foreign currencies.

BaFin concluded that taking Bitcoins as a substitute currency for cash or scriptural money in currencies of legal tender to participate in the economy does not need an authorization. In general, the same is true for the sale of mined or acquired Bitcoins or their purchase.

When accepting Bitcoins as payment, a company still provides no banking transactions or financial service. The mere participation in the existing market of Bitcoins does not need an authorization.

Although, things might get difficult when interposing a Bitcoins-payment-provider, who himself may need an authorization.

However, an authorization requirement will arise if additional circumstances appear. That is the case if a special contribution is paid to sustain, foster or create the market. E.g., if people advertise on the market that they regularly purchase and sell Bitcoins, this then qualifies as proprietary trading subject to authorization pursuant to the German Banking Act. The same normally applies for mining pools.

As far as Bitcoins becoming the object of trade themselves, there are several authorization elements that may be relevant, e.g. principal broking services, the multilateral trading system, investment and contract broking, as well as proprietary trading.

Tax Issues

As mentioned above, Bitcoins and other cryptographic currencies are not legal tender and can also not be classified as e-money, as the BaFin clarified in December 2013.

Besides the income tax effects of Bitcoin transactions, the value-added tax treatment of Bitcoins is of particular interest to companies. It

will be particularly troublesome for companies accepting Bitcoins as a means of payment if the tax authorities treat the later sale of Bitcoins via a trading platform as a service subject to value-added tax.

Whether this way of handling such transactions is correct, is at least questionable. First of all, according to a judgment of the European Court of Justice, the pure purchase and sale of securities in a company is not at all a business activity and thus not taxable. Transactions with Bitcoins could in this respect be considered similar. Regarding tax exemption in connection with Bitcoin transactions, the German Federal Ministry of Finance has already expressed its first opinion in 2013: The trading of Bitcoins and the procurement of Bitcoin sales is not exempted from the value-added tax, according to Section 4 no. 8b of the German Value-Added Tax Act, since Bitcoins are not legal tender. In individual cases, however, tax exemption may result from Section 4 no. 8c of the German Value-Added Tax Act, according to a September 2013 statement of the German Federal Ministry of Finance.

All this relates to the question of tax exemption as a second step of the examination of a VAT liability. Only in the case of an actual delivery or other service according to Section 1 (1) of the German Value-Added Tax Act, which is subject to value-added tax, the question arises, whether the transaction is according to Section 4 tax exempt or not.

Unlike the sale of Bitcoins, transactions, which are used merely for the pure payment of a fee, should not be subject to value-added tax according to a statement by the German Federal Ministry of Finance in September 2013. Therefore, the use of Bitcoins as a means of payment is not taxable according to Section 1(1) of the German Value-Added Tax Act. Assuming first, Bitcoins are ordinary assets and not money, and second, in a “payment process,” Bitcoins are exchanged for other goods and services (which normally triggers value-added tax on both sides), this statement

is surprising at first glance. The value-added tax law in many cases does not, however, strictly follow the income tax law. Therefore, it may be correct to treat Bitcoins at least as a “fee” for value-added tax purposes. In fact, the entrepreneur, who uses Bitcoins as a form of payment, pursues no economic interests beyond the pure payment of a fee. In 1969, the German Federal Finance Court already decided that in such a case no value-added tax accrues.

A statement of the Finance Ministry on April 23, 2014, shocked all companies. It was announced that besides the trade of bitcoins, also the use of Bitcoins must be considered a taxable service for which no tax exemption is applicable. This recent statement contradicts the announcement of September 2013. Back then, the Ministry said that the mere payment of remuneration is not delivery or other service, so that the use of Bitcoins as a means of payment is not subject to VAT at all. However, given the recent statement, entrepreneurs have to worry that the tax authorities will impose value-added tax on all transactions with bitcoins, including the use of Bitcoins as a form of payment.

So it is urgently needed that the value-added tax treatment of Bitcoin transactions be clarified in a satisfactory manner.

Conclusion

Bitcoins are a new, innovative and fast spreading technology with enormous potential. Due to its novelty, not all legal matters are settled at the moment. Everyone who is interested in implementing Bitcoins in his or her business case or starting one on the cryptocurrency should get extensive legal advice on the regulatory and tax issues concerning Bitcoins in the targeted jurisdiction. It remains to be seen, how regulatory institutions will assess Bitcoin transactions and Bitcoin trading in the future. 