SOCIEDADE DE ADVOGADOS, SP,RL
ROGÉRIO FERNANDES FERREIRA
& ASSOCIADOS

Nº 12/22

NEWSLETTER

THE TAXATION OF INCOME FROM DIGITAL TOKENS (CRYPTOCURRENCIES, NFTs, ETC.) IN PORTUGAL (UPDATE 2022)

*

***

SUMMARY

Portugal does not currently foresee a specific tax regime regarding income deriving from investments in digital tokens (crypto-currencies, NFTs, etc.), positioning as a very attractive country for investors.

www.rfflawyers.com
Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

WHAT ARE DIGITAL TOKENS?

In practice and on simplistic terms, digital tokens are lines of computer code, to which a certain value may be assigned, fungible or non-fungible, and which are registered and controlled by an interconnected database system (peer-to-peer network) that keeps a permanent transaction record (blockchain), protecting the tokens of counterfeits or thefts, as well as the identity of their holder.

It is important to take encounter that they may represent a plurality of different legal situations, together with a significant divergence between authors and jurisdictions as to their categorization, and the consolidation of universal concepts/typologies of digital tokens was not yet possible.

The Portuguese tax legislation defines virtual assets as "a digital representation of value that is not necessarily linked to a legally established currency and that does not have the legal status of fiat currency, but that is accepted by natural or legal persons as a means of exchange or investment and that can be transferred, stored and traded electronically".

However, this definition is far from solving the problems related to the qualification and, consequently, to the legal-tax framework of the different types of tokens.

Without prejudice to the qualification difficulties this new reality poses and to the relevant regulatory issues that are commonly raised, as the European Securities and Markets Authority points out, that digital tokens based on cryptography and blockchain may be categorized in a variety of ways.

Thus, a categorization does not necessarily exclude another, but the following one may serve as a guideline:

- **currency tokens**: when they function similarly to fiduciary currency, namely, when they intend, more strictly, to represent the value of that currency and serve as a potential method of

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

exchange or payment (e.g., Bitcoin);

- **securities and equity tokens**: when they have underlying financial assets and marketable securities and can be used to trade these assets;
- **utility tokens**: when their issuance does not imply the granting of rights beyond the ownership of the token itself, and may, on one hand, grant access to a product or a service (e.g., a usage token) or the permission to contribute and participate in a certain work (e.g., work token) but also, on another hand, admit their sale in the market (often also issued in the context of an ICO);
- **asset tokens**: when they correspond to an underlying digital or physical asset (e.g., digital or physical works of art, precious metals, such as gold, real estate, etc.); and
- **hybrid tokens**: when they have two or more of the different characteristics listed above.

At this point, it is relevant to note that the term "cryptocurrency" is currently employed to refer not only tokens with the characteristics of currency but also securities, utility, and hybrid tokens, but we believe the term should be reserved to currency tokens.

In fact, the first blockchain-based digital token created was Bitcoin, which is the original cryptocurrency and, per definition, a currency token, but today there are thousands of alternate digital tokens with various functions and specifications, with characteristics other than serving as a means of exchange or payment and, therefore, not merely qualifiable as "cryptocurrency" or currency tokens, but also as securities tokens and hybrid tokens.

This said, as per the European Central Bank's definition of cryptocurrency, they are a type of digital money, not 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. Thus, it is clear that this

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

definition is addressing merely currency tokens and not other types of digital tokens.

However, when a physical or digital currency is not under the control of a centralized supervisory entity, such as a Central Bank, from a legal point of view, it cannot be considered money, which is precisely the case with cryptocurrencies, which do not have legal tender, only conventional tender.

In any case, like physical money, currency tokens are fungible i.e., they can be traded or exchanged, one for another. For example, like one Euro has an equal value to any other Euro, one Bitcoin always has an equal value to any other Bitcoin.

Asset tokens are a different type of digital token and are an evolution over cryptocurrencies: they can correspond to an underlying fungible asset such as asset tokens related to gold or to an underlying digital or physical non-fungible asset.

The latter, the so-called NFTs, are cryptographic representations on blockchain that enable representations of digital or physical assets, such as digital or physical art works or real estate. As they represent a non-fungible asset they have unique identification codes and metadata that distinguish them from each other. Thus, unlike cryptocurrencies, they cannot be traded or exchanged at equivalency with one another.

WHY SHOULD INCOME FROM DIGITAL TOKENS BE TAXED?

The different types of digital tokens, fungible or non-fungible, and regardless of their specific characteristics and practical use, are assets in kind and may, in any case, have an equity correspondence convertible into a pecuniary amount, necessarily representing the contributory (tax) ability of those who own and use them.

The principle of contributory ability, deriving from the equality principle, is a structuring principle of the Portuguese legal system, which reflects the idea that the incidence of taxes should always have as a criterion the

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

income or the assets of each taxpayer.

IS PORTUGAL A TAX HAVEN FOR DIGITAL TOKENS' INVESTORS?

The short answer is "no" but we are talking about tax law, so there are, as always, many subtleties.

First and foremost, it is important to note that companies and other legal entities are taxed over their income, in Portugal, under Corporate Income Tax (CIT) and individuals are taxed, over their income, herein, under Personal Income Tax (PIT).

The taxation of income derived from digital tokens received by corporate investors (*i.e.*, by companies and other legal entities other than individual taxpayers) does not give rise to many doubts: all income must be included in the entity's taxable profit and should be subject to CIT.

In any case, the company's specific tax burden will depend on a number of factors, namely if the company is a resident (or has a permanent establishment in Portugal) or a non-resident entity, the source of the income, if the company is subject to any special regimes, etc., which requires a careful and full analysis of the specific situation at stake.

On the other hand, the taxation of income derived from digital tokens received by individuals rises some doubts, as PIT has different income categories, and each type of digital token can potentially generate different types of taxable income. Therefore, a careful and full analysis of the specific situation at stake is even more relevant here.

In abstract, there can be five types of operations involving digital tokens:

- original acquisition of digital tokens (through mining or minting);
- investing in digital tokens (e.g., buying and selling cryptocurrency or NFTs or receiving "passive income" from them);
- receiving a token as a payment for a good or service;
- receiving a token free of charge (through donations); and
- using tokens in the acquisition of goods and services.

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

Only the first four transactions will be able to generate potentially taxable income, at an individual's level, under PIT.

It should be noted, in any case, that the use of digital tokens in the purchase of goods and services by an individual may, nevertheless, correspond to a manifestation of wealth that may be relevant (and potentially used) to determine the taxpayer's income by the Tax Authorities and may also involve the payment of other taxes, such as Value Added Tax (VAT), by the individual, as the final consumer, of the goods and services purchased.

From a very high-level perspective, income from digital tokens can actually fall in any of the PIT's categories (as they can be used as payments in kind of the income with such characteristic: employment income, a rent from the lease of a real estate property and even a pension can be paid with digital tokens).

But looking at the income specifically generated by the investment in digital tokens, it can potentially be taxable in different categories (as business and professional income, in category B, as investment income, in category E or as capital gains, in category G).

For instance, the mining of cryptocurrencies could be seen as parallel to the mining of coal or gold or, also, to the creation of intellectual property. Thus, the income from mined cryptocurrencies could be taxable as business and professional income, under category B, regardless of the existence of an underlying self-employed activity, rendered in a regular, business-oriented manner.

On the other hand, the gains from the investment in security tokens, with underlying marketable securities, could be taxable as capital gains (category G – fixed rate of 28%), as there is a specific provision for the investment in marketable securities.

Moreover, regarding the consideration of any income as obtained within the rendering of a self-employed activity, it is very relevant to stress that this involves the verification of many characteristics, not only regularity.

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

In fact, a professional activity can be rendered in a single isolated manner or with regularity (habitually and periodically). So, the overall framework of the personal and tax situation and the economic substance of the situation as well as its profit goal must be carefully verified.

Also, many investors believe that there is an "official" and binding opinion of the Tax Authorities applicable to all situations related to the investment in digital tokens but, in fact, the Tax Authorities have only conveyed their opinion regarding a specific transaction related to one type of digital token: the purchase and sale of cryptocurrencies.

According to their opinion, the gains from the sale of purchased cryptocurrencies can only be taxed if they derive from a self-employed activity (category B – marginal rates up to 48%).

This is very general and is lacking several aspects of the situation, namely those related to the many characteristics of a self-employed activity. For instance, the gains resulting from the sale of shares are specifically foreseen as capital gains (category G – fixed rate of 28%) but if they are obtained through a "regular and professional" investment, should that investment activity be considered as a self-employed activity and taxed under category B? We believe not.

As seen, there are several other operations besides the mere purchase and sale of cryptocurrencies and, even more importantly, several other digital tokens with characteristics different that those of cryptocurrencies.

With this being said, and regardless of the operations entailed with any digital tokens by individual taxpayers, it is advisable that taxpayers are aware of the potentially applicable framework to their specific situation and also that they maintain the accountancy of their transactions, i.e., a register capable of justifying the origin of their income, especially if they incur in certain expenses, potentially seen by the tax legislator as unjustified manifestations of wealth.

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com

WOULD SPECIFIC REGULATION BE BENEFICIAL FOR BOTH THE INVESTORS AND THE TAX AUTHORITIES?

Even though Portugal still remains a true platform for investment and residency for both individual and corporate investors, the lack of specific regulation and the specific characteristics of the investors in digital tokens has made a lot of them to make life changing decisions and to roam to Portugal, believing this is a digital assets' tax haven, realizing relevant "cash-outs" herein (conversions of their proceeds in kind to currency with legal tender) and also suppoting significant expenses, without reporting their income to the Portuguese Tax Authorities.

The lack of specific regulation remains today, but we believe that a specific taxation framework would be better than the current undefined status, as this has not been beneficial for both the taxpayers and the Tax Authorities and is already causing litigation.

In order to provide legal order with some (very needed) certainty, it would be in everyone's interest that there is specific legislation soon, namely foreseeing rules to determine the territorial source of this digital income, which would then enable the respective conjugation with the special Non-Habitual Resident's tax status, which is the regime that actually makes Portugal very competitive in comparison to other jurisdictions.

***

Lisbon, March 21st, 2022

Rogério M. Fernandes Ferreira
Duarte Ornelas Monteiro
Joana Marques Alves
Ricardo Miguel Martins
Vanessa Lopes Rodrigues
Teresa Verdasca Salgueiro
Marta Cabugueira Leal
João Rebelo Maltez

(Private Clients Team)
www.rffadvogados.pt

Avenida da Liberdade nº 136, 4º (receção) /3º andar
Lisboa • Portugal
T: +351 215 915 220 • F: +351 215 915 244
contact@rfflawyers.com