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# Italy's tax treatment of cryptocurrencies: The risks and opportunities

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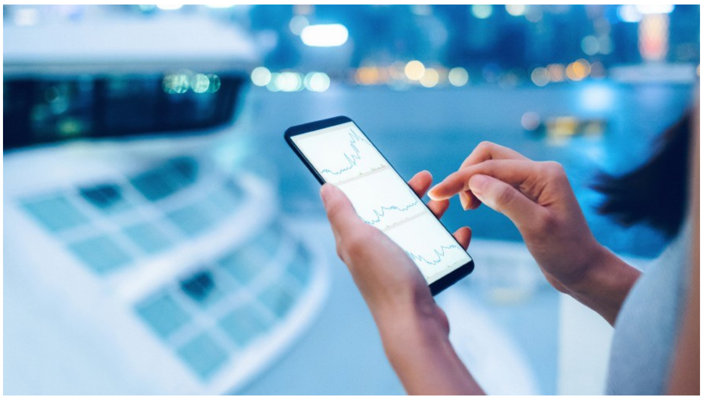

Interest in cryptocurrencies and crypto-assets has literally exploded worldwide over the last few years.

The reason they have become so attractive is that they serve a multitude of purposes: from being a cutting-edge payment method to acting as an alternative (and rather unregulated) means of speculating. The skyrocketing value reached from the second half of 2017 to 2018 by the main cryptocurrencies (when Bitcoin was worth approximately 20,000 USD) was indeed a key factor, supported, among others, by the ground-breaking decision of the Chicago stock exchange to allow trading of futures on cryptocurrencies.

Bitcoin (the first cryptocurrency, created in 2009) was originally conceived as "an electronic payment system based on cryptographic proof instead of trust, allowing any two willing parties to transact directly with each other without the need for a trusted third party" (S. Nakamoto – White Paper). After almost ten years, crypto-assets, still independent from governments and central banks, can make it possible to handle substantial sums in a rapid, anonymous and almost free manner.

As of today, several types of crypto-assets exist: (i) payment/exchange/currency tokens (such as Bitcoin and Ethereum), (ii) investment tokens (generally used in initial coin offerings) and (iii) utility tokens (which enable access to specific products or services). Inevitably, the widespread distribution of such assets boosted an area of business, constantly developing, of various service providers directly involved in the trading of crypto-assets and in the distribution of goods and services paid with crypto-assets.

Nonetheless, the crypto-asset phenomenon and its revolutionary technology (so-called blockchain, which is a type of distributed ledger technology) are perceived as a potential threat to monetary sovereignty: accordingly, in the European Union, the attention of central institutions towards crypto-assets has grown substantially. In effect, the latest reports from the European Banking Authority and the European Securities and Markets authorities highlight the potential risks about consumer protection, operational resilience and market integrity along with concerns about tax evasion, fraud and money laundering.

These comments notwithstanding, several jurisdictions have started to deal with crypto-assets in a reasonable manner, qualifying them as private money or foreign currency, although the same are not recognised in any EU member State or by the European Central Bank as fiat money (i.e. value designated as legal tender, typically in the form of notes or coins).

Although 2018 and 2019 registered a substantial loss of value of the major cryptocurrencies (confirming their high volatility), there are rumours that giants of finance and of big data companies are ready to implement blockchain-based internal payment systems for their clients (such as JP Morgan, Facebook and Telegram – Il Sole 24 Ore, 4 April 2019). This keeps crypto-assets fixed in the attention of investors and experts.

EU and non-EU State's authorities and regulators are not overlooking the risks and the opportunities of this global phenomenon. As concerns the Italian experience, absent comprehensive legislation, there are already guidelines on taxation of crypto-assets and specific provisions on anti-money laundering.

## ITALIAN TAXATION OF CRYPTOCURRENCIES: NEW RISKS AND OPPORTUNITIES

Private investors were able to derive impressive gains from the trading of crypto-assets across 2017 and 2018 (and for the same reason, dreadful losses across 2018 and 2019). All of this thanks to an environment counting more than 200 trading platforms operating globally (ESMA report 2019) allowing users to quickly upload cryptocurrencies from their physical wallets (e.g. hardware or paper wallet) or mobile / online wallets and carry out thousands of transactions a year (with minimum service fees). Transactions range from simple cryptocurrency-to-cryptocurrency or cryptocurrency-to-fiat cryptocurrency exchanges (pairs) to derivative-like transaction (margin trading) and token trades.

All of this is already known and partly understood by the Italian tax authorities, which from 2016 was asked by several taxpayers (mostly individuals) to issue rulings on the most appropriate tax treatment of incomes deriving from cryptocurrencies. On such occasions, the tax authorities reached the conclusion that cryptocurrencies are to be deemed as akin to foreign currency (going further than the findings of the first decision of the European Court of Justice on this subject – case no. C-264/14 "Hedqvist" based on which "it is common ground that the 'bitcoin' virtual currency has no other purpose than to be a means of payment and that it is accepted for that purpose by certain operators"). Accordingly, in the tax authorities' view:

- proceeds arising from "speculative" exchanges between cryptocurrencies or from cryptocurrencies to fiat currencies or should be subject to the standard rules applicable to income arising from trades of foreign fiat currencies (i.e. subject to a flat 26% substitutive tax for Italian resident individuals / non-commercial entities and to the standard corporate income tax for Italian resident / established entities); similar rules apply to proceeds arising from trades of utility tokens;
- the "market value" of cryptocurrencies is to be annually reported as if the same assets are held abroad by Italian resident individuals / non-commercial entities (the omission is potentially subject to a penalty ranging from 3% to 15%);
- certain cryptocurrency exchange services should be exempt from Italian VAT (as for standard services relating to foreign currencies).

Tax experts criticize the approach of the Italian authorities' as its results are highly inconsistent with the key features and the inner nature of cryptocurrencies. In effect, Italian standard tax rules applicable to fiat currency are not fit for cryptocurrencies, which are extremely volatile, far from being generally accepted as means of payment and often hard to convert to fiat currency (due to the money laundering concerns shared by the vast majority of the financial institutions). Eventually this could result in a burdensome taxation on an accrual basis rather than on a cash basis (as it is instead for fiat currencies).

Moreover, annual reporting duties generally applicable to (financial) assets held abroad are in contrast with the nature of crypto-assets, which are everywhere and nowhere.

## CRYPTO-ASSETS AND ITALY'S NEW RESIDENTS REGIME

Notwithstanding such issues, looking at the Italian tax authorities' approach from a different angle, some potential planning opportunities may arise. In fact, if crypto-assets are akin to foreign investments / assets held abroad for the Italian tax authorities, then gains arising from the latter should be deemed as sourced abroad in certain cases. If this holds true, new residents relocated to Italy under the so called "new residents tax regime" could benefit from a full exemption from Italian income tax on such gains and related reporting duties.

In effect, since 2017 Italy has applied a new territorial system of taxation aimed at attracting high net worth individuals, including successful individuals in the sports, arts, and fashion and design sectors, who could be interested in moving to Italy to take part in these thriving sectors.

In a nutshell, under this regime, Italian-source income and gains are taxable in the usual way while (i) foreign income and gains are sheltered from Italian tax and (ii) foreign assets are neither subject to the standard reporting duties not to Italian inheritance and gift tax (as well as to property taxes). Moreover, no remittance taxation mechanisms apply. The main conditions to benefit from this regime are that the new resident (i) has not been Italian tax resident for the last 9 out of 10 years (before the relocation to Italy) and (ii) pays an annual charge of €100,000 (which can be increased by €25,000 per each family member relocating with him to Italy under the regime).

It is worthwhile mentioning that the "new residents tax regime" does not provide shelter from the international automatic exchange of information (i.e. the so called Common Reporting Standard (CRS) as well as FATCA with the US). Although crypto-assets are still a rather uncharted territory in terms of CRS and FATCA, as anticipated States and financial institutions have started to take adequate measures to increase the level of monitoring of this phenomenon for tackling the misuse of crypto-assets in illegal transactions.

## AML REGULATIONS: THE FIRST STRONGHOLD AGAINST MISUSE OF CRYPTO-ASSETS

Recent developments on anti-money laundering ( AML) procedures of banks and financial institution are indeed the first answer to the need of tracking cryptocurrency transactions movements on a global scale. At the EU level, the fifth AML Directive (EU 2018/843) extends the AML reporting duties to cryptocurrency exchangers and service providers. Italy promptly implemented such EU rules and accordingly cryptocurrency exchanges and service providers are subject to the standard customer due diligence and related reporting duties on suspicious transactions. Moreover, the Italian Ministry of Finance is considering establishing a special registry to collect information from the market for cryptocurrencies in Italy.

Consequently, it is clear that holders of crypto-assets should pay particular attention to the importance of keeping adequate evidence not only of their initial investments but also (and more importantly) of their trading activities over the years. This should prevent technical complications and costly delays (considering how volatile cryptocurrencies are) for quickly liquidating investments (in fiat currencies) and maximising gains through banks and financial institutions.

## TAKEAWAYS

The legal treatment of cryptocurrencies is still a developing area and, as such, is still subject to different approaches. In fact, while EU institutions are trying to regulate cryptocurrencies in a specific way, national authorities tend to apply existing principles regarding currencies or financial products.

Since Italy still lacks an organic legal framework for crypto-currencies, the Italian tax authorities currently apply the existing income tax and reporting rules generally applicable to foreign currencies (seeking for a compromise between the different functions of cryptocurrencies). Although, this approach has been met by general criticism, it could have inadvertently opened the door to planning opportunities under the "new residents tax regime".

Finally, AML regulations and the related due diligence procedures could represent another open challenge. In fact, given the specific nature of cryptocurrencies and crypto-assets, evidence of the legal source of the funds initially invested could be difficult to collect, especially if the taxpayer has been in the crypto-market since before the introduction of these regulations.

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