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Luxembourg Tax Alert

Luxembourg Circular on virtual currencies

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On 26 July, the Luxembourg Tax Authorities published a new Circular on the topic of virtual currencies, providing useful clarifications on the tax treatment of income generated through virtual currencies, particularly in the scope of their creation or disposal.

The authorities remind that virtual currencies do not constitute an actual currency, because they cannot be considered as a legal tender and their exchange value is not guaranteed by the central bank.

In this context, the taxpayer is not allowed to either establish his accounts for tax purposes or declare his taxable revenue in virtual currencies.

Therefore, all revenues, expenses and costs formulated in virtual currency need to be determined either in euros or in any other currency, the exchange rate of which is fixed and published by the European Central Bank, based on the daily rate from an exchange platform approved by the CSSF. The proceeds should be determined based on the exchange rate on the day when they have been made available to the taxpayer, and expenses – on the day they have been incurred.

The usage of virtual currency for payment does not affect the tax nature of income. This means that for example, where rent is paid in virtual currency, it does not affect the nature of rental income. For the purposes of taxation, legal provisions should therefore be applied according to the nature of income.

For the purposes of corporate income tax, municipal business tax and net worth tax, virtual currencies constitute intangible assets.

The Circular clearly states that taxability of income does not depend on whether it has been accrued in real or virtual world, but whether it falls under one of income categories determined in Luxembourg Income Tax Law. Therefore, for the purposes of corporate income tax and municipal business tax, income derived in virtual currency can fall either under the category of commercial income or the so-called other income – both of which are explained more in detail below.

1. Tax treatment of disposal, exchange or mining of virtual currency: commercial income

Income in virtual currency can only be considered as commercial income where it falls under the definition of commercial income from Article 14 of Luxembourg Income Tax Law.

This would usually be the case for mining of virtual currency, operation of online stock exchange or vending machines of virtual currencies.

The tax Circular lists several criteria, which among others, can serve as indications of existence of commercial activity:

- Premises or organization assigned to operations on virtual currencies
- Financing by debt
- Frequent rotation of inventory of virtual currencies
- Trading on behalf of third parties

Operating expenses, such as costs of electricity related to virtual currency mining or conversion fees of the virtual currency exchange platforms, can only be deductible where generated exclusively by the enterprise and where not related to any tax-exempt income. The same applies to depreciation of computer infrastructure.

The tax Circular reminds at this point that income derived from all collective funds' activity, as well as mutual insurance associations, is automatically considered to constitute a commercial income. Commercial income is always subject to municipal business tax where the undertaking is located in Luxembourg.

2. Tax treatment of disposal, exchange or mining of virtual currency: other net income

In the absence of a commercial enterprise, it needs to be determined whether income derived through virtual currency falls within the category of other income from Article 99 of Luxembourg Income Tax Law. For instance, this can be the case where the mining activity does not fulfil all the criteria allowing it to qualify as a commercial undertaking following Article 14 of the Luxembourg Income Tax Law.

In the case of exchange of virtual currency against another virtual or real currency, as well as where settling any transaction (especially the purchase of goods or services), the taxpayer is considered to have ceded the virtual currency against a remuneration, followed by a purchase against a remuneration of the currency, good or service received in exchange. Any gain or loss resulting from such an exchange constitutes a speculation gain or loss, as long as the period from acquisition of the virtual currency to the transaction in which this currency is ceded, does not exceed six months.

Income derived from such a transaction would not be subject to tax as long as within a taxable year it would not exceed €500 in total.

The taxpayer is however required to keep consistent and continuous records including specifically the acquisition or creation dates of the virtual currencies, as well as all related expenses. In case of settling a virtual currency transaction, the

burden of proof of its circumstances falls on the taxpayer. Due to the fact that individual identification of a specific amount of virtual currency can be almost impossible, its price has to be determined according to an adjusted average price method (exclusive of “first in, first out” and “last in, first out” methods). The speculation gain is therefore to be determined only where it cannot be excluded that the virtual currency has been held for a period shorter or equal to six months.

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