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Navigating the complexity of global crypto taxation

The regulatory state-of-play around the world

The "borderless" nature of Bitcoin, and its offspring, makes it impossible for any single regulatory authority to "regulate" an asset that exists beyond their domain. That doesn't stop them from trying, as has been evidenced by China, the US, India, and more. This has created regulatory competition that has some countries competing for crypto capital to come into their economies, while others are attempting to exclude it. As a result, jurisdictions such as Wyoming in the US, as well as Singapore, Malta, & Switzerland, have been creating the regulatory clarity that attracts investors drawn to transparency around practical implications of rules governing their investments.

This has created many opportunities for regulatory arbitrage around internationally mobilised capital (i.e. BTC & its offspring) as it's creating choice for businesses to move into those jurisdictions that provide:

- The most clarity (i.e. Malta, Switzerland, Singapore, Wyoming, etc.), and the least risk (i.e. minimal AML data to collect and store)
- The most freedom to act (i.e. no "accredited investor" restrictions) and the lowest cost to do so (i.e. minimal bookkeeping costs and no taxes on capital gains).

Unlike real estate, stocks/bonds, and bank accounts, crypto assets can be moved to the countries that provide the most favorable regulatory environment for them to do business. This is creating competition for capital that now has more freedom of choice as to who has authority to regulate it. For those businesses with capital, it's about certainty as to the rules of the game. They do not like the risk inherent in an unregulated realm, and if given a choice will move to the jurisdictions offering the most business friendly regulations. (as evidenced by crypto companies fleeing the state of New York with its Bitlicense and flocking to Wyoming with its 13 new regulations promoting cryptocurrency use). Borderless capital like Bitcoin has a choice as to where in the world it is parked, so naturally businesses are choosing to domicile their capital in those countries that have clarified the rules, require the least documentation, and incur the least amount of tax liabilities.

The United States

In the USA, for instance, The US regulators require cryptocurrency holders to report capital gains for all transactions. They also lock out most investors from participating in ICO opportunities if they are not "accredited" with documented annual income over $200K or $1 million in assets. Recently the IRS issued a new guidance for cryptocurrencies that declared that airdrops and hardforks will be treated as income.

Europe

The UK and European Union have their own money laundering, proof of wealth, and data protection regulations that complicate these issues as well. These regulations now require collecting and securing not only personal information, but also the data for every transaction valued over $1K USD. The major concern is money laundering, leading to the recent '5AMLD' (Fifth Anti-Money Laundering Directive) framework for fiat-to-crypto exchanges and custodial wallets.

Asia

The clear and crypto-friendly regulations provided by Singapore and Hong Kong are already attracting many projects. Meanwhile, China is trying to capture the benefits of Blockchain technology, but without allowing the monetary freedom that Bitcoin enables. Rather, China plans to roll out its own digital currency. India too is 'pro-blockchain', cautious about cryptocurrencies and 'against any private digital currency' such as Libra.

The hard-hitting taxation challenges of today

But many challenges and complexities still remain today around the subject of bookkeeping crypto asset transactions.

These challenging issues require addressing:

- Historical transaction data
- Net asset value calculation
- Accounting (still classed as an intangible asset)
- Auditing, both internally and externally

All those challenges are made more complex due to:

- Blockchain historical transactional data being hard to extract, difficult to read and challenging to interpret. The data has to be accounted for not only centralised and decentralised exchanges, but also self-custody and P2P payments.

- Transactions often being spread across multiple wallets and exchanges between multiple trading pairs, (which make it difficult to consolidate the financial data and value the transactions in FIAT currency)

- A lack of education in both company management and sub-contracted specialists. (CFOs and CPAs often do not have the technology background to properly understand the exchanges and Etherscan exports)

Reporting challenges also exist regarding valuation of balances, which vary depending on:

- Where the pricing is determined, (pricing on each exchange may differ depending on which jurisdiction it is located in)

- Which trading pairs it's priced in, (not only between different crypto trading pairs, i.e. BTC/ETH, ETH/DASH, USDC/BTC, etc., but also with multiple Fiat valuations, the USD, EUR, Yen, etc.)

- The moment the price is determined. (price volatility often changes the valuation by 10% or more within an hour or less)

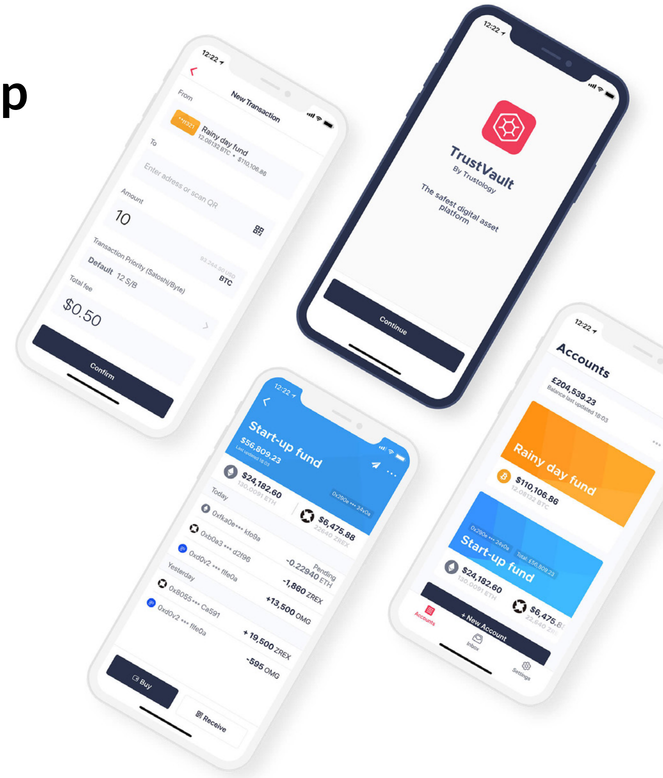
These challenges and complexities are now being addressed with specific tools being created to help automate these processes. The compliance costs of operating without these tools can add up quickly. This is due to the lack of infrastructure in place to simplify the requirements of complying with regulations regarding not only KYC/AML issues but also in documenting ALL the data points needed for both internal and external audits and tax purposes. There currently is a lack of solutions in the marketplace to provide the traditional data tools that can integrate seamlessly with cryptocurrency/blockchain explorers. It has become a nightmare to create reports for cryptocurrency transactions and the risks of not doing so are significant.

Firms need to produce reports that document:

- Capital gains & losses, (both long-term and short-term with liabilities varying greatly by jurisdiction)
- Expenses & income, (on trading fees, labor costs, material costs, mining operations, etc.)
- Opening & closing balances, (of multiple centralised and decentralised exchanges/ platforms)
- Token valuations, (of ICOs, IEOs, & STOs, as well as air-drops and hard forks)
- Trading activity; (segregate expenses into payroll, marketing etc,)

Currently most of this is done manually on excel, or it takes ages to clean the data (if it can even be acquired), in order to be able to import the information into existing accounting or financial reporting tools. Another challenge faced by all firms in this industry is the need to track which of their accounts they used to pay/receive funds, with whom, and when. Cryptocurrency addresses come with no names, which makes it difficult to track these details. But with the proper tools and processes it becomes possible to create even greater transparency regarding account activity, segregating activities according to each use case, transaction, and client. Doing so requires automation of those processes, with strong security protocols in place to protect all of that information, not only of the sending and receiving addresses but also, the client's, vendor's, and employee's identifying data.

Emerging service provider partnership models: a one-stop shop for tax, accounting and custody



"One thing is very certain – Businesses and individuals dealing in cryptocurrencies must meticulously document all their crypto transactional activity to be prepared for the tax season."

Antoine Scalia CEO of Cryptio

As the space gets more institutionalised and participation increases, the majority of fund managers are opting for registered/regulated fund structures. Most of which are mandated to appoint an independent fund auditor. In order to manage regulatory risks, it is essential to enable the fund auditor to ascertain the funds existence, current location, and to trace the source of the assets. To summarise, all the accounting processes for your cryptocurrencies and tokens, here are the tasks blockchain business bookkeepers must do:

- Record and track all expenses, costs and transactions
- Consolidate all cryptos across wallets and exchanges, as well as FIAT currencies
- Convert all crypto transactions into FIAT currency
- Monitor and analyse daily activity, asset performance and cryptocurrency balances
- Categorise transactions into expenses, revenue, operational costs etc.
- Reconcile bank accounts and wallet balances regularly
- Send invoices, pay bills, review account payables and account receivables
- Create and update financial reports Checking that the reports comply with the regulatory needs of your jurisdiction
- Analyse financial reports

Tools are now available for independent auditors & fund administrators to automatically get detailed reports and analysis of all their transactions by using the Trustology coordinated crypto custodial wallet solution in conjunction with Cryptio tax solutions. This combined automated solution saves a lot of time documenting ALL the information needed, minimising compliance costs as both internal and external auditing efforts become more efficient. For example, Cryptio already allows users to add public addresses and then generate reports. However, this can become a manually intensive effort for users holding multiple addresses, as with BTC for instance. Combining their solution, therefore, with Trustology's convenient, yet secure, hosted hot wallet service - TrustVault - ensures that all transactions are accounted for in an auditable, highly secure manner. How? Given that TrustVault only creates segregated wallet accounts, users simply only need to login into their account to allow Cryptio to sync up addresses and run reports. As a result, no private sub-ledgers are needed or added to the equation as the blockchain acts as the common ledger for custody and accounting all in one go, as was intended.

The recent creation of a strategic alliance between Trustology's custodial wallet solution with Cryptio's accounting and bookkeeping solution closes the transaction data loop minimising the chances of any audits being “qualified”, or failing altogether. Creating trust that the necessary systems are in place to collect all needed data, that it’s been verifying, and organised into manageable forms maximising the chances of a successful audit. While minimising the costs of preparing tax paperwork within any jurisdiction.

The documentation costs incurred by actively trading institutional crypto funds, combined with the current regulatory uncertainties, has made many legacy funds hesitate to move the assets under their management into virtual formats. To date, less than 1% of all international investment funds (in total, managing assets valued at over $60 Trillion USD), have begun investing in virtual assets. Of those that have, many are only moving a small portion (often only 1% of their Assets Under Management), of only their high-risk portfolios, into these types of investments. Once their need for safe, regulated, and insured custodial solutions have been found and appropriate data collection tools are available, even more Fund Managers will likely move even more of their assets into virtual forms. These institutional investors will undoubtedly also be needing segregated accounts, advanced control systems, access to new decentralised finance tools (DeFi), to developer APIs, and the ability to scale operations as needed.

These highly regulated entities will not move en-masse into the virtual asset realm until they have acquired some degree of regulatory certainty. This institutionally managed capital will not enter the crypto realm until they have properly created and organised special purpose crypto entities using regulated, insured, and registered custodial solutions with automated systems for both internal and external auditing of accounts. Crypto Fund Managers need all these tools in order to protect their investor’s capital, to manage their own liabilities, and to manage regulatory risks.

Concluding thoughts

Tools that simplify documentation of capital gains, income, expenses, and all transaction histories will not only save time, but also save money on compliance costs. Having a regulated, registered, and insured custodian that provides both convenience and security will allow Crypto Fund Managers to sleep peacefully, assured that their client’s funds are verifiably kept safe, yet liquid. Integration of data collection between all wallets, exchanges, and bank accounts using a crypto specific bookkeeping solution, as provided by Cryptio, creates confidence that when auditing needs to be done, the data needed to accurately do so will be readily available.

Related Reading

Crypto Taxes For Businesses In The UK – A Simplified Guide *(Cryptio.co)*

The Ultimate Accounting Guide For Crypto Businesse *(Cryptio.co)*

Meet The UK Startup On A Mission To Build The World’s Most Secure Crypto Wallet *(Trustology.io)*

Ex-Bankers Offer First Hot Wallet for Institutional-Grade Crypto Finance *(Trustology.io)*

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Contact us: contact@cryptio.co

Our mission is to stimulate the rise of a more decentralised economy. We build the communication layer between digital assets and traditional general ledgers.

Trustology

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Trustology’s vision is to create the most compelling cryptoassets company of the 21st century. Our first focus has been securing and managing cryptoassets with our TrustVault platform technology.