

Initial coin offerings – more clarity on tax implications

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Introduction

Switzerland has become a major hub for initial coin offerings (ICOs) and token-generating events (TGEs). Yet to date, there has been little clarity about the resulting tax implications. Recent discussions and tax ruling negotiations with representatives of several tax authorities in Switzerland have provided more clarity on the tax implications of ICOs and TGEs, at least regarding tokens issued by Swiss companies raising funds under the promise of a participation in future revenues.

As an example, if an entity in Switzerland intends to raise funds for a development project through an ICO or TGE, the investors will receive tokens granting a right to future income streams. Typically, the investor (ie, the token holder) is not entitled to a repayment of the funds invested in the ICO entity. Those participating in ICOs or TGEs not only wish to support the project and participate in future income streams, but also hope for a higher profit by selling the tokens at a certain time.

Corporate income tax treatment

The payment of the token holder to the ICO entity as part of the ICO or TGE is generally treated as income for accounting purposes at the level of the ICO entity. This will be reflected as income for tax purposes, as Swiss tax law generally follows accounting law. However, as the ICO entity must invest the funds in its own business (eg, use for an R&D activity), it may record the funds received as a provision in the same amount. Therefore, the collection of the funds will not trigger corporate income tax at the level of the ICO entity.

In a second phase, the entity will offset its future development costs against existing provisions. Therefore, if the development of the product is cheaper than expected (ie, less than the funds raised), the remaining provisions will be reversed. Such a reversal will trigger corporate income tax. The applicable tax rate depends on the canton of residence. By contrast, if the development costs exceed the funds received, such an amount will be treated as a loss for tax purposes which can be carried forward up to seven years.

If the development succeeds and the ICO entity remains profitable, the token holder will receive a certain share of its earnings. If the token holder receives payments under the tokens, such payments will constitute deductible business expenses for the ICO entity.

Withholding tax treatment

Switzerland levies a 35% withholding tax on dividends and interest on bonds, raising the question of whether the payments by the ICO entity to the token holders fall under one of these categories.

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The term 'dividend' is understood in a formal manner, pursuant to which only a payment based on a corporate right (eg, a share) may qualify as a dividend. A token is not considered a corporate right for withholding tax purposes.

For a bond, it is mandatory that a domestic tax payer issues notes containing a repayment obligation. Yet, as regards most ICOs or TGEs, no such repayment obligation exists. Therefore, a qualification of an investment in an ICO or a TGE as a bond is not persuasive.

It seems likely that the authorities will consider payments based on profit participation tokens which were issued during an ICO or TGE as neither dividends nor interest. This holds true, notwithstanding the fact that the payment to the investors may depend on whether the underlying operations of the ICO entity are profitable.

Therefore, no withholding tax should be levied on payments made by the ICO entity under the tokens to participants in the ICO or TGE, even though the token provides for a participation in the earnings of the company.

Stamp duty

The issuance of the tokens is not subject to Swiss issuance stamp duty. The transfer of tokens may be subject to Swiss transfer stamp tax of 0.15% (if a Swiss securities dealer is involved in the transaction and no exemption or exception applies).

VAT

From a valued added tax (VAT) perspective, the issuance of (profit participation) tokens is an exempt transaction (financial service) according to Swiss tax law. No VAT is due on payments by the ICO entity to the token holders.

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