Facebook Stablecoin Could Be A Taxing Problem for the Uninitiated

by William Hoke

While cryptocurrencies have been gaining popularity in recent years, a reported plan by Facebook to issue its own virtual coins could expand their use exponentially and have unexpected tax consequences for financially unsophisticated users.

The Wall Street Journal reported May 2 that Facebook is in talks with dozens of financial firms and online merchants to introduce a cryptocurrency-based payment system that would mesh with its social media website.

The plan, which the *Journal* said is code-named Project Libra, centers on a digital coin that could either be transferred between users or spent to buy goods or services on Facebook and other websites.

According to the article, Facebook is trying to drum up approximately $1 billion of investments and has held discussions with Visa, Mastercard, and First Data Corp., a payment processing company. The funding would be used to maintain the "stablecoin's" value, thereby avoiding the sometimes wild price gyrations experienced by bitcoin and other cybercurrencies. The price of a bitcoin plunged from over $17,000 in December 2017 to around $3,200 a year later.

A Facebook spokeswoman declined to comment on the report, which the *Journal* attributed to "people familiar with the matter," saying the article is speculative.

While the tax ramifications of transactions and transfers carried out with cryptocurrencies depend on the laws of the user's country, tax professionals say the recordkeeping involved can be daunting — especially for users who aren't accustomed to keeping track of investments — because each use of a Facebook coin would represent a possible disposition of a capital asset. It's also unclear whether the stablecoin that Facebook is contemplating would shield users from having to compute and report realized exchange gains and losses for tax purposes.

Capital Gains

Sinclair Davidson, a professor of institutional economics at RMIT University in Melbourne, Australia, said cryptocurrencies are subject to capital gains tax (CGT) in Australia. "To a large extent, the taxation aspects of the Facebook coin would depend on how you acquired it," he said. "So buying them for cash would be very different from, say, earning them like you would reward points. It's not clear to me why unsophisticated users would buy and hold these coins."

Because there is no specific legal framework under Danish law regulating gains and losses on cryptocurrencies, they are treated like any other assets, said Payam Samarghandi, a corporate and tax law attorney with the Horten Law Firm in Copenhagen. "Accordingly, gains on cryptocurrencies are nontaxable, while losses are nondeductible, unless the holding of cryptocurrencies is purchased with a speculative purpose," he said. "Naturally, this question is a concrete assessment which ultimately must be made by the Danish tax authorities."

If Facebook coins are held as nonbusiness assets by a Swiss resident, there are no CGT implications when they are used in a transaction, said Marius Breier, a tax lawyer with Walder Wyss Ltd. in Zurich. "Capital gains are, however, subject to taxation if the Facebook coins are held by a corporation or as a business asset by an individual," he said.

Canadian tax residents who dispose of or exchange Facebook coins would ordinarily be subject to tax at either capital gain or business income rates, said Alexander Demner, a tax lawyer with Thorsteinssons in Vancouver.

Katherine Forster, a private client lawyer with Mishcon de Reya in London, said any exchange gain realized by a U.K.-resident investor would be subject to CGT at a rate of 20 percent. "There may be cases where the individual is running a business which is carrying on a financial trade in cryptocurrency and will therefore have taxable trading profits," she said. "This is likely to be unusual, but in such cases income tax would take priority over capital gains tax. [HM Revenue and Customs] has indicated that it does not regard the buying and selling of cryptocurrency as gambling. This is unfortunate, since gambling winnings are tax-free."

Onerous Recordkeeping

"The recordkeeping would be no more or less onerous than existing recordkeeping, but it would be a new experience for many people who use Facebook but never trade assets liable for CGT," Davidson said.

Samarghandi said Danish law requires first-in, first-out reporting for taxable transfers of capital assets. "This leaves a significant burden on the shoulders of Danish tax residents, as this is a relatively complex calculation method for a nonprofessional," he said. "Additionally, this calculation method could result in significant tax claims, despite the fact that the particular Danish tax resident has had no net profits on his or her trading with cryptocurrencies."

Under Danish law, the tax impacts of capital gains and capital losses are determined separately, with the latter being subject to a much lower rate.

Demner said the recordkeeping burden on users of a Facebook cryptocurrency would depend on the system the company or its external partners put in place and whether they provide help in recording acquisitions and dispositions. "Other software which assist ordinary investors keep track of their buy/sell activities may also become more prominent and widely available," he said in an email. "Frankly, recordkeeping has been a longstanding issue for cryptocurrency investors of all stripes."

Forster agreed that the tax recordkeeping could be challenging for financially unsophisticated people using cryptocurrencies. "In particular, the cryptocurrency exchange may only keep records of transactions for a short period, or even the exchange may no longer be in existence when an individual completes a tax return," she said.

Because many cryptocurrencies are traded on exchanges that do not use pound sterling, the value of any gain or loss must be converted into pounds for tax reporting, Forster said. "If the transaction does not have a pound sterling value — for example, if one cryptocurrency is exchanged for another — an appropriate exchange rate must be established in order to convert the transaction to pound sterling," she said. "They should also keep records of the valuation methodology. This whole process could prove particularly onerous for taxpayers who just have a small holding."

Stablecoins

Samarghandi said stablecoins are generally circulated through either centralized or decentralized systems. Centralized stablecoins are controlled by a legal entity and collateralized with a fiat currency, such as the U.S. dollar or euro, he said. Decentralized stablecoins are controlled by an autonomous organization and can be collateralized by any asset, including a fiat currency, another cryptocurrency, physical assets, or any combination of currencies and physical assets. "While centralized stablecoins normally do not fluctuate in value . . . decentralized stablecoins fluctuate in value, although . . . very little," he said. "It is my firm presumption that the [Facebook] coin will be programmed as a centralized stablecoin, and the [Facebook] coins will thus be issued and governed by Facebook itself. Accordingly, one [Facebook] coin will be equivalent to one U.S. dollar or another fiat currency, which will . . . eliminate the possible tax implication."

Samarghandi said that if Facebook issues a stablecoin pegged to a fiat currency like the dollar or euro, the question of its taxability will depend on whether its value is volatile. "If so, the potential gains will be subject to Danish taxation, provided that the [Facebook] coin is purchased with a speculative purpose," he said.

Demner said the type of coin, including a stablecoin, doesn't determine whether a gain or loss is triggered on its disposition. "Nor does the country of any underlying currency," he said. "That said, being backed by a government-issued currency may make it easier to determine a value for the stablecoin, which would ease recordkeeping and reporting."

Forster said that if Facebook issues a stablecoin, exchange gains would only be eliminated for U.K. residents if its value is pegged at a one-to-one ratio with the pound.

There could be concern whether a stablecoin issued by Facebook or any other entity is fully backed by a fiat currency or other assets. The issuers of Tether — perhaps the most well-known stablecoin — originally said each token was backed by $1 of reserves. Despite that claim, Tether Ltd. also said owners of its coins have no legal right to exchange them for dollars on a one-to-one basis. The company has also failed to provide audited proof that its coins are fully backed by dollar reserves. On March 14 Tether said its reserves could include assets and loan receivables from third parties, which might include the company's affiliates. In an April 30 court filing, Tether's lawyer said the company's coins were only 74 percent backed by cash and cash equivalents.

Consumption Taxes

Demner said consumption tax could be due on the acquisition of a Facebook coin. "The [general sales tax/harmonized sales tax] treatment of cryptocurrency is still in flux, but the Canada Revenue Agency is on record as saying that acquisitions of cryptocurrency may require vendors to collect and remit [those taxes]," he said. "There remains significant uncertainty in this area."

Forster said HMRC's position is that the mining and trading of cryptocurrencies should be treated as outside the scope of VAT, which she said is consistent with a 2015 ruling by the Court of Justice of the European Union that "the exchange of traditional currencies for units of the Bitcoin virtual currency is exempt from VAT . . . under the provision concerning transactions relating to currency, bank notes, and coins used as legal tender" (*Skatteverket v. Hedqvist*, C-264/14 (CJEU 2015)). "However, in all instances, VAT will be due in the normal way on any goods or services sold in exchange for cryptocurrency," Forster said. "The value of the supply of goods or services on which VAT is due will be the sterling value of the cryptocurrency at the point the transaction takes place."

Popular, but Possibly Problematic

"I would have thought the biggest challenge for these coins wouldn't be taxation, but rather the know-your-customer regulations and money laundering laws," Davidson said. "Facebook wants to operate a financial settlement system and move money across international borders — more strength to them — but this is something governments take a very close interest in."

Forster agreed. "Cryptocurrency has been associated with the risks of money laundering and terrorist financing, along with legal and reputational risks to banks, and this remains a concern," she said.

Demner said that depending on its rollout, availability, and other factors, a Facebook coin could be widely used in everyday transactions by ordinary Canadians. "It may very well represent the first foray into owning and dealing with cryptocurrency for the majority of those persons," he said. "It would be interesting to see how the Canadian government or CRA responds, if at all, in that situation." ■