

Cryptocurrencies in terms of tax burden for a specific entity

Kateřina Mazancová¹

DOI: 10.32725/978-80-7394-976-1.15

Abstract: Cryptocurrencies are a modern phenomenon not only in terms of technological advancement, but also as a means of payment or investment. The aim of the paper is to evaluate the impact of dealing with cryptocurrencies in terms of tax burden for a particular entity. To assess the tax burden, personal and corporate income tax and value added tax are selected. The analysis is complemented by recommendations for optimising the tax liability and a list of consequences of not declaring income from cryptocurrencies. The conclusion summarizes the results, including the outstanding legislative issues of further taxation.

Keywords: cryptocurrencies, tax, VAT, comparison of personal and corporate taxation

JEL Classification: H25

1 Introduction

Cryptocurrencies are digital assets created using computer networking software that allows for secure trading and ownership. It is a medium of exchange that is digital, encrypted and decentralised. Unlike the US dollar or the euro, there is no central authority that manages and maintains the value of a cryptocurrency. Administrative tasks are widely distributed among cryptocurrency users via the Internet. The 21st century society, through cryptocurrencies and other innovations from Industry 4.0, demonstrates the abnormal potential that lies in technology and its applications. With cryptocurrencies, it is possible to buy common goods and services, although most people invest in cryptocurrencies just like they invest in other assets, for example stocks or precious metals. While cryptocurrency is a new and exciting asset class, buying it can be risky because an investor must do proper analysis to fully understand how each cryptocurrency works.

Experts' opinions on investing in cryptocurrencies are mixed. Because crypto is a highly speculative investment with the potential for intense price fluctuations, some financial advisors do not recommend investing in them at all. For example, Bitcoin's value nearly quadrupled during 2020, and by the end of the year it was valued at over 28 900 USD. By April 2021, the price of BTC had more than doubled from the beginning of the year, but all of that growth had passed by June of that year. Subsequently, BTC more than doubled again, reaching an intraday high above 68 990 USD on November 10, 2021, before falling again to around 46 000 USD by the end of 2021. It is quite noticeable that cryptocurrencies can be very volatile.

The downside is the frequent energy consumption (energy is mainly obtained by burning fossil fuels) and the subsequent environmental impacts associated with cryptocurrencies. Bitcoin mining generates about 96 million tonnes of carbon dioxide emissions each year, a similar amount produced by a small country. In contrast, Ethereum mining produces more than 47 million tonnes of carbon dioxide emissions annually. However, there are also low-energy cryptocurrencies like XRP or Split.

2 Methods

The literature research is mainly based on professional books and partly on foreign articles. Specialized literature was used to study and understand the issue. The books were borrowed largely from the Academic Library of JU or searched in online catalogues on the Internet.

The second part of this thesis is practical. The introduction of the practical part discusses the details of the future business of the FD entity. In 2022, it plans to be involved in trading, mining cryptocurrencies, creating virtual worlds and collecting the new phenomenon of NFTs. Non-fungible token refers to an unquestionable confirmation of possession of a digital item (song, game item, tweet or image) and quick identification of the owner. In the following practical section, the business plan is analysed in terms of the tax burden on the FD entity.

The analysed plan thus provides an overview of the most common situations related to the handling of cryptocurrencies, which together form a complete treatment for the issue of their taxation. The FD entity assumes two

¹ University of South Bohemia in České Budějovice, Faculty of Economics, Studentská 13, 370 05 České Budějovice, Czech Republic, mazank01@ef.jcu.cz

strategic plans for its business. The first plan, which is rather critical, assumes revenues of up to CZK 1 800 000, and the second, more ambitious plan calculates revenues of around CZK 3 600 000. The practical part for these purposes analyses the situation of taxation of the FD entity's income as an individual, as a legal entity and the related impact of VAT. Doing business through a legal entity brings a number of advantages and disadvantages, of which the FD entity is aware, when it counts on the so-called cheaper and more expensive plan. The analysis of possible alternatives should reflect the potential paths for the FD entity in its future decision-making.

The practical part is divided into logical sub-sections, with the first one dedicated to the business plan, the second one to personal income tax, the third one to corporate income tax, the fourth one to value added tax and the last one to non-taxation of cryptocurrencies. The calculation of each type of tax is discussed in detail below.

3 Research results

When comparing whether it is more advantageous to tax cryptocurrency profits as an individual or a legal entity, there is no clear answer in general terms, as market developments, investment decisions or the introduction of government regulations play a significant role. Also, from a strategic management perspective, an FD entity may pursue very different objectives than a low tax burden. The conclusions drawn are only used by the FD as supporting material for setting further objectives.

4 Business plan of the FD entity

The Business Plan is considerably abbreviated in its scope due to the trade secrets and specific procedures to which the FD Entity claims the right.

For its technical analysis, the FD Entity uses the TradingView portal and other trading and analytical platforms from brokers such as xStation or MetaTrader. When deciding on a trade, it is further oriented by patterns (candle formations that indicate signals of future market development for opening and closing positions) such as a classic trend line, single (123gap) or triangle. It also uses indicators such as trading volume, moving averages, trend indicators, oscillators and others.

It intends to conduct its trading through Coinbase, Crypto.com, Binance and other verified brokers XTB, eToro and Plus500. In its personal calculations, the FD entity assumes membership and brokerage fees, which by their nature are not specifically quantified in the paper.

It estimates its revenue at between CZK 1 800 000 and CZK 3 600 000 and its actual costs at around CZK 800 000. The FD entity in 2022 will have the following in its economic life:

Software used:

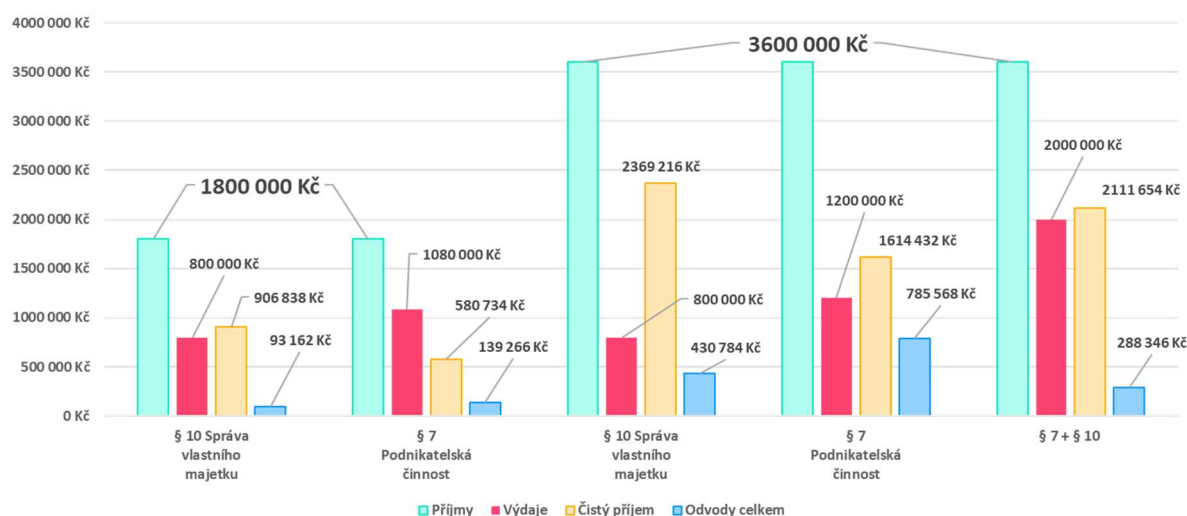
- For cryptocurrency safekeeping: Ledge Vault and Digital assetss Fidelity
- For cryptocurrency payments: Coinomi and BitPay

Basic Hardware:

- Dell XPS7390 13" InfinityEdge Touchscreen Laptop = 27,000 Kč
- HP Omen 870-213w Desktop PC = 45 000 Kč
- Gaming Hexblade, gaming keyboard, Cherry MX Silent Red = 2 000 Kč
- Trust Voxx Rechargeable Ergonomic Wireless Mouse = 1 300 Kč
- 2 x 35" LG Ultrawide 35WN75C-B screen = 23 000 Kč

In the case of income of CZK 1 800 000 for an FD as an individual, the difference in levies is not as marked as for income of CZK 3 600 000. The recommendation for the entity in this regard is to use Section 7 and Section 10 at the same time. Tax the income of CZK 2 000 000 according to §7 and use the highest possible flat rate and tax the remaining CZK 1 600 000 according to §10 using the actual expenses incurred. The tax base would be rapidly reduced to CZK 1 600 000, the net income would be CZK 2 111 654 and the total levies would amount to CZK 288 346. In this case, the net income is distorted by the lump-sum expenditure, without the lump-sum being taken into account it amounts to CZK 2 511 654. Another proposal for the FD entity is to increase the existing deductible items or to use other items such as examinations verifying further education, etc.

Diagram 7: Graphical comparison of taxation in §10 and §7



Source: own processing

Without a doubt, it is necessary to mention the advantages of investing in cryptocurrencies as an individual. The first is the entry costs, which can be low, which is not the case for an FD entity. Income is not subject to health and social insurance unless the individual is a business and uses Section 10. As long as the entity's income does not exceed 48 times the average wage, its income is taxed at only 15%, compared to 19%, the corporate rate. If the limit is exceeded, the rate increases to 23%, and there is more talk of a disadvantage. Disadvantages include the inability to offset losses from previous years, the non-application of overhead costs to reduce the tax base, the inability to offset losses of other attributes in one year (Bitcoin and shares) and full liability for its obligations.

5 Capital intensity for legal entity

The share capital of s.r.o. is divided into a part in Czech crowns and cryptocurrencies ETH and BTC (CZK 61 000 and CZK 860 000 as of 26 February 2022). The necessary technical equipment of the company is quantified in Table 7. Again, the company gives two options for initial expenditure, depending on the development of the company's economic situation. The initial expenditure is divided into surplus and expendable expenditure. Hardware for mining is considered expendable, as mining is considered to be only a supporting activity in the company's business strategy. Related to this is the possibility of cloud mining, where no hardware is required and the company would use a cheaper plan at this point in time. Conversely, if the company assessed the situation as promising, according to its internal procedures, it would use the more expensive plan. The positive perception of the future situation is also supported by the fact that in the summer of 2021, the ban on mining in the Sichuan region of China meant the end of 90% of cryptocurrency mining in the country, which meant a general decrease in mining costs. Another imaginary clue for society is "fake news" about bans on the use of cryptocurrencies in various countries, or speculation over central bank negotiations on monetary policy (e.g. the Fed's negotiations, or Turkey's acceptance of cryptocurrencies)

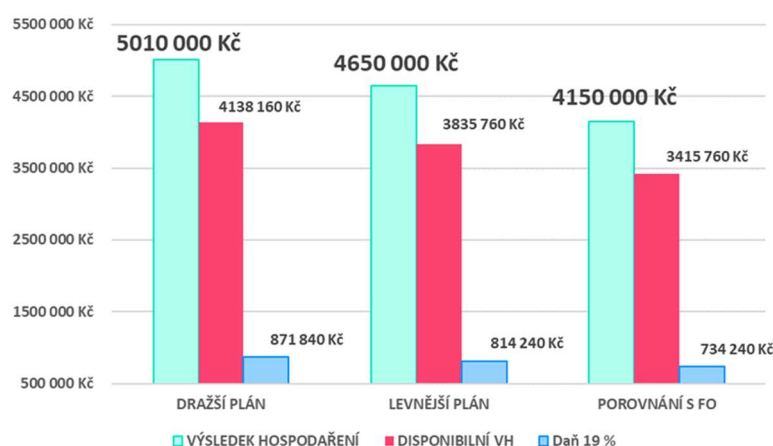
Picture 1 Initial expenses of the company

	DRAŽŠÍ PLÁN		LEVNĚJŠÍ PLÁN	
	bez DPH	DPH	bez DPH	DPH
Založení společnosti	11 000 Kč	13 310 Kč	11 000 Kč	13 310 Kč
pronájem prostorů	120 000 Kč	25 200 Kč	120 000 Kč	25 200 Kč
Stolní počítače	360 000 Kč	75 600 Kč	360 000 Kč	75 600 Kč
Kancelářský nábytek	80 000 Kč	16 800 Kč	80 000 Kč	16 800 Kč
Monitory	184 000 Kč	38 640 Kč	184 000 Kč	38 640 Kč
Příslušenství k počítači	32 000 Kč	6 720 Kč	32 000 Kč	6 720 Kč
Webové stránky	10 000 Kč	2 100 Kč	10 000 Kč	2 100 Kč
Projektor	15 000 Kč	3 150 Kč	15 000 Kč	3 150 Kč
Tiskárna	25 000 Kč	5 250 Kč	25 000 Kč	5 250 Kč
Radeon RX 6900 XT XTREME WATERFORCE WB 16G			470 000 Kč	98 700 Kč
Profi Mining farma – 60x 3060TI NON LHR	5 000 000 Kč	1 050 000 Kč		
CELKEM	5 837 000 Kč	1 236 770 Kč	1 307 000 Kč	285 470 Kč
	7 073 770 Kč		1 592 470 Kč	

Source: own processing

Corporate taxation, on the other hand, allows for netting losses from the previous 5 years, offsetting losses on various attributes, and applying a range of expenses. The disadvantages appear mainly in higher upfront costs, administrative tasks and higher tax rates. Depending on the type of legal entity, the liability is divided among the owners of the company or the liability falls only on the assets of the company.

Diagram 8 Graphical summary of the income tax variants of PO



Source: own processing

The different options represent a situation where the company has opted for more or less expensive capital intensity. The column of the graph on the far right shows a comparison where the company is able to generate the same returns as the FD entity would have been able to generate on its own. Here it can be seen that under the specified internal conditions, the company is able to generate less than a million more free funds. However, it should be noted that the funds remain in the company and, in the event of a profit sharing distribution, the recipient would have to tax this income as an individual. The use of employee benefits seems to be a recommendation not only to optimise the tax liability of the legal entity but also to motivate the employees.

6 Conclusions

Cryptocurrencies are a hot topic in the global financial system, although there is a high volatility of cryptocurrency exchange rates, which is associated with high trading risk. Their growth has managed to gain the attention of many speculators. They are easily transferable but untrustworthy. If cryptocurrencies fail to gain trust, their boom may decline. Even some economies have begun to issue national cryptocurrencies. There is room for less developed countries to use cryptocurrencies for their economic transformation.

The objective of this paper is to evaluate the impact of dealing with cryptocurrencies in terms of tax burden for a particular entity. The introductory theoretical part provided the reader with a space to understand the nature of

cryptocurrencies and then this knowledge was applied in the methodology and practical part. As a result of the practical part, the author concludes the following.

1. The publications and methodologies published so far are insufficient to define and treat cryptocurrencies in a uniform manner. There is no legal anchorage in the Czech Republic that would give an objective view of cryptocurrencies. Taxpayers have a greater tendency not to declare income as they are not aware that it is taxable income and do not know how to practically record cryptocurrency transactions.
2. All known tax jurisdictions point only to the burden of cryptocurrency income, but only marginally address value added tax. Taxpayers are thus faced with a situation where they are unable to clearly identify the expected tax burden as part of their business plans. Again, the tendency to deny income or tax even exempt transactions is increasing.
3. The inability of taxpayers to routinely check whether they have taxed all their cryptocurrency income due to anonymity. Control authorities lack the tools and principles for normal taxpayer supervision and do not pay attention to educating their staff about cryptocurrencies.

The author considers the contribution of the paper to be the demonstration of not only the tax burden and accounting cases related to cryptocurrencies, but also the summary of references to specific cryptocurrency platforms that can inspire similar business ventures. For further information, the author refers to the thesis entitled Tax and Accounting Aspects of Cryptocurrencies by Bc. Ladislav Novotný, a dissertation on a similar topic, Binance academy and mcoin.cz, which focuses on news from the world of cryptocurrencies. The only starting point for orientation for accountants, tax advisors, analysts and auditors is to follow the current events around cryptocurrencies and new innovations coming with them.

References

Mazancová, K. (2022). Kryptoměny z hlediska daňového zatížení pro konkrétní subjekt (Diplomová). České Budějovice.