

Taxing Tokens – A Swiss Perspective On the Taxation of Initial Coin Offerings and Blockchain-Based Tokens

by Marius Breier, Peter Hongler, and Maurus Winzap

Reprinted from *Tax Notes International*, March 19, 2018, p. 1159

Taxing Tokens – A Swiss Perspective on the Taxation of Initial Coin Offerings and Blockchain-Based Tokens

by Marius Breier, Peter Hongler, and Maurus Winzap



Marius Breier



Peter Hongler



Maurus Winzap

Marius Breier, Peter Hongler, and Maurus Winzap are with Walder Wyss Ltd. in Zurich.

In this article, the authors examine three different types of blockchain-based tokens being used to fund business endeavors, particularly the development of new technology, and consider how Switzerland's existing tax laws apply to these new fundraising tools.

Recently, start-ups and even well-established companies have become increasingly interested in issuing coins or tokens as a new way to finance their business activities. In an initial coin offering (ICO), also called a token sale or token-generating event, the issuer raises funds from investors based on a detailed white paper describing the specific project. Recent examples include Zurich-based modum.io AG, which is using the funds generated to develop a blockchain-based supply

chain technology, and the U.S.-based Filecoin, which is using the proceeds to develop a decentralized storage network.

In return for the investment — usually paid in bitcoin or ether, but sometimes using other crypto- or even fiat currencies — the investor receives specific entitlements or rights in the form of tokens deposited on a blockchain, which is a decentralized internet-based storage ledger.¹ Thus, the investor acquires his or her entitlements in the form of tokens rather than as a corporate right. The tokens may be transferred electronically to third parties at a future time.²

Many different types of entitlements can be represented by tokens. We will focus on the following three categories:³

- tokens that give the holder the right to a share of a company's future profits (income-sharing tokens);
- tokens that give the holder the right to a share of future royalties generated by means of a specified technology (royalty-sharing tokens); and
- tokens that enable the holder to use technology to be developed by the issuing entity (utility tokens).

The three token designs should be distinguished from tokens that are exclusively used as a digital currency (also known as intrinsic

¹ See Mirjam Eggen, "Chain of Contracts," *AJP* 3 (2017) (providing a recent analysis of blockchain from a legal perspective including a discussion of terminology).

² This article will not address the question of whether tokens qualify as securities from a regulatory perspective.

³ These are our definitions; no legal categorization of tokens is available. For a different approach to categorizing tokens, see Matthias Langer and Sascha Valenta, "Taxation of Cryptocurrency and Blockchain-Based Companies in Liechtenstein," *Tax Notes Int'l*, Jan. 8, 2018, p. 171.

or native tokens) like bitcoin. Depending on the definition used, any tokens could be considered digital currency if they have a value and can be transferred electronically. However, tokens like bitcoin that are used solely as digital currency are unusual.⁴

Switzerland has been a popular location for companies engaged in these cutting-edge transactions. It has been on the front lines as countries try to figure out how this new form of financing fits into existing legal, economic, and regulatory frameworks — including the appropriate tax treatment of ICOs and token income. This article will briefly outline the primary characteristics of the three most common types of tokens and then examine the relevant tax implications for both investors and issuers under Swiss law.

I. Model Cases

In describing the model cases, we will use the term “issuing entity” to describe the entity (for example, a limited liability company, a foundation, or another legal entity) that issues the tokens⁵ and the term “issuing event” to describe the process of the issuing entity actually issuing the tokens to the investors. When we describe the company’s payment obligations, we refer to the sum owed to all token holders and assume the holders receive a percentage of the overall sum based on the share of tokens owned (that is, all tokens are equally valued).

A. Case 1 — Income-Sharing Token

An income-sharing token enables the token holder to participate in the income generated by the issuing entity. There are different subcategories of income-sharing tokens. In the traditional form, the token holder receives payments corresponding to a share of future income based on the profit and loss statement

(before or after tax) of the issuing entity. In other cases, the token holder receives payments if other conditions are met, such as if the issuing entity generates positive earnings before interest and taxes (EBIT) or distributes dividends to its shareholders. These tokens share the common factor that future payments to the token holders are linked to some reference value reflecting the overall success of the issuing entity. Unless the reference value is positive, payments are not usually made to the token holder.

For example, a Swiss start-up company (ROB) intends to develop a new robot designed for household tasks. To finance the development of the robot, ROB issues 10 million ROB tokens. It offers the tokens for CHF 1 each, usually paid using a digital currency such as bitcoin or ether. The ROB token gives the holder the right to participate in the future success of ROB, as ROB is obliged to pay the token holders 30 percent of future positive EBITs.

B. Case 2 — Royalty-Sharing Token

A royalty-sharing token enables the token holder to participate in the future royalties generated by the issuing entity as a result of a new technology. Thus, the amount of any future payments to the token holder depends on the amount of royalties received by the issuing entity in the future. Tokens that use other reference values directly tied to the income generated by a specific technology are conceivable, and they also belong to the category of royalty-sharing tokens.

Consider a Swiss start-up company (SOFT) that develops new software for data management. To finance the development, SOFT issues 20 million royalty-sharing tokens for CHF 1 per SOFT token, payable in bitcoin or ether. Once the software has been developed using proceeds from the token sale, it will be licensed to third parties. SOFT agrees to pay the token holders 30 percent of the royalties generated by the new data management software in the future.

C. Case 3 — Utility Token

Utility tokens give the token holder the right to use a specific technology developed by the issuing entity — the investor receives a direct share in the technology rather than a right to profits or royalties.

⁴ Other articles have addressed the treatment of traditional cryptocurrencies from a Swiss income and wealth tax perspective. See, e.g., Thomas Linder and Christoph Rechsteiner, “Leitfaden zur Deklaration von Bitcoins in der Steuererklärung,” 65 *Zuger Steuerpraxis* 23 (Aug. 2017).

⁵ A special purpose vehicle can also be used as issuing entity via a two-tier structure in which the operating company is a subsidiary of the issuing entity. However, for the purpose of this article, we will focus on a single-tier structure in which the issuing entity is also the operating company.

With utility tokens, the fundraising and the issuance of the tokens are not necessarily contemporaneous. Often, the fundraising significantly precedes the actual issuance of the tokens because the technology behind the tokens must first be developed by the issuing entity using the funds raised. The investor receives the right to tokens when they are generated and operational.

Our example for utility tokens is a Swiss start-up company (COM) that intends to develop a new internet-based decentralized communication application. COM issues 10 million COM tokens for CHF 1 per token, payable in bitcoin or ether. The funds will be used to develop this new communication application. COM tokens enable the investor to use the new application after completion. It is not possible to use the new application without COM tokens.

II. Income Tax at the Issuing Entity Level

A. Issuing Event

For accounting purposes, payments from token holders to the issuing entity as part of the issuing event are generally treated as income received by the issuing entity. This would trigger corporate income taxes because Swiss tax law, as a general rule, follows accounting law.⁶ The issuing entity should, however, be allowed to record provisions in the amount of the funds received, thereby neutralizing the income from the issuance of the tokens.⁷ There are at least two justifications for allowing this provision.

First, the provisions are justified in all three model cases because the issuing entity is obligated to use the funds generated by the issuing event for the development of the new technology. The development will involve tax-deductible expenses at the level of the issuing entity in accordance with the treatment of business expenses under Swiss law. Because these deductible expenses are directly linked to the

income from the issuance of the tokens, the income should be neutralized by a provision for these future expenses.

A second justification applies to income-sharing and royalty-sharing tokens. These are not only linked to future development expenses, but also to the expectation that future payments will be made to the token holders based on a future reference value. The funds generated from the issuing event are inherently linked to these future payments, which represent tax-deductible expenses at the level of the issuing entity.

To conclude, recording provisions in the amount of the collected funds should allow the issuing entity to avoid triggering any corporate income taxes at the time of the issuing event. However, in practice, the recording of a provision requires a detailed case-by-case analysis of whether it is justified in that instance.

B. Development Phase

If a provision has been accounted for at the time of the issuing event on the grounds that the funds generated will be used for the development of the new technology, the issuing entity should offset its development costs in the following years against the existing provision. Therefore, if the development of the product is cheaper than expected (that is, less than the total funds raised), the remaining provisions should be reversed. This 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, the excess should be treated as a loss for tax purposes and may be carried forward for up to the next seven years.⁸

If the provision has been accounted for at the time of the issuing event on the grounds that the issuance of the tokens is linked to future payments to the token holders, the provision should not be reversed during the development phase but rather when payments are actually made by the issuing entity to the token holders. The payments to the token holders will constitute tax-deductible business expenses for the issuing entity.

⁶ Article 58 of the Federal Law on Direct Taxation (Bundesgesetz über die direkte Bundessteuer, or DBG).

⁷ See article 960e of the Code of Obligations (Obligationenrecht, or OR) (defining the term "provision" according to Swiss accounting law). See also Langer and Valenta, *supra* note 3, at 172 (discussing taxation in Liechtenstein and referencing "anticipated development costs and projected maintenance costs").

⁸ See article 67 DBG.

III. Income Tax at the Investor Level

A. Overview

As for the treatment of income from tokens for tax purposes, it is important to note that the tokens may be considered evidence of a contractual agreement between the issuing entity and the investors — the tokens themselves do not constitute corporate rights from a civil law perspective.⁹ The terms of the contract between the token holder and the issuing entity are outlined in the “Terms of Token Sale.”

At the same time, however, it is difficult to find a comparable contractual relationship in Switzerland’s civil law code that could encompass all tokens. Some token holders have rights and duties similar to a creditor, while others are more akin to a shareholder, a licensor, or a service contractor. The following income tax discussion is based on this unspecific legal framework. To identify the most appropriate treatment, we distinguish between the tax consequences for investors holding tokens as private assets (Section III.B, *infra*) and investors holding tokens as business assets (Section III.C, *infra*).

B. Tokens as Private Assets

The income tax consequences for individual investors holding tokens as private assets depends on the classification of the respective contractual agreement under Swiss income tax law. Thus, we must first classify the contractual agreement and then assess the tax consequences of that contractual agreement.

This approach — comparing the tokens to other contractual arrangements — is currently favored by the authorities. Another approach would be to derive the tax treatment from the existing legal and constitutional framework without undertaking a detailed comparison with other contractual arrangements.

1. Income-Sharing Tokens

a. *Classification.* We believe that the contractual relationship between the issuing entity and the token holders is likely to be treated as a derivative

financial instrument because the value of the token depends on the development of a reference value.¹⁰ In other words, it is comparable to a derivative financial instrument allowing the investor to participate in the appreciation of an underlying security, such as a share or a bond.

In our example involving ROB, the value of the contractual agreement reflected by the ROB token depends on the expected level of ROB’s EBIT because ROB is obligated to pay the token holders 30 percent of all future positive EBITs. If the expected future EBIT increases, the value of the ROB tokens should increase as well.

This provides clues as to which category of derivative financial instruments the various tokens belong. Within the category of derivative financial instruments, at least two subcategories should be considered when evaluating the treatment of income-sharing tokens from a Swiss income tax perspective. The tokens could qualify as a prepaid forward contract or the tokens could qualify as certificates for income tax purposes. The latter is the position currently adopted by the Swiss Federal Tax Administration.

i. *Prepaid forward contract.* One option is that the tokens could be considered prepaid forward contracts (also referred to as an atypical forward contract) between the issuing entity and the investors receiving the tokens.¹¹ In a prepaid forward contract, one party makes its payment at the beginning of the contract and, in return, expects a delivery of the agreed-upon securities (such as shares) by the other contracting party at a future time. Applied to tokens, investors prepay for the anticipated tokenized securities, which are future payments to the token holders based on the agreed-upon reference value such as the overall income of the issuing entity for an income-sharing token (or, as noted below, the royalties received for a royalty-sharing token).

¹⁰ This view is based on the initial discussions with several tax authorities in Switzerland. Swiss income tax law does not provide a specific legal definition of derivative financial instruments. However, according to Circular Letter No. 15, “Obligationen und Derivative Finanzinstrumente als Gegenstand der Direkten Bundessteuer, der Verrechnungssteuer sowie der Stempelabgaben,” ESTV (Oct. 3, 2017), Section I.B.1, an investment deriving its value from an underlying asset is considered to be a derivative financial instrument.

¹¹ Prepaid forward contracts are comparable to low exercise price options, economically speaking. See, e.g., *id.* at Section I.B.3 (final paragraph).

⁹ Please refer to Eggen, *supra* note 1, for a more detailed analysis from a civil law perspective.

ii. *Certificate (sui generis)*. According to informal discussions we have had with representatives of the Swiss Federal Tax Administration, they do consider income-sharing (and, as noted below, royalty-sharing tokens) to be derivative financial instruments. However, rather than further qualifying the derivatives as forward contracts prepaid by the investors, the authorities seem to consider the tokens to be certificates with the agreed-upon reference value serving as the underlying asset and paying compensation to the investors.¹²

For example, an income-sharing token giving its holder the right to participate in future dividend payments should be regarded as a certificate with dividends as the underlying asset. Likewise, an income-sharing token granting the right to participate in the future EBIT of the issuing entity should be seen as a certificate tied to future EBIT, which constitutes the underlying asset. Following this classification, all future payments from the issuing entity to the investors are regarded as “compensation payments.” The income tax consequences of such a classification are outlined below.

b. *Tax Implications*. The tax consequences of tokens will vary depending on their classification.

i. *Income tax implications of classifying income-sharing tokens as a forward contract prepaid by the investors*. If the relationship between the issuing entity and the investors is regarded as a forward contract prepaid by the investors, the investors should not owe income tax at the time of the issuing event because their payments and their receipt of the income-sharing tokens result in neutral exchange.

Future payments from the issuing entity to the token holders should not be subject to income taxation until the total amount of payments has reached the invested amount. This is because the receipt of payments from the issuing entity at the level of the individual token holders should be offset against the investment made by the token holders. This tax treatment is actually comparable to the tax treatment of an ordinary purchase — the purchased tokenized securities are exempt from

taxation at the purchaser level because the acquisition is offset against the amount paid.

If, however, the payments from the issuing entity to the token holders exceed the invested amount, the excess amount would be taxable. In an atypical forward contract, the element of prepayment triggers the question whether an investor should inherently expect some level of interest for pre-financing the business development.¹³ Economically speaking, the investors as the contracting party prepay the forward contract and thus can reasonably expect future payments that correspond to the invested amount plus an additional interest amount.

The interest amount would be subject to income taxation. If a forward contract was issued by a financial institution, the authorities would assume a market interest rate to define the taxable interest component (for example, the three-year swap rate in the respective currency). However, because the market rate is almost impossible to define in these cases, it seems reasonable to assume that all payments exceeding the invested amount should be qualified as taxable interest income according to a pure differential taxation.¹⁴

Any gain from the sale of income-sharing tokens — secondary market transactions involving a third party — should, under Swiss law, constitute a tax-free capital gain for individuals holding the tokens as private assets, unless the investor qualifies as a professional securities dealer.¹⁵

Applying Swiss tax law to case 1 and considering tokens to be equivalent to prepaid forward contracts, the payments of the investors to ROB at the time of the ICO should be tax neutral at the level of the investors. Future payments from ROB to individual token holders should be tax free until the total amount of payments reaches the invested amount. Thus, for an individual who invested CHF 50,000 for 50,000 ROB tokens at the time of the ICO, all payments

¹² See *id.*

¹³ See *id.* at section 4(a).

¹⁴ The interest component cannot be calculated using the swap or LIBOR market rate (used for structured products issued by banks and other financial institutions). First, this approach only applies to issuers rated single A or higher. This requirement is almost certainly not met by our issuing entity. Second, this approach only applies to products with a definite term; the term of an income-sharing token is usually indefinite.

¹⁵ See article 16(3) DBG.

from ROB to the investor should be tax free until the investor receives CHF 50,000. All payments above this amount should, however, be taxable as interest income. If the investor sells his ROB tokens in the secondary market, any profits should be considered tax-free capital gains.

ii. Income tax implications of classifying income-sharing tokens as certificates involving compensation payments. The Swiss Federal Tax Administration appears to favor considering income-sharing tokens to be certificates on the respective reference value.

Here, much like when tokens are considered prepaid forward contracts, payments to the issuing entity at the time of the issuing event and the receipt of the income-sharing tokens result in a tax-neutral transaction at the level of the investor.

However, based on the qualification as a certificate, the Swiss authorities take the position that all future payments made by the issuing entity to the token holders should be considered taxable compensation payments to the investor. Thus, in contrast to the result under the forward contract classification, all future payments to the token holders should be subject to income taxation and not just payments exceeding the invested amount.

As for the tax treatment of capital gains made by selling income-sharing tokens in the secondary market, the Swiss Federal Tax Administration seems to share the view that these qualify as tax-free capital gains unless the individual investor selling the tokens is a professional securities dealer.

Applying Swiss tax law and the certificates qualification to case 1, payments of the investors to ROB and the receipt of tokens at the time of the ICO should be tax neutral at the level of the investors. However, because of the qualification as a certificate, all future payments from ROB to the ROB token holders would be subject to income taxation, irrespective of the amounts invested at the time of the ICO. If the ROB investor sells her ROB tokens in the secondary market, possible capital gains would qualify as tax-free capital gains.

2. Royalty-Sharing Tokens

a. Classification. The classification analysis for royalty-sharing tokens is comparable to the

classification of income-sharing tokens. Royalty-sharing tokens should either be classified as a prepaid forward contract entered into by the investors or as a certificate involving compensation payments.

b. Tax Implications.

i. Income tax implications of classifying royalty-sharing tokens as a prepaid forward contract entered into by the investors. If they qualify as prepaid forward contracts entered into by the investors, the tax treatment of royalty-sharing tokens at the level of the token holders should be identical to the tax treatment of income-sharing tokens qualified as prepaid forward contracts entered into by the investors described above.

Applying Swiss tax law and the prepaid contract qualification to case 2, the payments of the investors to SOFT and their receipt of SOFT tokens at the time of the ICO should be tax neutral at the level of the investors. Future payments from SOFT to individual SOFT token holders should be tax free until the total amount of payments surpasses the threshold of the invested amount. Thus, if an individual invested CHF 50,000 for 50,000 SOFT tokens at the time of the issuing event, all payments from SOFT to the investor should be tax free up to CHF 50,000. All payments beyond the amount of CHF 50,000 should be subject to taxation as taxable interest income. If the investor sells his SOFT tokens in the secondary market, any gains should qualify as tax-free capital gains.

ii. Income tax implications of classifying royalty-sharing tokens as certificates involving compensation payments. Similarly, if they are considered certificates, then the tax treatment of royalty-sharing tokens at the level of the token holders should be identical to the tax treatment of income-sharing tokens qualifying as certificates explained above.

Applying Swiss tax law to case 2 and using the certificate qualification, payments of the investors to SOFT at the time of the ICO should be tax neutral at the level of the investors. However, all future payments from SOFT to the token holders would be subject to income taxation regardless of the amount invested at the time of the ICO. If the SOFT investor sells his or her ROB tokens in the secondary market, any profits would be tax-free capital gains.

3. Utility Tokens

a. Classification. For utility tokens, the agreement between the issuing entity and the investors resembles a contract development agreement because the token holders will have exclusive access to the new technology once it is developed by the issuing entity. The technology is therefore being developed on behalf of the investors. The token holders — as investors — are the (economic) owners of the newly developed technology, at least from a tax perspective.¹⁶ According to informal discussions with the Swiss Federal Tax Administration and cantonal tax authorities, it looks like the authorities will agree to this classification.

b. Tax Implications. Payment made by the investors at the time of the issuing event and the receipt of the utility tokens are tax neutral as to the investors because the value of the tokens is offset against the amount invested. This tax treatment is in line with the tax treatment of ordinary contract development and research agreements.

Profits on the sale of utility tokens in the secondary market should generally be treated as a tax-free capital gain for individuals holding utility tokens as private assets.

Applying Swiss tax law to case 3, the payments of the investors to COM at the time of the issuing event and the receipt of the COM tokens — tokens that will be required to use the new technology — should be tax neutral at the level of the investors. If the investor sells COM tokens in a secondary market transaction, any gains qualify as tax-free capital gains.

C. Tokens as Business Assets

The classification of tokens — a critical part of the personal income analysis — is irrelevant to the income tax treatment applicable to investors holding tokens as business assets. This is because taxation at the investor level follows the treatment of the tokens from an accounting perspective.

At the time of the issuing event, the tokens should be considered assets that may be accounted for at cost value. This accounting

treatment does not result in any income at the time of the issuing event. However, if the tokens are sold and the sale price exceeds the book value acceptable for tax purposes (considering depreciations and write-downs in the interim period), the difference between the sale price and the book value constitutes taxable income. Under Swiss law, that amount is subject to income tax in the canton of residence. Payments from the issuing entity to the token holder should also result in taxable income unless the value of the tokens can be depreciated by the same amount following the payment.

IV. Withholding Tax Treatment

This section looks at whether the issuing entity must deduct withholding taxes from payments to token holders. Since utility tokens do not transfer income, this discussion will focus on income- and royalty-sharing tokens.

A. Legal Background

There are four categories of payments that, *inter alia*, trigger withholding taxes under Switzerland's Federal Law on Withholding Tax (Verrechnungssteuergesetz, or VStG):

- income from a corporate right;¹⁷
- income from bonds;¹⁸
- income from Swiss collective investment vehicles;¹⁹ and
- lottery gains.²⁰

The Swiss withholding tax system follows a scheduler approach — income items that are not covered by one of the taxable categories are not subject to withholding taxation. Therefore, we will consider whether any of the categories applies to payments to token holders and, if no category is suitable, we can conclude payments to the token holders are exempt from withholding tax.

¹⁶ The classification of utility-tokens from a civil law perspective is beyond the scope of this article. It is, however, questionable whether token holders would qualify as the legal owners of the newly developed technology solely because they are granted access to this technology.

¹⁷ Article 4(1)(b) VStG.

¹⁸ Article 4(1)(a) VStG.

¹⁹ Article 4(1)(c) VStG.

²⁰ Article 6 VStG.

B. Income From a Corporate Right

A dividend payment is one example of income from a corporate right. Early indications from the Swiss Federal Tax Administration suggest that a payment to a token holder does not qualify as income from a corporate right even though an income-sharing token, like many corporate rights, enables the investor to participate in the entity's profit. This is because income from a corporate right is understood in a rather formal manner, meaning only payments based on specifically defined corporate rights qualify and no substance-over-form analysis applies.

The VStG explicitly mentions several corporate rights such as shares (Aktien), a participation in a limited liability company (Stammanteil), participation rights (Partizipationsscheine), and jouissance rights (Genussscheine).²¹ These are all corporate rights mentioned in the Swiss Civil Law Code.

As a token is an evidence for a contractual relation, it would go beyond the existing legal framework to qualify a token as one of the corporate rights triggering withholding taxes in Switzerland. In other cases, the Swiss tax authorities have followed this form-over-substance practice of the Swiss tax authorities. For example, a certificate mirroring the value of an underlying share does not qualify as a corporate right, even though the investor is exposed to the same risk as someone who directly invests in the underlying share.²²

Of course, this does not exclude the possibility that payments to token holders who are related parties (that is, shareholders) might qualify as constructive dividends triggering withholding taxes.

C. Income From a Bond

As mentioned above, Switzerland levies a withholding tax on interest on bonds.²³ In order for an investment to qualify as a bond for withholding tax purposes, a domestic taxpayer

must issue debt instruments containing a repayment obligation. However, in our examples above, no repayment obligation exists; the investor is not entitled to a repayment of his investment.

Therefore, we do not believe that payments based on one of the outlined categories of tokens will be considered payments on a bond for withholding tax purposes.

D. Income From a Collective Investment Vehicle

Another category of income that is subject to withholding tax is payment from a Swiss collective investment vehicle. The wording of this provision is very specific and explicitly refers to regulated Swiss collective investment vehicles under the Law on Collective Investment Vehicles.²⁴ Since, at least as a general matter, the issuing entity in an ICO does not meet this criteria, this provision cannot be used to render payments to token holders subject to withholding taxes.

E. Income From Lottery

According to article 6 VStG, income from domestic lotteries is subject to withholding taxation in Switzerland. Income from lottery-like events also triggers withholding taxes. However, issuing events are not mentioned among the lottery-like events listed in the ordinance to the VStG that further outlines the scope of article 6 VStG.²⁵ Therefore, even though some token investments do pose significant risks to the investors, a qualification as a lottery would not be appropriate.

F. General Conclusion – No Withholding Tax

Therefore, we can conclude that no withholding tax should be levied on income from tokens issued by entities in Switzerland, even though the tokens may have elements of share, a bond, a collective investment vehicle, or even a lottery.

This article will not address further withholding tax issues at the level of the issuing

²¹ Article 4(1)(b) VStG.

²² See Circular Letter No. 15, *supra* note 10, at section 1(a).

²³ Article 4(1)(a) VStG.

²⁴ Article 4(1)(c) VStG.

²⁵ Article 39(3) VStV.

entity. For instance, a more detailed analysis would be required to determine whether the issuing entity is the beneficial owner of the received royalties from a royalty-sharing token or whether the authorities would assume that the issuing entity is bound to forward a portion of the royalties and, thus, would not be the beneficial owner of the income.²⁶

V. Treatment Under Double Tax Treaties

Even though we believe that income from tokens does not trigger withholding taxes in Switzerland and that there is no need to mitigate double taxation of cross-border investments into Switzerland, we will briefly examine the treatment of income from tokens under the OECD model income tax treaty. This discussion is only intended as an initial, high-level analysis.

There are several options for categorizing token income under the OECD model, namely as:

- dividend according to article 10;
- interest according to article 11;
- royalty according to article 12; and
- other income according to article 21.

The categorization of income under the existing double tax treaties depends on the underlying method of interpretation and wording used in the treaties. In particular, article 3(2) of the OECD model influences the outcome of this analysis.

First, the term “dividend” is defined in article 10(3) of the OECD model. It includes three subdefinitions, all of which are conditional upon a corporate right being granted.²⁷ However, as outlined above, a token is not a corporate right; it is merely a contractual claim and, therefore, unlikely to qualify as a dividend. This is true even though profit-participating tokens may allow the investor to participate to the same degree as a shareholder.

Second, the term “interest” is defined in article 11(3) of the OECD model. Only payments on debt claims may qualify as interest.²⁸ However,

as detailed above, a token does not qualify as a debt claim because it lacks the repayment obligation that is mandatory for that classification.

Finally, royalties are defined in article 12(2) of the OECD model:

2. The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

It seems obvious that payments from an income-sharing token are outside the scope of this definition.

The situation is more complex for royalty-sharing tokens, but we still do not believe that the royalty article applies thereto. The payment from the issuing entity is not “consideration for the use of or the right to use” intellectual property because the investor does not transfer a right to use to the issuing entity. Rather, the issuing entity is the originator of the intellectual property and is obliged to transfer the right to use to the token holder.

Therefore, we believe that income from tokens would generally qualify as other income under article 21 of the OECD model, presuming the relevant double tax treaty contains the provision and it follows the wording of the OECD model.

Despite our general analysis, a different result may apply in an individual case, depending in part on the interpretive approach of another jurisdiction.

VI. Stamp Duties

Switzerland levies an issuance stamp duty on equity contributions to companies resident in Switzerland.²⁹ However, payments to the issuing entity in connection with the issuance of the tokens do not constitute equity contributions. Rather, the issuing entity receives the funds based

²⁶ See article 12 of the OECD model income tax treaty.

²⁷ For further details, see Peter Hongler, *Hybride Finanzierungsinstrumente im Nationalen und Internationalen Steuerrecht der Schweiz* 237 (2012).

²⁸ See *id.* at 252.

²⁹ Article 5(2)(b) of the Gesetz über die Stempelabgaben (StG).

on a contractual obligation between the token holder and the issuing entity. Therefore, tokens do not trigger any Swiss issuance stamp duty.

Switzerland also levies a transfer stamp duty on the sale of specified securities, including the sale of shares or bonds if a Swiss qualifying securities dealer is involved in the transaction.³⁰ The transfer of tokens may be subject to a Swiss transfer stamp tax of 0.15 percent, since they may qualify as securities.³¹

VII. VAT

A complete discussion of tokens and Swiss VAT would require an in-depth analysis beyond the scope of this article. In general terms, the issuance of income- or royalty-sharing tokens and future payments from the issuing entity based on those tokens should qualify as VAT-exempt financial transactions according to Swiss VAT law (*Mehrwertsteuergesetz*, or MWSTG).³² Therefore, for income-sharing and royalty-sharing tokens, Swiss VAT should not be payable on the initial funds raised nor on the future payments from the issuing entity to the token holders.

Funds raised through the issuance of utility tokens may, however, qualify as compensation for services rendered by the issuing entity to the investors and may therefore be subject to Swiss VAT. This would be in line with the qualification of the contractual agreement underlying utility

tokens as a contract development agreement between the issuing entity (developer) and the investors (principals). Compensation for services is subject to 7.7 percent Swiss VAT if the recipient of the service is located in Switzerland. However, the compensation for services is not subject to Swiss VAT if the investor is located abroad. Thus, funds raised by an issuing event for utility tokens should only be subject to Swiss VAT to the extent the tokens are sold to investors located in Switzerland.

VIII. Conclusion

The treatment of income from tokens triggers a multitude of tax questions. These new investment tools are difficult to assess based on the existing tax law framework and the existing tax practice. This article is a first attempt, from a Swiss perspective, to outline the potential treatment of income from tokens, both from a domestic and international tax perspective.

We have dealt with the three major types of tokens and examined how Switzerland's tax law may apply to each. In the coming months and years, the industry will develop further designs that might again trigger different tax consequences.

While this article looks at some early signals from the Swiss authorities, no practical guidelines have been issued to date. We recommend companies (and investors) that are considering an upcoming issuing event approach the tax authorities and request a tax ruling to provide clarity and avoid any detrimental and unintentional tax consequences. ■

³⁰ Article 13 StG.

³¹ See Circular Letter No. 15, *supra* note 10.

³² See article 21(2)(19) MWSTG.