

SWITZERLAND

Bär & Karrer



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Swiss taxation of NFTs

Cyrill Diefenbacher and Ollin Söllner of Bär & Karrer discuss the changing landscape of crypto assets, particularly non-fungible tokens (NFTs), and the Swiss taxes that the buying, holding, and selling of NFTs can trigger.

Non-fungible tokens (NFTs) are cryptographic assets on a blockchain with unique identification codes and metadata that distinguish them from each other. Last year set new records in NFT sales with Beeple's *Everydays: The First 5000 Days* selling in a Christie's auction for \$69.3 million. Later in the year, Pak's *The Merge* sold for a total of \$91.8 million, thereby establishing the highest price paid for NFT art yet – and the hype around NFTs continues.

Switzerland has a well-developed practice around the tax treatment of cryptocurrencies and crypto assets in general but, so far, no specific guidelines relating to NFTs have been published. This article explores some of the key Swiss tax principles applicable to NFTs, to be reviewed on a case-by-case basis.

Buying and selling NFTs

In Switzerland, capital gains on the sale of private assets are in principle tax-free, whereas capital gains on the sale of business assets are subject to income tax. Business assets are considered to be all assets that serve a self-employed activity.

In that respect, an individual who invests work and capital and carries out their activity on the market at their own risk, in a self-chosen organisation, for continuous periods of time and with the intention of making a profit, is typically considered self-employed as per the definition used by Swiss tax authorities and courts. Any income derived from such activity is thus subject to income tax and social security contributions.

Where a Swiss-resident individual directly creates and sells NFTs outside of a

structure involving a legal entity, they may regularly fulfil the abovementioned criteria, and any gains resulting from such sales would be subject to income tax. In such cases, it should be reviewed whether a legal entity set up may be more tax-efficient for the relevant commercial activity.

The trading of NFTs that exceeds the threshold of managing one's own private wealth can also qualify as a self-employed activity, with the consequences as mentioned above. The thresholds to be exceeded for an activity to qualify as such a professional dealing of NFTs are not yet set in stone. However, many of the Swiss cantonal tax authorities have stated that for trading of crypto assets (without specifically mentioning NFTs), the same criteria as for professional securities dealings, as set out in a circular published by the Federal Tax Administration, should apply.

The circular sets out certain conditions to be cumulatively met to exclude the qualification of a professional activity (the 'safe haven' criteria). If the safe haven criteria are not met, a case-by-case review needs to be carried out, taking into consideration all relevant circumstances of the case.

The key criteria to be reviewed in this context would involve the transaction volume (a high frequency of transactions and short duration of holding periods would be harmful) and the potential use of debt to finance the transactions, as well as the use of derivatives (both would be harmful elements).

With the general volatility of the crypto markets leading to higher trading volumes and shorter holding periods, some question the analogy made between trading in crypto assets (including NFTs) and trading in securities. These commentators call into question the application of these criteria to establish the existence of a professional activity, suggesting that the general criteria for a self-employed activity, as detailed above, should be reviewed instead.

Although the practice of the tax authorities in this respect still needs to be further developed, we know from experience that the tax authorities have focused in the past on clear cases of professional trading when reclassifying such activity into a self-employed activity.

As investments in NFTs, in the form of works of art or collectibles for example, often have longer holding periods and lower trading volumes (as compared to trading with cryptocurrencies) and rarely use debt-

financing, it is likely that the threshold of managing one's own private wealth will not be exceeded in a lot of cases. This is particularly true where the investor's cost of living is not financed through investments and the respective capital gains.

Holding of NFTs

In Switzerland, all cantons levy an annual wealth tax on the taxable net wealth of a Swiss resident individual taxpayer. This includes immovable assets (such as real estate property), movable assets such as bank account balances and securities, and other valuable assets including cars or art collections. The applicable tax rate depends on the canton of domicile, and ranges between approximately 0.1% and 1.03% on taxable wealth.

In this regard, the valuation of assets is crucial. As a general rule, assets are to be valued at market price. For NFTs, determining the market price is not a simple venture. Indeed, contrary to the practice applicable with respect to certain crypto currencies, the Federal Tax Administration does not publish year-end valuations for NFTs.

Moreover, NFTs are unique, which means that no representative secondary market prices exist. For example, NFTs of the "Bored Ape Yacht Club" are currently listed on the OpenSea platform with ethereum prices ranging from ETH 84 (approximately \$237,000) to ETH 18,880. Where it is impossible to value a certain asset before the time of its potential future sale, acquisition costs may serve as a fallback for the declaration of taxable net wealth.

Swiss VAT aspects

The potential VAT implications of buying and selling NFTs should not be neglected. While the definition of electronic services in Swiss VAT law is broadly aligned with EU VAT law, the sale of NFTs should generally qualify as the provision of an electronic service, the place of supply of which is determined based on the recipient of the service's residence.

Where a Swiss person is commercially active and generates revenue of at least CHF 100,000 (\$104,000) per annum from taxable services in Switzerland or abroad, a Swiss VAT liability may be triggered, and the sale of such services is subject to Swiss VAT at a rate of 7.7%.

However, there is a Swiss VAT exemption for electronic works of art

directly sold by the creator, which would apply to NFTs in the form of works of art directly sold by their creator.

The Swiss reverse charge mechanism is not applicable to electronic services being provided to non-VAT registered recipients (mainly Swiss resident individuals). A Swiss VAT liability may therefore also arise for non-Swiss resident sellers with a worldwide turnover of at least CHF 100,000 per annum that are providing electronic services to non-VAT registered recipients domiciled in Switzerland. This is with the exception of electronic works of art directly sold by the creator, as discussed above.

In any case, a proper Know Your Customer procedure (KYC) is recommended from a Swiss VAT perspective.

OECD transparency initiative on crypto assets

As the Automatic Exchange of Information (AEOI) has so far insufficiently covered the field of crypto, the OECD has launched a public consultation process on “the Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard”, which is set to also cover certain NFTs.

Service providers engaging in exchange transactions in relevant crypto assets (crypto to crypto or crypto to cash (FIAT)) will, in principle, be subject to new reporting obligations. If introduced, the framework will significantly increase transparency for tax authorities at the international level on the holding of crypto assets, as well as transactions involving crypto assets.

Buying, holding, and selling NFTs with a connection to Switzerland may be subject to tax in Switzerland and should therefore be carefully reviewed. Tax rulings may be obtained and can provide legal certainty regarding the tax implications that transactions involving NFTs may trigger.

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