



VAT NEWSLETTER

## Federal Ministry of Finance on crypto exchanges: VAT exemption for cryptocurrency trading expanded

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### 1 Introduction

The prices of cryptocurrencies such as *Bitcoin* and *Ethereum* are currently facing an all-time high. Trading volumes are also continuing their steady rise and now exceed those of some traditional exchanges. The immense economic importance of crypto exchanges recently became evident in the crypto marketplace *Coinbase's* \$100 billion IPO. Wherever high turnover is generated, VAT inevitably comes into focus.

In 2015, the ECJ equated the virtual currency *Bitcoin* with legal tender in the *Hedqvist* decision (Case C-264/14). As a result, the Federal Ministry of Finance published a notification on 27 February 2018, which also comments on the scope of the VAT exemption for supplies of crypto trading platforms (KMLZ VAT Newsletter 11|2018).

### 2 Status quo for centralized and decentralized crypto exchanges

Marketplaces can be operationally structured in different ways. The exchange can act in its own name and for its own account or it can act as a mere trading platform and process the transactions. In the field of crypto exchanges, one refers to centralized (CEX - contractual partner) and decentralized exchanges (DEX - mere trading platform).

In the case of centralized exchanges (*Coinbase*, *Binance*, etc.), trading and deposits take place on the marketplace's server system. The control over the access keys lies with the exchange and not with the user. Central exchanges are therefore a popular target for hackers. Thus, crypto exchanges are increasingly organized as decentralized exchanges (*Pancakeswap*, *Uniswap*, etc.). Users hold their cryptocurrencies in their own wallet and can transfer them directly to the wallets of other users. The decentralized exchange carries out the matching (bringing the parties together), as well as the



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clearing (creation of positions and hedging) and the settlement (performance of the settlement transaction), via so-called liquidity pools. The transactions are stored, tamper-proof, in a blockchain. Both forms of crypto marketplaces have in common the fact that they require a variety of IT services in order to function, in addition to the actual crypto transaction.

In its notification of 27 February 2018, the Federal Ministry of Finance took the view that the VAT exemption of Sec. 4 No. 8 German VAT Act only applied if a platform operator carried out the purchase and sale in its own name. However, if a platform acted merely as a technical marketplace, the VAT exemption did not apply. Consequently, decentralized crypto exchanges were excluded from the VAT exemption. Questions regarding the uniformity of the supply and any ancillary supplies (e.g. IT services) in connection with crypto transactions have, to date, remained entirely unresolved.

### 3 The Ministry of Finance notification dated 3 May 2021

The latest notification initially refers to traditional exchanges. However, the content is explicitly transferable to supplies of crypto exchanges. The statements on crypto marketplaces in the notification of 27 February 2018, are repealed. For participants in the exchange business, it must, as a first step, be examined whether a single service or several individual services, assessed separately, exist. In a second step, it must be examined whether the VAT exemption of Sec. 4 No. 8 lit. e German VAT Act applies. VAT-exempt financial services are to be distinguished from merely material or technical services. The latter are not exempt from VAT.

Accordingly, central exchanges provide a single supply of service consisting of the traditional trading business, the provision of the platform and related IT services. The IT services represent ancillary supplies to the main supply, namely the financial service. The technical connection and the trading platform provision are part of a single VAT-exempt supply. If a single decentralized exchange provides the matching, clearing and settlement, this is also considered to be a single supply of service. The clearing and settlement are ancillary services to the main service of matching. The VAT exemption of Sec. 4 No. 8 lit. e German VAT Act applies for this supply of service. It is not necessary to examine whether decentralized exchanges provide an intermediary service under Sec. 4 No. 8 lit. e German VAT Act, because there is already an exempt "transaction in securities".

Both centralized and decentralized exchanges may opt for VAT liability under the conditions of Sec. 9 German VAT Act and claim input VAT deduction from input supplies. If no option is chosen, an input VAT deduction is only possible if the service recipient is domiciled in a third country according to Sec. 15 para. 2 no. 2 and para. 3 no. 2 lit. b German VAT Act.

### 4 Consequences for the practice

Fortunately, the VAT exemption for financial services now also applies for decentralized crypto exchanges. Furthermore, all marketplaces benefit from the clarification that IT services can be VAT-exempt as ancillary services. In our opinion, the same must apply to other ancillary services. Merely material or technical services continue not to be exempt from VAT. However, there is also a downer: The notification does not answer the crucial practical question as to which crypto-assets are even considered as a means of payment/securities within the meaning of Sec. 4 No. 8 German VAT Act.

The notification is to be applied to all open cases. For both centralized and decentralized crypto platforms, VAT refunds for the past may therefore result, provided that supplies, subject to German VAT, were previously assumed. Operators may treat IT services as independent supplies subject to German VAT until June 30, 2021. The right to deduct input VAT also remains in place until then. Thus, exchanges must adjust their accounting by July 01, 2021 at the latest.