

Lower tax court rules on income tax treatment of cryptocurrency transactions

Lower tax court confirms treatment of cryptocurrency gains as taxable income.

In a decision dated 11 June 2021, which was published in the beginning of 2022, Germany's lower tax court of Baden-Wuerttemberg provided its opinion on the income tax treatment of capital gains resulting from the sale of cryptocurrencies. The lower tax court confirmed the treatment of such capital gains as "other income" under section 23 (1) no. 2 of the income tax code (ITC) and, therefore, subject to income tax. The decision of the lower tax court is in line with the 17 June 2021 draft Ministry of Finance (MoF) decree on the tax treatment of virtual currencies and tokens (see [GTLN dated 22 June 2021](#)).

In the case decided by the lower tax court, the taxpayer generated capital gains from the sale of cryptocurrencies that were held as private assets. The taxpayer argued that the various cryptocurrencies that were sold do not qualify as assets in terms of the other income provision of section 23 (1) no. 2 ITC, and, therefore, capital gains from the sale of such cryptocurrencies should not be taxable for income tax purposes. The taxpayer, in addition, argued that as a result of a general lack of enforcement by the tax authorities when it comes to the taxation of cryptocurrencies, the taxation of cryptocurrency transactions violates constitutional principles.

The lower tax court rejected the arguments of the taxpayer on all counts. In line with the view of the tax authorities, the tax court confirmed the treatment of cryptocurrencies as assets for purposes of the other income provision of sec. 23 (1) no. 2 ITC. Based on this provision, short-term capital gains from the sale of assets (i.e., cryptocurrencies in the case at hand) that are held as private assets are taxable. Short-term in this regard refers to an acquisition and sale occurring within a 12-month period (under certain circumstances the 12-month period may be extended to 10 years). The lower tax court did not consider the arguments of the taxpayer based on technical considerations for cryptocurrencies, such as ownership of a node, ownership of the public-private key, and distributed ledger technology but, rather, stated that such technical considerations and differences between various types of cryptocurrencies are not of relevance for the income tax qualification of capital gains from the sale of such cryptocurrencies.

The lower tax court further explained that, based on the extensive interpretation of the federal tax court of the term "asset" in this regard and the fact that there is a general trade with and a demand for cryptocurrencies, the conditions for an asset are fulfilled. The lower tax court cited a 20 June 2019 decision of the lower tax court of Berlin-Brandenburg that made the same argument. The decision of the lower tax court of Berlin Brandenburg, however, was a decision in an interim court order procedure and only included a preliminary, high-level analysis. The lower tax court also briefly referred to a controversial discussion about the asset qualification of cryptocurrencies in tax literature and did not mention an 8 April 2020 decision of the lower tax court of Nuremberg (also a decision in an interim court order procedure) that expressed certain doubts on the asset qualification of cryptocurrencies.

The argument of the taxpayer that a general lack of enforcement potential violates constitutional principles was rejected by the lower tax court, which referred to the increased information obligations of taxpayers when it comes to cross-border transactions. The tax court also highlighted administrative assistance and international cooperation between governments to enforce German taxing and information rights in this area. Finally, the lower tax court stated that a violation of constitutional principles would need to be determined by the federal constitutional court and would be outside of the lower tax court's jurisdiction.

The decision of the lower tax court does not come as a surprise but leaves many points of interest unanswered for taxpayers and is a missed opportunity for a more detailed analysis of the cryptocurrency treatment for income tax purposes. So far, there is no decision by the federal tax court regarding the income tax treatment of cryptocurrencies. Even though the lower tax court allowed for an appeal of the decision to the federal tax court, the taxpayer withdrew its already pending appeal with the federal tax court so that the decision of the lower tax court became final. Taxpayers will need to wait for another opportunity for the federal tax court to provide its opinion on this matter. The lower tax court's decision should, however, highlight the broad documentation and information obligations for taxpayers when it comes to cryptocurrency transactions.

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