PORTUGAL: WHAT'S THE FUTURE OF CRYPTO MARKET IN THE COUNTRY?

The worldwide growing adoption of crypto and decentralized finance (DeFi) ecosystems around the globe (some of them reaching 9-digits market cap) have resulted in policymakers and supra-national institutions' alertness to regulate the market, either seeking to take it over, frame it or rejecting its adoption.

I. Supra National General Regulatory Approach on Digital Assets

First, it's important to highlight the pivotal role of supra-national powerful institutions controlling and benefiting from the financial system the cryptocurrency is in the process of replacing. This is a powerful force that can change the whole crypto environment for better or for good.

These institutions are currently working close to governments and regional policymakers to function as international regulatory bodies building up standardized regulations on multiples subjects. They are clearly committed to regulate, restrict, or take control of the digital assets market by providing guidelines, recommendations, or quasi-mandatory propositions to its members

Among such organizations, it's worth to mention the Bank of International Settlements (BIS), the Financial Act Task Force (FATF), the International Monetary Fund (IMF), the World Bank, the World Economic Forum (WEF) and Wall Street itself.

A deep understanding of the supra national bodies' role in the digital assets regulations falls outside the scope of this article, but we might cover the subject in articles, studies or reports regarding crypto regulation in different jurisdictions to be released soon.

II. Global Approach on Drafting Crypto Assets Regulation

Most of the policymakers in developing countries are indeed seeking to strike a balance between systemic risks, while enabling future innovation to win the race to become a global crypto/blockchain hub.

In general, the 7 (seven) fundamental priorities the policymakers/governments take into consideration when drafting crypto regulations for their respective jurisdictions tend to cover the subjects below:

1. Consumer protection
2. Anti-money Laundering/KYC
3. Securities regulation and market manipulation
4. Tax
5. Financial stability
6. Trademark/Copyright (usually applied for NFTs regulation)
7. Intellectual Property (usually applied for NFTs regulation)

III. EU approach on Digital Assets

So far, the EU has only issued/approved three relevant Directives/Guidance regarding crypto regulation that should be mandatory for all member states: (i) the consumer protection issue (item II, a above), i.e., the exchange of client data between virtual asset service providers (VASPs)[1] and (ii) the anti-money laundering issue (Item II, b above), through the implementation of the Fifth Anti-money Laundering Directive (AMLD 5) in 2020[2].

Moreover, any token may be classified as a security token in the EU and comply with any existing regulation regarding securities in the EU, as long as it falls into the scope of a financial instrument according to the less prescriptive classification given by the Markets in Financial Instruments Directive II (MIFID II).

Due to this regulatory gap left in the EU level, a few member states have already enacted multiple domestic law on crypto assets which are currently regulated by their respective National Competent Authorities (NCA)[3], covering some of the topics stated in item II, (a) to (g) above.

Thus, when it comes to crypto regulation, EU became a patchwork pinpointed with disagreeing views and several differences on policy statements among local governments, which in some degree may generate intricacies and increased costs for players.

On the 30th of June 2022, the European Commission has approved the Cryptocurrency Markets Proposal (MiCA) regulation, covering issuers of uncollateralized cryptocurrencies, stablecoins, trading venues and wallets in which the assets are held. This means that all member states will have to change any domestic legislation regarding crypto assets enacted so far to comply with MiCA, which will be in full force by 2024.

IV. EU Member States Approach

Currently, when it comes to the 27 countries in the EU, they can still implement domestic regulations to cover regulatory gaps left by the EU, but they should all be duly met by 2024.

Despite of that, tax regulations on each member state are usually not covered by the EU sphere of influence, but almost entirely by their respective National Competent Authorities (NCA). This means that any EU country has fully sovereignty to establish its own tax policy on the revenues and gains earned from crypto assets.

V. Portuguese Crypto Assets Regulatory Approach

Moving on the opposite side of most European countries, Portugal became one of the most crypto-friendly Environment for investors in Europe due to its limited cryptocurrency taxation, as well as its lack of regulation regarding crypto assets, except for the mandatory compliance to AML/KYC and part of the FATF recommendations for consumer protection as mentioned above.

Thus, if anyone wants to set up a virtual asset service provider or any related business in Portugal, he should simply register a request before Banco de Portugal and comply with the provisions regarding money laundering and terrorist financing (AML/CFT)[4].

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[1] The guidance for virtual asset service providers (VASP) from the Financial Action Task Force (FATF) in 2019 defines rules around the exchange of client data between VASPs when funds are transferred.

[2] the Fifth Anti-money Laundering Directive (AMLD5) in 2020 requires VASPs operating in EU member states to register with National Competent Authorities (NCAs) and follow strict know-your-customer (KYC) and anti-money laundering (AML) standards for cash-to-crypto transactions and vice versa

[3] Among them France, Germany, Italy and Spain.

[4] The first licenses in Portugal were granted in May 2021 to two Portuguese companies: Criptoloja and Mind the Coin. In 2022, three more licenses were granted to Luso Ativos, Utrust and Bison Ativos Digitais.

VI. Portuguese Tax Regulatory Approach

Until 2016, Portuguese authorities were silent on the taxation of crypto assets activities performed in the country, but due to member states discretion to set any tax legislation on this regard and the large adoption of cryptocurrencies by Portuguese people, in 2016 taxpayers officially requested Portuguese Tax Authorities to assess the application of IRS laws to this emerging market.

In a nutshell, according to the latest guidance on this regard released by tax authorities in 2018 and 2019[5], cryptocurrency activities are exempt from VAT tax and from personal income taxes in Portugal, Crypto is not considered an asset in Portugal, thus you don´t need to do an annual tax return with no obligation to declare amounts held, although crypto businesses activities need to pay taxes on any profits from cryptocurrency gains.

Yet, it's worth to note that if you invest precious metals or in stocks through a Portuguese intermediary you don´t pay taxes, which are assigned to those intermediaries, and if you invest outside Portugal, you pay only a small amount as capital gains. This leaves the door open for further legal interpretation on the trade of cryptos on the same grounds.

Thus, Portugal deems cryptocurrencies as assets that generally bring about income in earnings from (i) the sale and purchase of coins, (ii) the profits from encumbered commissions related to services on the acquisition of use of cryptocurrency, and (iii) profits coming from the sale of products (or services related thereto) for cryptocurrency

Portuguese response was bidding and stated that any income generated from crypto assets activities in the country could, in theory, fall into the scope of three categories of income, namely, equity accruals (category G), capital income (category E) and business or professional income (category B):

(a) **Equity accruals (Category G)** – Tax Authorities recollected that article 10 of the IRS Code sets forth that a <u>very specific set of capital gains is taxable</u>: "(…), the legislator, when constructing this norm of incidence, resorted to a closed classification", that is, "taxation is only levied on the gains derived from the facts specifically described therein" and in no way do cryptocurrencies suit such requirement. "From what it can be concluded that this reality (equity accruals) is not taxable in the case of category G".

(b) **Capital Income (Category E)** - The same conclusion was drawn for category E. Regardless the fact that incidence rule is "constructed in an open way", the Tax Authorities indicated that, in terms of cryptocurrencies, "the income generated is obtained by the sale of the right, so it will not be liable to be taxed in the realm" of that category.

(c) **Business or Professional Income (Category B)** – it usually pertains for self-employed income, the Tax Authorities may deem that there may be a right to pay tax, if the "income" was generated from "the exercise of a business or professional activity" as we can infer by the following statement: "It is concluded, therefore, that the sale of cryptocurrency is not taxable under the Portuguese tax system, unless, due to its habituality, it constitutes a professional or business activity of the taxpayer, in which case it will be taxed in category B". In this instance, companies specifically providing services related to cryptocurrency may be taxed on capital gains, between a sliding scale of 28% to 35%.

It's worth to mention that in Portugal, tax is paid on a sliding scale, but a great range of professional activities may also benefit from the non-habitual tax regime (NHR) when moving tax residency to Portugal, as it offers a drastic

[5] In 2018, they took the view that, as long as a 'utility token' serves as a means of payment, its sale must be exempt in line with the national provision corresponding to Article 135(1)(e) of the EU VAT Directive (EVD). In 2019, the tax authorities confirmed that the same exemption was applicable to the exchange of cryptocurrencies for legal tender and vice versa. Moreover, they reminded that the determination of the status of the customer must follow Articles 17 and 18 of the VAT

reduction and exemptions on taxes levied over capital gains outside Portugal, and a fixed 20% tax rate on salaries and professional income in tax for over a 10-year period for individuals of high cultural or economic worth.

Regarding VAT, the EU understand that as long as a 'utility token' serves as a means of payment, its sale must be exempt in line with the national provision[6] corresponding to Article 135(1)(e) of the EU VAT Directive (EVD). Yet, EU has followed the same rationale issued by a decision the Court of Justice of the European Union (ECJ)[7]

in 2018 and 2019 the Portuguese tax authorities have issued several advance rulings on the VAT treatment of crypto-assets[8] following the EU recommendation by stating that "[An] exchange of cryptocurrency for 'real' currency constitutes on-demand, VAT-free exercise of services."

Note that when it comes to individual income tax crypto assets, trading may be deemed tax-free if it's not done regularly and it's not your primary source of income. Thus, <u>you just need to file a tax return if you or your activity falls into the scope of one of the taxable categories mentioned above</u>.

Finally, the most suitable approach for crypto investors who consider moving tax residency to Portugal shall include (i) the assessment of the frequency of trade, (ii) the holding period of your crypto assets, (iii) the number of platforms you are using, (iii) the profits raised and the importance of this activity in your overall gains.

VII. Current Crypto Investment Environment in Portugal

Safety, cost of living, weather and friendly environment are key advantages pointed out by those who are considering a tax residency in the country.

For those reasons, Portugal crypto and fintech ecosystem has been steadily growing for the last years, attracting not only cryptomonads, but also startups, fintech, and large companies, contributing to bring qualified professional and increasing tax collection to Portuguese Treasury.

Competition to become a crypto hub is rising among countries in the region. Switzerland, UK, and Malta are accommodating their regulatory framework and budget to create a welcoming environment for investors and players.

Indeed, a proper tax and an attractive regulatory approach are needed at this point if the country wants to avoid companies reconsidering investment plans and diverting the influx of capital and minds to greener pastures like Malta or Switzerland which have pointed to a tax-free zone for cryptos.

This current environment is considered very favorable for the development of the sector in Portugal and consequently for attracting long term residents. According to Chainalysis data[9], in 2021 crypto transactions to and from Portugal amounted to € 27 billion, while transaction volume with ETH represents 70% of the investors' portfolio in the country.
See Chainalysis Team article "DeFi Whales Turned Central, Northern & Western Europe into the World's Biggest Cryptocurrency Economy on
Crypto investors based in Portugal also realized € 1.3 billion in crypto gains, above countries such as Belgium, Austria and Norway and Investments in startups went from € 345 million in 2020 to € 1.3 billion in 2021 and in the first

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[6] Corresponding to Article 135(1)(e) of the EU VAT Directive (EVD)
[7] in Hedqvist (C-264/14)

[9] See Chainalysis Team article "DeFi Whales Turned Central, Northern & Western Europe into the World's Biggest Cryptocurrency Economy on

quarter of 2022 it already reached € 1.1 billion, meaning a large influx of money and economic and technological development in multiple ways.

VIII. Future of the Tax and Regulatory Regime for Crypto Assets in Portugal

Due to the few constraints imposed by the EU regulations so far either for tax or regulatory issues, European countries have room to maneuver within their own tax regimes to attract investors on the crypto space. Thus, if taxes are properly addressed in favor of the crypto ecossystem, investors won't look to move away to more favorable jurisdictions happy to open the gates for large capital and qualified labor influx.

The chances of Portugal winning this race are still in place and the previous assessment of the subjects below may give you enough elements to consider whether to move to Portugal or not:

1. Two Defeated Tax Proposals

As the Assembly of the Republic reviews its state budget for the year 2022, the Portuguese Parliament has overwhelmingly rejected two new Bills to tax cryptocurrencies, the proposal established the collection of taxes for earnings above € 5,000 (five thousand euros).

On the other hand, Portuguese Finance Minister, Fernando Medina said that there should not be any "gaps" in the regulations that could result in tax-free gains, while the government could probably work on a regulatory framework to start taxing crypto but did not suggested any deadline for the elaboration of this regulation.

2. The Digital Transition Action Plan[10]

In 2021, Portugal approved a plan for the digital transition to encourage adoption by people, companies and the State. The project contributes to the creation of "technological free zones" in the country to encourage Portuguese and foreign companies and cryptomonads to experiment an environment with artificial intelligence, Blockchain, bio, nanotechnology, virtual reality, robotics, the Internet of Things, and 5G to name a few.

The Plan aims at bringing foreign companies to Portugal, facilitate the implementation of tax residency in the country and obtain investment from startups with innovative but risky projects, which includes opening doors for all types of digital companies, including blockchain, fintechs and virtual assets related ventures.

3. Studies on the Impact of Eliminating Recent Tax Benefits in Portugal

According to estimates[11], a recent study made by VOX EU[12] which used evidences from a tax reform implemented by Portugal in 2012, when tax benefits for startups based in inland Portugal were extinguished (in a moment when Portugal was experiencing a capital outflow due to world financial constraints in place). Most of the companies, who benefited from the tax regime at that time, closed the doors and thousands of jobs were destroyed, similar to the economic constraints we have been facing after the COVID outbreak.

The study concludes that if a lower corporate tax rate had been outfitted instead, nearly 30,000 (thirty thousand) new companies and more than 220,000 (two hundred and twenty thousand) new jobs could have been generated.

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[10] Please check the Digital Transiction Action Plan here: https://www.portugal.gov.pt/gc22/portugal-digital/plano-de-acao-para-a-transicao-digital-pdf.aspx

[11] See at https://sifted.eu/articles/portugal-crypto-tax/

[12] Article: Reducing Corporate Taxes – a boost for high quality entrepreneurship. See at https://voxeu.org/article/reducing-corporate-taxes-boost-high-quality-entrepreneurship

The corporate tax rate levied on start-ups in Portugal before 2001 was 34%, later reduced to 25% in that year after the implementation of the so-called "Portuguese Tax Benefits for Inland Regions", and subsequently reduced to 15% in 2004, and 10% in 2007, returning to 25% after the abolishing of the tax exemption.

4. *Portuguese Secretary of Tax Affairs Signals for Waiting for an EU Decision*

In 2021, the Portuguese Government has requested a report to propose a tax regime for Crypto currencies, but it ended up releasing a statement that they support a concerted position on this issue at European level before taking any long term decision on this regard.

According to a Portuguese governmental source, "it determined, by order of the Secretary of State for Tax Affairs, dated 2021, that the Tax and Customs Authority should study the framework of crypto assets in the light of international best practices in order to propose an appropriate fiscal framework for these new instruments, taking into account the necessary balance between the fair distribution of income and wealth and the attraction of foreign investment, and this assessment has not yet been finalized."[13]

5. *Changes in the IRS Tax Code Can Only be Done by the Parliament.*

The Government cannot tax cryptocurrencies without Parliament amending the IRS Code, a topic that could be discussed only in the next parliamentary term. Nevertheless, the Portuguese Parliament voted against two separate proposals by minority political parties on taxing cryptocurrency earnings, while the Government itself has already declare its willing to wait for a concerted EU position regarding Cryptocurrencies before moving forward with fundamental changes in crypto regulation.

Yet, it's worth to bear in mind that any decision changing the tax regime in the country should take at least a year to be effective, which leaves room for those who consider moving out.

6. *Portugal is Among the Largest Investors in Europe, most of them from Younger Generation*

According to a Report from XTB Broker[14], Portugal is the third among the European countries that invest the most in cryptocurrencies behind the Czech Republic (41.2%) and Spain (37.7%).

The report further reveals that the typical cryptocurrency investor is 34-year-old, meaning a group of people that can easily move away if proper conditions are not delivered by the country regarding crypto businesses.

There are some crypto-related ventures in the country that shows the willingness of young investors to establish in the country, including the first Europe's first "blockchain village" in Algarve, a self-sustaining crypto village planned to set up 25 houses, where people will be able to live and share 'blockchain' and 'crypto' knowledge with each other and with younger generations.

Finally, note that there is a new generation of investors, especially in crypto, who are not seeking for higher protection from the State as older generation, as they are much more independent, know the risks and are willing to take it.

[13] See the source (in Portuguese) https://eco.sapo.pt/2022/05/05/governo-pede-ao-fisco-para-estudar-impostos-sobre-criptomoedas/

[14] "Portugal is the third European Country with the Most Cryptocurrency Fans". See at: https://europe-cities.com/2022/04/06/portugal-is-the-third-european-country-with-the-most-cryptocurrency-fans-says-broker-xtb/

IX. How to Apply for a Tax Residency in Portugal

There are different avenues to get tax residency in Portugal. The most common are:

1. You own a property in Portugal of a certain value, which may depend upon the its usage.
2. You legally reside in Portugal for more than 183 days (there are specific regulations that eases the route to get residence for EU citizens and some Portuguese speaker countries.

Application for tax residency for investors may be complex and can made on a tailor-made basis, we suggest you to look for tax and immigration attorneys if you want to get tax residency in Portugal.

X. Elements to Support Portuguese Future Decisions on Crypto Taxation

The likelihood of Portugal final decision for crypto taxation adoption should be assessed on a combination of political, fiscal, social and economic scenarios:

1. Political

(a) Most of the Parliament members, including the controlling party (PS) has rejected the latest attempt for implementing crypto taxation in Portugal, although the Bill was filed by the minority Party members, who has little support in the Parliament. Note that the controlling Party has not filed any Bill on this regard yet.
(b) Portugal has a usual policy of waiting for EU instructions before taking decisions that may impact the EU.

2. Fiscal

(a) Fiscal year Budget has been approved and no crypto provisions have been embraced so far. Considering a legal change on the IRS approach necessary to change the Tax Authority current position would require a structural change, which means a qualified majority in the Parliament apt to be implemented only within 1 to 2 years from its approval date.

3. Social

(a) There's a Digital Transiction Action Plan currently in place, meaning that there's a genuine effort from the country to encourage adoption of digital products and services, including blockchain and crypto technology by people, companies and the State itself.
(b) There's a real need for young entrepreneurs in Portugal, given the increasing number of young people moving out of the country after graduation for over a decade. Crypto ecosystem is bringing in a large number of crypto young investors from all over the world. Their willingness to invest in the country, even engaging in crypto-related ventures in a long-term, is common knowledge.

4. Economic

(a) If government increases individual and corporate tax rate, it may represent the loss in tax collection of nearly 30,000 (thirty thousand) new companies and more than 220,000 (two hundred and twenty thousand) new jobs, which means lower revenues for the State Treasury.

XI. Conclusion

We must be aware that supra-national influence from powerful institutions globally may considerably change the EU approach on crypto assets, leading it move to a diverse avenue. Nevertheless, in a nutshell EU wants to become a safe and friendly space for crypto investors pretty soon, and Portugal has now the option to follow this trend and take the opportunity to became one of the most important crypto hub in Europe for the next decades. The county needs to show its actual willingness to become a welcoming destination for the influx of capital from a trillion-euros market.

Not only a proper tax collection influx, but also demographic, technological and social benefits are at stake when it comes to Portugal decision on crypto regulation from now on. Thus, considering the fact that the Executive and Legislative branches are controlled by the same Portuguese Party, part of the solution will probably flow from the executive branch who probably wants to maintain more control over the shape of future legislation.
Nonetheless, a joint coordination and proper feedback from stakeholders and main players in the market are of utmost importance and seems to be a key element to move forward in this venture.

We expect Portuguese government, lawmakers, private companies, stakeholders, and investors to work together to build consensus on this matter, not only by maintaining the current regime ahead of the legislative proposals, but also to commit in building up a large crypto community to improve specific areas, such as jobs, transfer of technology and the surging of a huge market for service providers surrounding the space.