

Virtual situs

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Andrea Tavecchio and Riccardo Barone discuss situs of cryptocurrencies in the context of Italy's new resident regime

Key Points

What is the issue?

The characterisation of crypto-assets is of foundational importance to understand how they fit within existing tax systems.

What does it mean for me?

Individuals holding crypto-assets who are considering relocating to Italy under the 'new residents regime' should be advised of any tax implications.

What can I take away?

The Italian tax authorities treat virtual currencies as foreign fiat currencies. Accordingly, in certain cases, individuals holding crypto-assets under the forfeit tax regime could benefit from a full exemption from income tax.

Framing of cryptocurrencies in the Italian tax system

The increasing interest in cryptocurrencies represents a topic of a very significant scope that has exploded over the past years. Indeed, provided that cryptocurrencies and crypto-assets are freely transferable and can be traded on certain markets in exchange for legal tender currencies, their use has been developed in almost all the countries of the world.

However, despite their increasing use, there is still a lot of uncertainty about their tax treatment in many jurisdictions, as there is no specific legislative provision.

Due to the lack of a specific legislation or provision governing the tax treatment of transactions involving cryptocurrencies, the Italian Revenue Agency (*Agenzia delle Entrate*, the Agency) began to question the legal nature attributed to cryptocurrencies and the related tax treatment. Currently, the only official document issued by

the Agency is *Resolution n. 72/E of 2 September 2016*, where it has been clarified that, from a tax perspective, cryptocurrencies have to be defined as an alternative currency to traditional legal tender. Basing its argument on the findings of *Skatteverket v David Hedqvist*,^[1] the first decision of the European Court of Justice on this subject, the Agency reached the conclusion that cryptocurrencies are to be treated in the same way as foreign currencies.

Accordingly, cryptocurrency transactions are not generally taxable unless they are deemed speculative. The Agency considers speculative activity has occurred if, during the fiscal year and for at least seven consecutive days, the threshold of ownership of cryptocurrencies exceeds the equivalent of EUR51,645. If the threshold is reached, under the Italian ordinary income tax regime, proceeds arising from exchanges of cryptocurrencies into fiat currencies and vice versa are subject to the standard rules for income arising from trades of foreign fiat currencies, which provides for a 26 per cent substitutive tax.

This position has been held in tax ruling *No. 956-39/2018*, (the Ruling) where the Agency confirmed that any conversion of a virtual currency into another virtual currency (or from virtual currencies into fiat currencies) is relevant for personal income tax purposes provided the above-mentioned threshold is reached.^[2] The Ruling also clarified the relevance of cryptocurrencies for the purposes of tax-monitoring obligations provided for by *Law Decree no. 167/90*, which includes an obligation for Italian-resident individuals to declare the assets held outside of Italy. In line with the general principles indicated in *Circular no. 38/E/2013*, this conclusion was based on the fact that foreign currencies are deemed foreign financial assets.

Cryptocurrencies and the new residents regime

The interpretation put forward by the Agency may represent an interesting opportunity for those individuals who intend to move their residency in Italy taking advantage of the so-called 'new residents regime' (the Regime). The Regime provides for lump-sum taxation of EUR100,000 per year on non-Italian-source income and gains and other advantages, such as exemption from:

- tax-monitoring obligations in relation to foreign assets;
- Italian inheritance and gift tax on rights and assets held abroad; and
- payment of wealth taxes on real estate properties and financial assets held abroad.

The Regime is reserved for individuals transferring their tax residence to Italy and have had non-resident status for tax purposes for nine out of the ten preceding taxable years.

Although only a very brief overview has been provided, it is clear that the main question is: where are cryptocurrencies located for tax purposes?

Indeed, for an 'ordinary' Italian resident, the answer to this question is unlikely to matter since they pay taxes on their worldwide income and gains; however, for Italian 'new residents', the answer has important repercussions for their tax liability. Under the Regime, individuals pay EUR100,000 on foreign-source income and gains and ordinary Italian tax on Italian-source income or gains.

According to the Italian *Income Tax Code*, the foreign nature of a specific income must be ascertained throughout a 'mirror reading' of the criteria provided for in art.23 to identify whether an income is deemed sourced in Italy for non-residents. Pursuant to art.23, miscellaneous income deriving from activities carried out in Italy and from assets located in Italy, as well as capital gains deriving from the disposal of shareholdings in resident companies, are deemed Italian-source income.

Issues determining residency

Accordingly, with regard to virtual currencies and assets, the issue is to identify their location. The answer to this question has to take into account the different ways in which cryptocurrencies can be held and traded. In particular, the transactions can be performed via centralised cryptocurrency exchanges (CEX) or decentralised cryptocurrency exchanges (DEX).

CEXs are online platforms that facilitate transactions by connecting buyers and sellers. Users deposit funds in fiat or cryptocurrency on the exchange and trade in its internal systems. CEXs operate as trusted intermediaries and act as custodians by storing and protecting the investor's funds. In addition, CEXs help users manage their account by performing accurate security checks.

In contrast, decentralised virtual currencies are created and maintained in an open community without an administrator. Therefore, the exchanges do not take place through service providers, i.e., 'trusted intermediaries', but the transaction takes place directly between the wallets of two users. So, instead of depositing funds into the exchange wallet, the individual trades directly from their own wallet. When a trade is executed, the funds are transmitted directly to the blockchain using so-called 'smart contracts' (i.e., an application that runs on a blockchain) that enable the creation of 'trustless' protocols. This means that two parties can make commitments through the blockchain without having to know or trust each other.

Hot and cold wallets

It is worth noting that crypto wallets do not truly store cryptocurrencies but provide the tools required to interact with a blockchain network. In other words, these wallets can generate the necessary information to send and receive cryptocurrency via blockchain transactions. There are three types of crypto wallet: software, hardware and paper wallets. Depending on their working mechanisms, they may also be referred to as 'hot' or 'cold' wallets.

A hot wallet is any wallet that is connected to the internet. For example, when an individual creates an account on a CEX and send funds to the CEX's wallets, they are depositing funds into the CEX's hot wallet. In contrast, cold wallets have no connection to the internet but use a physical medium to store the keys offline, making them resistant to online hacking attempts. An example of cold wallet is the so-called 'hardware wallet', i.e., electronic devices that use a random number generator to generate public and private keys.

Conclusion

In light of the above, it can be concluded that in the case of CEXs, if the intermediary (i.e., the exchanger) is located outside of Italy, income from cryptocurrencies is deemed a foreign-source income and is therefore

covered by the EUR100,000 lump sum. When it comes to DEXs, the income from cryptocurrencies is deemed a foreign-source income provided that the hardware wallet is stored and 'used' outside of Italy.

[1] C-264/14

[2] Falling within the category of 'miscellaneous income' set forth in art.67, para.1, letter c-ter and para.1 ter of the Italian income tax code

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