

Case notes

Regulating virtual currency: Case C-264/14 *Skatteverket v David Hedqvist* [2015] ECLI:EU:C:2015:718

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1 Introduction

In the judgment of the Fifth Chamber in Case C-264/14 *Skatteverket v David Hedqvist* [2015] EUECJ C-264/14, ECLI:EU:C:2015:718 the court was called to examine the meaning of supply of goods¹ and services² effected for consideration under Article 2(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the VAT Directive). The case concerned the value added tax (VAT) applied to 'bitcoin' virtual currency. Mr Hedqvist sought to determine whether transactions to exchange 'traditional currency' for the bitcoin virtual currency or vice versa were subject to VAT. If the court's decision was affirmative, it would have to resolve the question of whether Article 135(1) of the VAT Directive³ is to be interpreted as meaning that the exchange transactions are tax exempt. The court resolved the question on the basis of settled case law relating to exemptions under VAT, interpreted in light of the objective pursued by the provisions. The significance of this ruling lies in the interpretation of the VAT Directive and the notion of 'supply of goods and services'. The case is likely to be of particular interest in an increasingly important yet under-developed body of law: regulating virtual currency.

2 Factual and legal background

As noted, the case concerned the VAT Directive enacted on the common system of VAT, but can only be understood against the background of relevant provisions.

Title 1 of the Directive deals with 'subject-matter and scope'. Article 2(1) of the VAT Directive deals with distinguished transactions which shall be subject to VAT. Article 2(1) provides context for the supply of goods⁴ and services⁵ for consideration within the territory of a member state by a taxable person acting as such.⁶ Article 14(1) specifies that the 'supply of goods' transaction shall mean 'the transfer of the right to dispose of tangible property as owner'. Alternatively, Article 24(1) provides that, for any transactions which do not constitute a supply of goods, they shall mean a supply of services. Virtual

1 Article 14(1).

2 Article 25(1).

3 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

4 Article 2(1)(a).

5 Article 2(1)(c).

6 Ibid.

currencies are clearly not tangible, even if they do need physical storage (i.e. a computer), and as such fall within the scope of 'services'.

Express circumstances exempt from VAT are provided under Article 135(1). The exemptions cover financial services, including currency.⁷ The court found that the purpose of Article 135(1)(b) to (g) exemptions should be interpreted with the objective of avoiding difficulties involved in making financial services subject to VAT.

REFERENCE FOR PRELIMINARY RULING

Reference for a preliminary ruling was made by the Supreme Administrative Court (Högsta förvaltningsdomstol) to the Court of Justice. Mr David Hedqvist was a Swedish national, who requested a preliminary decision from the Swedish Revenue Law Commission to establish whether VAT needed to be paid on the purchase and sale of bitcoin virtual currency units. A bitcoin refers to 'a virtual currency used for payments between private individuals over the internet and in certain online shops that accept it; users can purchase and sell the currency on the basis of an exchange rate'.⁸ The Revenue Law Commission concluded that Mr Hedqvist would be supplying an exchange service effected for consideration. However, the service was covered by the Swedish legislation which provided an exemption under chapter 3, para 9 of the Law (1994: 200) on VAT.⁹

The Revenue Law Commission's decision on bitcoin virtual currency is that it is a means of payment similar to other legal means of payment. It further provided for the decision to limit the scope of the exemption Article 135(1)(e) to cases of bank notes and coins, not currency. The Swedish Tax Agency (Skatteverket) appealed to the Supreme Administrative Court arguing that the service to which Mr. Hedqvist refers is not covered by the exemption under chapter 3, para 9 of the Law on VAT. The Supreme Administrative Court determined the provision of service of consideration by an inference from the judgment in *First National Bank of Chicago* (C-172/96, EU:C:1998:354). The ruling was made on a similar question to the main proceedings. The Court of Justice held that exchange of currencies, where a bank sets different rates for sale and purchase, constitutes a supply of a service effected for consideration.¹⁰ The transaction in review was in regard to the exchange activity not the transfer of currency.

The transactions referred to in this instance were in respect of the exchange of a virtual currency for a traditional currency and vice versa, where payment is the net value between the paid price (exchange rate) and sale price (consideration for the exchange) of the operator. The Supreme Administrative Court decided to stay the proceedings based on the second issue of whether the transactions were within the scope of exemptions for financial services within Article 135(1) of the VAT Directive. On the basis of Article 267 the court requested a preliminary ruling on 27 May 2014.

The order of reference made note of anonymous ownership and the transfer of bitcoin within the network of users who have 'bitcoin addresses'. Moreover, the order referred to the 2012 report by the European Central Bank on virtual currencies that they be defined as a type of 'unregulated digital money', consisting of a 'bidirectional flow', where users purchase and sell on the basis of an exchange rate. Bitcoin was further

7 Article 135(1)(e)(d).

8 Judgment para 11.

9 Judgment para 16.

10 Case C-172/96 *First National Bank of Chicago* [1998] I-354, paras 25–35.

distinguished from electronic money¹¹ as the funds were not expressed in traditional accounting units (e.g. euros), but in virtual account units (bitcoin). This interpretation gives rise to a virtual currency scheme determined on its form rather than its function; in other words based on the form of money rather than it being a new way of executing transactions without the use of traditional government-backed currency. The bitcoin unregulated network provides a platform in which bitcoins are used as compensation offered for goods and services.

The order of reference defines Mr Hedqvist's transaction to be limited to the purchase and sale of bitcoin units in exchange for traditional currency, such as Swedish krona and vice versa. Neither the reference order nor the court's judgment tackle the question of whether VAT is applied to bitcoins used to purchase goods and services. The Supreme Administrative Court referred two questions to the court.

1. Is Article 2(1) of the VAT Directive to be interpreted as meaning that transactions in the form of what has been described as the exchange of virtual currency for traditional currency and vice versa, which is effected for consideration included by the supplier when the exchange rates are determined, constitute the supply of a service effected for consideration? (judgment para 23)
2. If so, must Article 135(1) (of that Directive) be interpreted as meaning that the abovementioned exchange transactions are tax exempt? (judgment para 23)

3 Judgments of the court

Is Article 2(1) of the VAT Directive to be interpreted as meaning that transactions in the form of what has been described as the exchange of virtual currency for traditional currency and vice versa, which is effected for consideration included by the supplier when the exchange rates are determined, constitute the supply of a service effected for consideration? (judgment para 3)

The first question required the court to determine whether the meaning of the transaction was one which constitutes the supply of services for consideration within the meaning of Article 2(1)(c) of the VAT Directive.

The court refers to the definition of supply of goods to distinguish bitcoin from the scope of the provision. Advocate General Kokott stated the findings of the referred court, defining bitcoin as a form of stored data which can be transferred electronically.¹² Bitcoin is created by an algorithm program as opposed to having a particular issuer, such as those of traditional currencies recognized as legal tender. The advocate general emphasised the distinction between legal tender and other means of payment and concluded that the application should be recognized equally, dependent on the function.¹³ The court agreed with her opinion that virtual currency has no purpose other than as a means of payment.¹⁴ Consequently, the context of the exchange transaction

11 Directive 2009/110/EC of the European Parliament and Council of 16 September on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directive 2005/60/EC and repealing Directive 2000/46/EC (OJ 2009 L 267, p 7).

12 Case C-264/14 *Skatteverket v David Hedqvist* [2015] ECLI:EU:C:2015:718 Opinion of Attorney General Kokott, para 7.

13 *Ibid* para 15.

14 Judgment para 24.

could not be characterized as ‘tangible property’ within the meaning of Article 14 of the VAT Directive.¹⁵

After concluding that the transactions constituted the supply of services within the negative definition of Article 24 of the VAT Directive, the court moved on to the effect of ‘for consideration’ within the meaning of Article 2(1)(c). The court examined whether the sale price would be subject to VAT. The court examined the case law on taxable events, concluding that VAT was payable ‘only if there is a direct link between the services supplied and the consideration received by a taxable person’.¹⁶ The legal relationship (direct link) is established between the provider of a service and the recipient pursuant to which there is a reciprocal remuneration.¹⁷ The court examined the contract between Mr Hedqvist’s company and the other parties to the transactions. The legal relationship is based on bidirectional flow of the reciprocal agreement to transfer an amount of a certain currency in exchange for a corresponding value in a virtual currency (bitcoin). The court found consideration in the difference between the sale price and the exchange rate.¹⁸

The court further emphasised that the form of remuneration is irrelevant for the purpose of determining consideration for the supply of service.¹⁹ The court concluded that the meaning of transaction – exchange of traditional currency for units of the bitcoin virtual currency and vice versa – does constitute the supply of service for consideration within Article 2(1)(c). In other words, the service is subject to VAT.

If so, must Article 135(1) (of that Directive) be interpreted as meaning that the abovementioned exchange transactions are tax exempt? (judgment para 23)

The second question referred to the court was whether the transaction, as concluded above, is exempt from VAT interpreted within Article 135(1)(d) to (f). The court’s approach was to examine the objective of the exemptions. It provided a preliminary point in accordance with the case law, namely that the exemptions constitute a purpose to provide uniformity in the application of the VAT system within the EU.²⁰ Moreover, the general principle that VAT is levied on all services supplied for considerations requires the strict interpretation of terms used to specify those exemptions.²¹ However, the court emphasised the principle of fiscal neutrality inherent in the common system of VAT. Therefore, the strict interpretation must be limited in a way that avoids depriving the effect of the exemptions.²² As a general principle of equal treatment, this principle was developed by the court in VAT matters. The implications for the VAT common system arise from the differences in treatment which affect competition and the effect of the internal market.²³ The court referred to its previous case law on fiscal neutrality to highlight that flexibility in the interpretation is taken into account if the effect of the exemption is to be deprived.²⁴

15 Judgment para 24.

16 Ibid para 27.

17 Ibid.

18 Ibid para 28.

19 Ibid para 29.

20 Ibid para 33.

21 Ibid para 34.

22 Ibid para 35.

23 P Rendahl, *Cross-Border Consumption Taxation of Digital Supplies* (International Bureau of Fiscal Documentation 2008) 72ff.

24 Case C-461/08 *Don Bosco Onroerend Goed* EU:C:2009:722, para 25; Case C-259/11 *DTZ Zadelhoff* EU:C:2012:423, para 21; Case C-326/11 *JJ Komen en Zonen Bebeer Heerengovaard* EU:C:2012: 461, para 20.

ARTICLE 135(1)(d)

Because of the nature of the provisions as an exception to the VAT principle, the foreign exchange transaction has to be strictly interpreted. The exemption laid down in Article 135(1)(d) of the VAT Directive states that exempt transactions involve ‘deposit and current accounts, payments, transfers, debts, cheques and other instruments’. In the case of *Axa UK*, the court established that the service in question must form a whole, fulfilling the specific, essential functions of the service provided in the provision.²⁵ The court gave short shrift to this account, noting that transactions under Article 135(1)(d) are defined according to the nature of services provided.²⁶ Moreover, in *Granton Advertising*, the court concluded that transactions referred to in Article 135(1)(d) are services or instruments that operate as a way of transferring money.²⁷ The court made clear its agreement with the judgment, reading the wording of the provision strictly.

In light of Advocate General Kokott’s observation,²⁸ the provision does not cover transactions that involve money itself. Bitcoins are financial services, ‘a contractual means of payment’²⁹ which are not subject to negotiable instruments such as debts or cheques. The court concluded that the bitcoin virtual currency is a direct means of payment between the parties that accept it.³⁰

ARTICLE 135(1)(e)

The court went on to examine Article 135(1)(e) on the question of whether the transaction could be interpreted as involving ‘currency, bank notes and coins used as legal tender’. The court acknowledged the fact based on the concepts used in the provision in light of the versions of all the languages of the EU.³¹ It draws this from the advocate general’s reference verifying that various languages do not allow it to be determined without ambiguity whether the provisions apply only to transactions involving traditional currencies or other forms of currency.³² The court highlighted that the question of the scope of the expression read literally, where the linguistic differences arise, cannot be determined.³³ The court drew further attention to the purposive rather than literal approach that is to be taken into account. The purpose of Article 135(1)(e)³⁴ was to ‘alleviate the difficulties connected with determining the taxable amount and the amount of VAT deductible which arise in the context of the taxation of financial transactions’. The court has already concluded, in agreement with the advocate general that transactions involving a non-traditional currency that has no other purpose than as a means of payment are financial services.³⁵

Specifically, in the context of exchange transactions of traditional currencies, there are difficulties connected with determining the taxable amount and the amount deductible, where an exemption is found under Article 135(1)(e). The court

25 Case C-175/09 *Axa UK* EU:C:2010:646, para 26 and 27 and the case law cited.

26 Judgment para 39.

27 Case C-461/12 *Granton Advertising* EU:C:2014:1745, paras 37 and 38.

28 Opinion para 51.

29 Judgment para 42.

30 Ibid.

31 Ibid para 45.

32 Opinion paras 31–34.

33 Judgment para 47.

34 Ibid paras 36 and 37.

35 Ibid para 49.

acknowledged the fact that the difficulties may be the same.³⁶ The court concluded that the provision of Article 135(1)(e), within a purposive interpretation, would be deprived of its effect if it was limited to traditional currencies.³⁷ As such, transactions involving the exchange of currencies for units of the bitcoin virtual currency are to be covered under Article 135(1)(e).

ARTICLE 135(1)(f)

The exemption provided under Article 135(1)(f) covers ‘shares, interests in companies or associations, debentures and other securities’. The court underlined that these securities, as ‘conferring property right over legal persons’ and ‘other securities’, should be regarded as being comparable in nature. The court had already found common ground that bitcoin virtual currency is neither a security-conferring property right or of a comparable nature.³⁸ Thus, the transaction fails to fall within the scope of Article 135(1)(f) of the VAT Directive.

4 Analysis

The expansion of forms of digital transactions means that the existing legal models must be developed and policy-makers must make an appropriate regulatory regime. Analogous to the expansion of debit and credit cards, the popularity of bitcoin has facilitated the business of virtual currency. This was a transformative judgment changing the status of virtual currency in the realm of VAT. The rulings of the European Court of Justice were correct as they interpreted and applied the scope of the VAT Directive. It now seems pressing that the European Commission make proposals for a change in the framework. In line with the Advocate General’s opinion, the lack of stable value and vulnerability to fraud of bitcoins, raised by the Federal Republic of Germany, cannot justify the difference between traditional currency and virtual currency.³⁹ Both will be affected by similar risks. The ruling has underlined and reinforced the difference in treatment between virtual currency created by algorithms and traditional currency backed by governments. The case can be read in the context of a broader policy disquietude about the lagging regulatory context of digital currency. The questions remain whether the same solution will be reached in determining VAT application regarding purchases for goods and services rather than ‘exchange transactions’. In future, the view of technology and currency in regulation terms will need to provide further mechanisms of oversight, but ultimately embrace the uniqueness of virtual currency.

³⁶ Judgment para 49.

³⁷ Ibid para 51.

³⁸ Ibid para 55.

³⁹ Opinion para 44.