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An Israeli court has ruled that cryptocurrency traders will have to pay taxes when they trade in Bitcoin, even though traders can get a tax break on the profits they make from fiat currency trades.
Photographer: Luke MacGregor/Bloomberg via Getty Images

Crypto Traders in Israel Must Pay Back Taxes Under Court Ruling

By Matthew Kalman

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- *Ruling on Bitcoin confirms tax authority's view that cryptocurrencies are assets*

- *Traders can use voluntary disclosure program to declare what they owe*

Cryptocurrency traders will come under closer scrutiny following a court ruling that any profits they make—or have made in the past—will be subject to a capital gains tax.

In a precedent-setting ruling, Israel's Central District Court determined an Israeli taxpayer won't get a tax break on the profits made from buying and selling bitcoin, even though this is available for fiat currency trading.

The retroactive requirement could end up being a problem for traders if they haven't kept full records dating back to the birth of cryptocurrency.

The Israeli Tax Authority, concerned that the market is used for money laundering and tax evasion, hasn't indicated it will make any allowances for late filing. But late payers could join a general voluntary disclosure program that runs to the end of 2019, according to Daniel Paserman, partner and head of tax at Gornitzky and Co. law firm in Tel Aviv. This would allow them to declare and pay what they owe without penalty. And it would be inclusive of tax owed for undeclared cryptocurrency trading profits.

The tax authority issued a circular in 2018 in which it stated that profits from the sale of cryptocurrency are subject to capital gains tax and should be declared. The policy, which interpreted a tax ordinance that doesn't mention cryptocurrency, had not been tested in the courts until the recent ruling, which completely accepted the authority's position. It now has the force of law and therefore applies to all previous cryptocurrency trades, as well as future ones, unless overturned by a higher court.

In the May 19 ruling, Judge Shmuel Bornstein rejected an appeal by Noam Copel against an assessment for capital gains tax on profit of 8.3 million shekels ($2.3 million) on the sale of bitcoin in 2013 that he purchased in 2011. Copel argued that the profit should be exempt from tax as an exchange fluctuation on a foreign currency.

Youval Rouach, CEO of Tel Aviv-based Bits of Gold, Israel's largest cryptocurrency exchange with more than 50,000 clients, conceded that taxpayers like Copel, who haven't paid tax on their past cryptocurrency profits, must now declare them and pay for the capital gain.

"The ruling ends the substantive discussion on Bitcoin's status under the existing law, and it strengthens the position of the Tax Authority on the subject—Bitcoin is an asset and must be taxed retroactively," Rouach said by email May 21.

Ruling Will Likely Stay

Bornstein's ruling is unlikely to be overturned under existing Israeli law, Paserman said.

"I don't think they will appeal to the supreme court," Paserman said by phone May 21. "The judge gives a thorough analysis and it makes a lot of sense. To say today that it's a currency is not something that's reasonable."

"As of today, according to the current regulatory framework, it's an asset, fully taxed. If tomorrow morning the State of Israel suddenly issues a bitcoin, it will be different," Paserman said.

The tax authority, which declined to comment on the court decision, has said it will pursue taxpayers it believes are profiting from cryptocurrency trades and in its 2018 circular called on all those involved in the trade to report their profits. In 2018 it demanded and received Bits of Gold's records, including its lists of clients and trades.

While the size of Israel's cryptocurrency market is not known, Copel's $8.2 million profit suggests there may be substantial revenue in store for the tax authority.

Not a Legal Tender

The tax authority has targeted cryptocurrency traders by sending letters to thousands of people it suspects of dealing, warning that they owe tax on their profits, effective from the launch of cryptocurrencies in 2009.

“Bitcoin is not ‘legal tender’ in any country and cannot be regarded as ‘currency’ or ‘foreign currency’ according to the definition of ‘foreign currency’ in the Bank of Israel Law,” the tax authority said in an argument that the court accepted.

The court rejected Copel’s argument that bitcoin is used as legal tender at more than 200 locations in Israel, noting that most of the locations mentioned were gambling websites.

“It is impossible to ignore the significant use made of Bitcoin for criminal purposes, including via the Darknet, where various illegal products, such as weapons and drugs, are traded, in view of the fact that Bitcoin allows relative anonymity,” the judge said. “It is difficult to view Bitcoin as fulfilling a significant function of means of exchange.”

The ruling echoes the policy of the central bank. “Bitcoin and similar virtual currencies are not a currency, and are not considered foreign currency,” Nadine Baudot-Trajtenberg, outgoing deputy governor of the Bank of Israel, told a Knesset committee in January 2018.

Changes Possible

The judge noted that his decision was based on existing legislation, which could change in the future.

“It is not impossible that at some point in the future the nature of money will change so that it will not have any of the characteristics of a ‘currency’,” he said in the ruling.

“The judge does not rule out a future scenario in which bitcoin or another virtual coin will be regarded as a currency due to an economic or legal turnaround. However, there is still a long way ahead of us before such turnaround will occur,” said Yitzchak Chikorel, partner and head of international taxation at Deloitte in Tel Aviv.

The current law “is problematic and reflects a situation that may have been true 50 years ago, but it does not stand in the spirit of today,” said Meni Rosenfeld, chairman of the Israel Bitcoin Association, the largest group in Israel representing cryptocurrency traders and investors. Rosenfeld added that he expected the newly-elected Knesset parliament to draft new legislation to ease the use of cryptocurrency.

“As time goes by, the technology based on Bitcoin improves and facilitates faster, more efficient and larger transfers; confidence in it increases and volatility decreases,” Rosenfeld said by email May 21. “We expect continued growth in its use as a currency, and now it is necessary merely that both legislation and regulation advance and allow such use without obstacles.”

The Bank of Israel, which, along with many central banks, has declined to classify cryptocurrency as a currency, should take the lead in formulating a new approach, Rouach said.

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