Which country has jurisdiction to tax DAOs' transactions?

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A Decentralized Autonomous Organization (DAO) may be defined as a group of people that own tokens (representing voting rights), programmed to execute activities oriented towards an objective (philanthropy, investment, etc.) through poll deliberations, in a decentralized manner.

Defining which country has jurisdiction to tax the profits and revenues of DAOs is a complex question given the difficulty to identify its legal nature for tax purposes (as for de facto companies, consortiums, investment funds, etc.) as well as the diversity of activities that may be conducted by DAOs. Must taxation fall on DAOs or directly on its revenues and the capital gains of associates, since it is a transparent entity?

The definition of tax jurisdiction is challenging, since it is done, usually, via elements of personal connection (residence/nationality) or objective ones (source of payment), which are not easily determinable in the case of DAOs. This difficulty, in the case of the digital economy, was highlighted by OECD back in 2015 through the Project BEPS (Base Erosion and Profit Shifting), especially in Action 1 (Tax Challenges Arising from Digitalization).

In 2020, OECD published Pillars 1 and 2, with more concrete solutions to problems deriving from the digital economy. In sum, Pillar 1 concerns the reallocation of tax competence in a fairer manner, using the concepts of origin/source jurisdiction and market jurisdiction. Pillar 2, in turn, aims to establish a minimum global taxation[1] by observing internal rules and a treaty-based rule.

As a general rule, the solutions proposed by Pillars 1 and 2 are related to the existence of a material and economic result in the tangible world. Yet, DAOs may be fully operationalized in cyberspace, without tangible-world reflexes.

The organization in cyberspace does not support the identification of physical elements of connection, considering that the blockchain arrangement is not physically located anywhere. Along the same line, the blockchain organization does not require, as a rule, the identification of users, so that their nature and fiscal residence remain unknown.

As a rule, the governance, on a global level[1], of DAOs' activities in cyberspace would bring some degree of centralization to blockchain relations. Nonetheless, given the lack of intermediaries on the blockchain, who is responsible for the DAOs' reports: the DAO itself, its members, or third parties that conduct transactions with the DAO?

OECD is discussing, at the request of the G20, a new tool for the promotion of tax transparency that provides for the presentation of crypto assets information (the Crypto-Asset Reporting Framework), as well as the altering of the Common Reporting Standard (CRS) for the automatic exchanging of such information. This obligation would have its source in exchanges or individuals acting in the conversion of crypto assets into fiat currency, or even companies that manage e-wallets[2].

If this becomes an actual obligation, this obligation may be an instrument to turn effective the taxation of DAOs' operations, based on the beneficiaries and the source of crypto assets. However, this solution would be limited given that access to the information would occur only when, and if, crypto assets are exchanged for fiat currency, and if the mentioned exchanges have a physical presence or, at least, are not decentralized.

Policymakers of tax issues face, therefore, a relevant and complex task to be developed in light of the new possibilities of transactions operated by DAOs.

>>> This content belongs to our e-book "DAOs: Legal Challenges for Decentralized Autonomous Organizations". Click here to read more articles.

NOTES:

1. Cambridge University conducted the symposium “Global Governance Implications Of Blockchain”, in 2021. Available at: https://www.cambridge.org/core/journals/americanjournal-of-international-law/ajil-unbound-by-symposium/the-global-governance-implications-of-blockchain (Accessed: 5 August 2022).

2. Shakow, David J., “The Tao of The DAO: Taxing an Entity That Lives on a Blockchain” (2018). Faculty Scholarship at Penn Law.

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