Position Paper:

Crypto Taxation in Germany – seizing Opportunities, preventing Exodus

1. The Opportunity for Germany in the digital financial world

The blockchain and crypto industry is developing rapidly and has the potential to change the global financial world significantly in the future. Other countries have already recognised that clear, innovation-friendly regulations are essential to attract investment, companies, and skilled workers. Germany still has the opportunity to position itself as one of the leading locations for digital financial innovations – but to get there, we must design the regulatory and tax environment accordingly to retain skilled professionals and young companies in the country.

Modern and practical taxation of crypto assets can secure Germany as a financial centre, ensure legal certainty, and strengthen our country and Europe economically. Companies in the blockchain industry create highly qualified jobs, and drive technological developments and digitalisation. At the same time, digital assets offer a new, forward-looking asset class that can channel capital into the economic area. Through prudent tax policy, Germany could establish itself as an attractive location for investment and thus benefit from the potential of blockchain technology in the long term.

2. Hurdles of current treatment of taxes

Instead of promoting innovation, the current tax regulations in Germany significantly complicate the handling of crypto assets. The existing rules are opaque and bureaucratically complex and difficult for taxpayers to manage without highly specialized advice. The tax administration also faces significant challenges, as many authorities lack sufficient capacity or expertise to assess crypto cases uniformly.

A key reason for these problems is the lack of specific tax regulations for crypto assets. Instead, the open issues are forced into existing tax bases initially designed for traditional assets such as stocks or real estate. However, these regulations have not been designed to address the unique characteristics of digital assets, which leads to considerable uncertainty in practice.

The result is numerous unwanted tax traps that are not the result of targeted political decisions but simply the product of a lack of a regulatory framework. While it was justifiable to work with existing rules in the early days of crypto innovation, market development has now reached a level that makes specific legal regulations unavoidable. Without precise adjustments, Germany will remain stuck in a tax grey area that hinders innovation, unsettles investors, and complicates efficient tax administration.

A severe example of this inadequate regulation is the taxation of economically unrealized gains. Gains from crypto assets are generated in digital assets, but taxes must be paid in euros. This means that taxpayers may be forced to sell part of the crypto assets received to pay their tax burden.

If such a sale is possible without problems, that's fine. Ultimately, it is the taxpayer's responsibility to set aside reserves for the resulting tax burden. The situation becomes problematic in cases where a sale of the assets received is practically impossible or only possible at significant disadvantages. The reasons for this can be varied:

- **Contractual restrictions:** Many tokens are subject to contractual vesting periods that prevent recipients from selling their assets immediately upon receipt. Nevertheless, tax liability often arises upon receipt, even though the assets may not be sold. This is particularly problematic for investors in or qualified employees of token projects.

- **Technical or regulatory restrictions:** Some blockchain protocols employ mechanisms that prevent or restrict immediate sales, such as staking commitments or lock-up periods for token releases. Furthermore, regulatory frameworks can make trading in certain crypto assets more difficult. This would mean that particularly innovative blockchain protocols that take technical measures to combat speculation would not establish themselves in Germany.

- **Market liquidity and price stability:** In many cases, crypto exchanges lack sufficient liquidity to sell large amounts of tokens without a noticeable price decline. This mainly affects projects with low market capitalisation or during weak market phases with significantly reduced trading volumes. It poses a threat to startups and their employees during such phases, so the very existence of a company can only be threatened by the tax situation.

- **Strategic and market-psychological factors:** The markets often scrutinise founders, major investors (so-called whales), or key personnel of a project. If they sell large amounts of tokens, this can undermine confidence in the project, trigger a price collapse, and jeopardise the project's long-term success. Many of these actors feel compelled to hold onto their tokens to prevent these negative effects—even if tax payments are required.

This problem is further exacerbated by the valuation methodology used to tax crypto revenues. The price on platforms such as CoinMarketCap or CoinGecko is often used to determine the taxable value of tokens. However, this is the last traded price for a comparatively small amount of the token in question – not the price that would be achievable for larger sales volumes.

This is comparable to the price differences between wholesale and retail: While retail prices apply to small quantities, wholesale prices are often significantly lower because larger quantities cannot be sold at the same price. In the case of crypto assets, taxpayers have to tax their tokens based on a theoretical price that they often cannot achieve in practice. This mainly affects projects with low liquidity or founders who hold more significant amounts of tokens. For them, the price stated on CoinMarketCap is often a theoretical figure with no practical relevance.

Another structural shortcoming in the current tax treatment of crypto assets concerns the lack of loss offsetting for income from staking and similar activities. While this income is taxed upon receipt, there is currently no possibility of offsetting losses from the subsequent sale of the received crypto assets against the original income.

If the tax is levied upon receipt of the rewards, which (contractually) cannot be sold at that time or can only be sold at a loss, this results in a tax-related reduction in assets that directly contradicts the tax principles of equal treatment and ability to pay. This leads to considerable uncertainty for taxpayers and represents a systematic tax disadvantage compared to other asset classes.

This problem can be illustrated by an analogy to the taxation of rental income: If landlords received their rent not in euros but in the form of shares in an apartment, they would have to regularly sell parts of their real estate holdings to pay the tax due on them. If the sale of these shares were only possible at a loss, this loss would not be offset against the rental income. This is acceptable if the rental income is earned in Euros, but not if the sale is a prerequisite for paying the taxes in euros. This is precisely the problem that arises when taxing crypto rewards from staking, team tokens, or other mechanisms.

3. Solution: Loss offsetting to create tax fairness

An adjustment of the loss offset rules is urgently needed to ensure tax fairness and create legal certainty.

An appropriate solution would be to offset losses from the sale of crypto assets, which accrued as income from staking, team tokens, or similar mechanisms, against the initially taxed income, even in private assets.

Such a reform would not only distribute the tax burden more fairly but also improve taxpayer planning. It would also prevent taxpayers from falling into a "dry income" situation, in which they must bear a significant tax burden without having the necessary liquid assets. Transparent and fair tax regulations in this area would be crucial to strengthening Germany's competitive location for digital innovation and preventing the exodus of technological expertise, skilled workers, and capital.

Germany can still reposition itself as a pioneer of innovation-friendly and economically advantageous crypto regulation. However, the time to act is limited. To seize this opportunity, the tax treatment of crypto assets must be revised and adapted to actual economic conditions. Fair loss offsetting would be a decisive step in this direction and could help eliminate tax inequities and sustainably strengthen Germany as a financial centre—a slight adjustment with a significant impact.

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