

METHODOLOGY OF USING VIRTUAL ASSETS AS MEANS OF PAYMENT AT THE FIAT LEVEL: PROBLEMATIC ISSUES IN UKRAINE

Serhii Hrytsai

Ph.D. in Law, Associate Professor,

Associate Professor at the Department of Legal Support of Business Security,
State University of Trade and Economics, Ukraine

e-mail: frick165487@gmail.com, orcid.org/0000-0003-0051-6149

Summary

The FinTech sector, as one of the dynamic parts of Ukraine's economic frontier, has not only withstood the challenges of one of the most difficult times of independence, but has also continued to develop despite all the difficulties of the difficult time, and often despite it. *The purpose* of the article is to study the legal framework and methodology for the use of virtual assets as a means of payment in Ukraine before and after the entry into force of the cryptocurrency-specific Law No. 2074. *Methodology*. Both general scientific and special legal research methods were used to achieve the purpose of the study. *The scientific novelty* is an attempt to provide a legal assessment of the existing methodology for conducting increasingly popular transactions with virtual assets through the acquiring mechanism, against the background of an almost non-existent legal framework for their regulation. *Conclusions*. In fact, there is a paradigm in Ukraine regarding the recognition of virtual assets as means of payment. On the one hand, formally, at the legislative level, there are no plans to recognize virtual assets as a means of payment after the entry into force of Law 2074. On the other hand, from a practical point of view, before the entry into force of Law 2074, virtual assets are increasingly accepted as a means of payment in Ukraine. Prior to the entry into force of Law 2074, banks and cryptocurrency exchanges must act as tax agents in acquiring transactions for the purpose of payment for services and goods. Amendments to the Tax Code of Ukraine for the entry into force of Law 2074 do not provide for withholding tax when paying income to an individual from transactions with virtual assets. This will not contribute to the timely and full payment of taxes to the budget. The widespread use of cryptocurrencies directly in payments for goods and services in Ukraine, without official acquiring operations, before the entry into force of Law 2074 may have certain negative tax consequences for business entities.

Key words: cryptocurrency, cryptoasset, virtual asset, bitcoin, stablecoin, digital currency, electronic money, fintech.

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1. Introduction

At least 12.7% of Ukrainians use cryptocurrency. Ukraine ranks first in the world in terms of crypto adoption, according to a UN report at the Trade and Development Conference in August 2022. The CrossPay CEO noted a number of major players in the cryptocurrency payment solutions market in Ukraine: Binance, WhitePay, Kuna (*Melnyk, 2022b*).

Mastercard Ukraine and Moldova CEO said: "Cryptocurrency payments are one of the most anticipated innovations in payments for Ukrainians, and according to a recent Mastercard SME Index study, one in ten SMEs in Ukraine already accepts cryptocurrency as payment for goods or services. I am confident that the launch of the first cryptocurrency card in Ukraine will open a new page in the development of the payment market with the further launch of crypto innovations in the industry" ("*Ukraine launches payment card for cryptocurrency payments – weld card,*" 2022).

On 17.02.2022, the Verkhovna Rada of Ukraine adopted the Law of Ukraine "On Virtual Assets" No. 2074-IX (hereinafter referred to as the "Law 2074") (*On virtual assets, Pub. L, 2022*), taking into account previously submitted proposals from the President (Card of the draft law "On virtual assets". Card of the draft law. 2020). According to the section "Final and Transitional Provisions" of Law 2074, the law itself will come into force, inter alia, from the date of entry into force of the Law of Ukraine on Amendments to the Tax Code of Ukraine regarding the peculiarities of taxation of transactions with virtual assets (*Explanatory Note to the Draft Law of Ukraine No. 7150 "On Amendments to the Tax Code of Ukraine on Taxation of Turnover of Virtual Assets in Ukraine", 2022*). In order to fulfill the requirements of paragraph 1 of Section VI of Law 2074 and to bring it into force, the Verkhovna Rada of Ukraine on 13.03.2022 registered (*Comparative Table to the Draft Law of Ukraine "On Amendments to the Tax Code of Ukraine Regarding Taxation of Transactions with Virtual Assets" No. 7150, 2022*) Draft Law No. 7150 "On Amendments to the Tax Code of Ukraine on Taxation of Transactions with Virtual Assets" (hereinafter – Draft Law 7150) (*Draft Law On Amendments to the Tax Code of Ukraine on Taxation of Transactions with Virtual Assets, 2022*).

Under the concept of virtual assets (*Hrytsai S. O., 2022k, 2022h*) Law 2074 contains a definition that covers the entire spectrum of (*Hrytsai, 2023*) a more familiar concept to us (*Hrytsai, 2022c*), as a cryptocurrency (*Hrytsai S. O., 2022c*), except for the concept of CBDC (*Hrytsai, 2022a*) – digital currency of central banks.

The legal status of virtual assets is defined in part 7 of Article 4 of Law 2074 and has the following interpretation: "*Virtual assets are not a means of payment on the territory of Ukraine and cannot be exchanged for property (goods), works (services)*".

However, the current practice in Ukraine does not correspond to the meaning of Law 2074 (*Hrytsai S. O., 2022m, 2022j*).

2. Purpose of the article

The purpose of the article is to analyze the legal framework and methodology of using virtual assets as means of payment in Ukraine before and after the entry into force of Law 2074.

3. Methods

The goals determine the methodology for achieving them, just as the tasks set determine the methods for solving them. The methodological basis of the study included a combination of philosophical, general scientific and special legal methods of scientific knowledge.

The source base of the study was based on the analysis of the legislative framework of Ukraine. The empirical basis of the study was formed by official letters of explanation from state regulators, as well as reports and interviews with senior executives of business entities in Ukraine.

The general philosophical (universal) method of cognition was used at all stages of the study. The dialectical method with a systemic and structural approach was applied to the study of scientific literature and legal and regulatory material governing taxation.

The Aristotelian method was useful in analyzing the content of the current legislation on the legal nature of the object of study, explaining the problems of their provision, in terms of legislative technique in the relevant draft laws and regulations.

The interdisciplinary approach to the study of various aspects (definition of the legal nature, tax regulation, etc.) of the mechanisms of legal regulation of relations related to cryptocurrency proposed in the draft laws contributed to the proper substantiation of the conclusions and proposals made.

The selected source base and methodology of its research corresponds to the formulated purpose and achievement of the goal and generally contributes to the creation of an optimal structure of the conclusions drawn.

4. Results of the study

1. Acquiring with virtual assets. In 2022, electronics retailers in Ukraine, such as Stylus and TechnoIzhak, began to increasingly accept cryptocurrencies as payment for goods purchased from them. The whole process was implemented in partnership with the crypto processing platform Whitepay, which is part of the European exchange WhiteBIT. Payments are made through the acquiring form in online stores or directly at the point of sale through special POS terminals. Payment is accepted in more than 130 types of cryptocurrencies and their list is constantly expanding (*Electronics retailers TechnoEzhak and Stylus start accepting cryptocurrencies to pay for goods, 2022*).

Mastercard, together with Weld Money, a fintech startup based on the Ukrainian bank Unex Bank, has launched a cryptocurrency payment card "Weld" in Ukraine. The card allows you to pay for goods and services with cryptocurrency in a convenient mode where cashless payments are available: POS terminal, online payments. From a practical point of view, the process of paying with the Weld cryptocurrency card is no different from paying with any bank card based on Debit Mastercard. This card can be added to Apple Pay, Google Pay and pay with cryptocurrency without the need for the user to convert it into regular (fiat) currency, as the conversion of cryptocurrency is automatic. When paying with the Weld card, the equivalent amount is deducted from the cryptocurrency balance of the Weld Money wallet in the form of USDT stablecoins. Weld Money has announced that Bitcoin and a number of altcoins will soon be added to the wallet ("*Ukraine launches payment card for cryptocurrency payments – weld card*", 2022).

The online cryptocurrency exchange Binance and the supermarket chain Varus, which has 97 supermarkets in different cities of Ukraine, have launched online payments for goods in online stores using a crypto wallet and Binance Pay technology. The head of the Varus e-business center said, among other things: "[...] *Thanks to our technology partners Binance and SettlePay, we will soon announce this opportunity in the offline network.*" Binance Pay is a contactless cryptocurrency payment technology that is one of the many products of the Binance ecosystem that supports more than 50 cryptocurrencies (*Tarasovskiy, 2022*).

Along with the Varus network, the well-known WOG gas station chain has become a partner of the Binance cryptocurrency exchange and launched the possibility of paying for fuel with cryptocurrency through Binance Pay. In a press release, the company said: "Cryptocurrency payments have become another alternative tool for paying for fuel. It can be used for

contactless payments using the WOG PAY service in the PRIDE mobile application. The integration was implemented in partnership with SettlePay." The Head of Digital Transformation at WOG filling stations added: "Our team is working to offer our customers innovative products and services... The addition of the Binance Pay cryptocurrency payment option will expand this line" (Zharykova, 2022).

OKWINE, the Ukrainian chain, was the first in its segment to add the ability to pay for drinks and food with cryptocurrency. More than 130 types of cryptocurrencies are now available for payment in the Okwine.ua web market and to visitors of OKWINE stores through POS terminals in Kyiv and Lutsk. The project was implemented in partnership with the crypto processing service Whitepay. In the near future, the option is planned to be integrated in all outlets, as cryptocurrency payments are gaining popularity and new momentum in the Ukrainian market (Symonenko K., 2022).

At the end of May 2022, Foxtrot, one of the largest retail chains in Ukraine in terms of the number of stores and sales, integrated a tool from the cryptocurrency exchange Binance. According to the results of the first month of trading, Foxtrot accepted more than 1000 payments in cryptocurrency (Meljnyk, 2022a). Binance Pay technology is used. The average receipt in such purchases is close to the average in the Foxtrot network (Shapoval, 2022).

This is not the first time that Ukrainian businesses have picked up the crypto payment trend. The previous wave took place in 2017–2018, but payments did not become widespread. Currently, businesses have picked up the trend of introducing cryptocurrency payments again. This is because over the past 5–6 years, infrastructure solutions for crypto payments have caught up with market demands. "Five years ago, everyone wanted to make payments with crypto, but they did not understand how and what," WhitePay CEO said in his interview with Forbes.

In 2019, major cryptocurrency players appeared on the Ukrainian market. Whitebit, a cryptocurrency exchange with more than 3.5 million users, launched WhitePay crypto processing. Binance, one of the world's largest crypto exchanges, started testing crypto payments through its BinancePay crypto processing in 2021. The services developed by these crypto market players helped to accept payments from the buyer and send them to the seller of services or goods – the retailer. WhitePay has developed a payment terminal for offline outlets, having invested more than \$1 million, and BinancePay has introduced payment in stores via QR code. The director of the Ukrainian office of the cryptocurrency exchange Binance notes that they are preparing integration with 10 retailers in the near future: "We plan to announce a new partnership every month." At the same time, WhitePay is negotiating integration with 45 companies (Meljnyk, 2022a).

We assume that all of the above examples of the use of virtual assets are carried out through a banking service – acquiring, which takes place automatically. And this is despite the fact that virtual assets remain unregulated in Ukraine, as Law 2074 has not yet entered into force (Hrytsai S. O., 2022l).

The widespread use of acquiring would be more logical after the entry into force of Law 2074 (Hrytsai S. O., 2022b), when such a scheme will work through official service providers (Hrytsai S. O., 2022n) on the turnover of virtual assets that have received the appropriate authorization (Hrytsai S. O., 2022i) from the relevant market regulators in Ukraine (Hrytsai S. O., 2022d, 2022e).

Today, there are at least two types of acquiring. Acquiring (merchant acquiring) is a bank service that allows you to accept payment cards of international and national payment systems for goods, works and services using a POS terminal (or its analog) (*What is acquiring, acquirer, POS terminal?* 2020). Mobile acquiring is a technology that allows you to accept

payment for goods or services with bank cards using a smartphone or tablet computer and a connected M-POS terminal. Mobile POS terminals can be connected to a smartphone or tablet based on Apple iOS or Android, as well as to a personal computer. There are no specific restrictions on the acceptance of bank cards by a mobile POS terminal. The types and kinds of payment cards may be limited both by the acquiring bank (availability of certifications in the PS) and by the capabilities of the mobile POS terminal (acceptance of cards with a magnetic stripe and/or chip, contactless cards) (*Mobile acquiring, 2022*).

However, today, despite everything, as we can see from numerous examples, acquiring is used, i.e., there are agreements between the bank and service providers acting at their own discretion, without any control from the state. Due to the existing lack of regulation, this issue cannot be applied and penalties cannot be imposed on the following business entities (*Hrytsai S. O., 2022a*), – what encourages arbitrariness.

2. Tax agent: acquiring transactions with virtual assets before and after the entry into force of Law 2074. All of the above touches upon an equally important topic, namely the taxation of transactions with virtual assets that take place today before the entry into force of Law 2074. At a minimum, banks that carry out acquiring operations for "semi-legal" cryptocurrency exchanges should act as tax agents when conducting transactions with virtual assets on the part of individuals (*Hrytsai S. O., 2022g*).

Let's analyze the existing regulatory framework of Ukraine regarding the functioning of the institute of tax agent, which, according to the letter of the Ministry of Justice of Ukraine dated 23.11.2006 No. 20-5-478 with reference to the Tax Code of Ukraine dated 02.12.2010 No. 2755-VI (hereinafter – the TCU), is recognized as a legal entity (its branch, department, other separate subdivision) or an individual or representative office of a non-resident legal entity (*On Procedure for Withholding Personal Income Tax and Social Security Contributions from the Amount of Employee's Wages, 2006*).

According to subpara. 14.1.180 of para. 14.1 of Art. 14 of the TCU, a tax agent with respect to personal income tax is a legal entity (its branch, department, other separate subdivision), self-employed person, representative office of a non-resident legal entity, investor (operator) under a production sharing agreement, which, regardless of the organizational and legal status and method of taxation with other taxes and/or form of accrual (payment (in cash or in kind) of income (in cash or in kind) are obliged to accrue, withhold and pay the tax provided for in Section IV of the TCU to the budget on behalf and at the expense of an individual from the income paid to such person, keep tax records, submit tax reports to the controlling authorities and be liable for violation of its provisions in the manner prescribed by Art. 18 and Section IV of the TCU (*Tax Code of Ukraine, Pub. L., 2010*).

Section IV of the TCU provides for the procedure for the calculation, withholding and payment (transfer) of personal income tax (hereinafter – PIT): for resident individuals with a source of origin in Ukraine and foreign income; for non-resident individuals with a source of origin in Ukraine (paragraph 162.1 of the TCU).

A tax agent that accrues (pays, provides) taxable income in favor of an individual taxpayer is obliged to withhold tax from the amount of such income at the taxpayer's expense using the tax rate specified in Article 167 of the TCU (subpara. 168.1.1 of the TCU).

The tax withheld from the income of residents (non-residents) is subject to crediting to the budget (paragraph 168.4.1 of the Tax Code) in accordance with the provisions of the Budget Code of Ukraine dated 08.07.2010 No. 2456-VI (hereinafter – BCU) (*Budget Code of Ukraine, Pub. L., 2010*).

The personal income tax paid (transferred) by the tax agent is credited to the relevant budget at their location (location) in the amount of tax accrued on income paid to an individual (clause 2 of Article 64 of the BCU).

Tax agents, as a general rule, withhold and pay personal income tax and military duty to the budget simultaneously with the transfer of money (in the form of income) to the individual's bank account (subpara. 168.1.2 of the TCU).

In addition to the use of the tax agent institution for personal income tax and military duty (reporting on these taxes is unified), the Tax Code and letters of the State Tax Service of Ukraine also use the term "tax agent" in relation to other taxes and fees: military duty; tourist tax; and withholding tax (the so-called repatriation tax). A personal income tax and military duty declaration is filed by individuals only if they are registered as an entrepreneur under the general taxation system or such taxes were not withheld by tax agents, and in all other cases personal income tax and military duty are paid and reported by tax agents:

- *legal entities, individual entrepreneurs* on the general system or 2,3,4 groups of the single tax, who are employers: a). pay their employees wages and other income (dividends, royalties, bond income, income in the form of additional benefits) (subpara. 162.1.3, subpara. 164.2.14 of the TCU, subpara. 171.2 of the TCU); b). taxes are also accrued and withheld from the income of individuals who do not have the status of an entrepreneur under civil law contracts (contracting services, sale and purchase of movable property), if the agreement was not notarized and taxes were not withheld directly by the notary (subpara. 173.3 of the TCU);

- *notaries* – in the case of notarization of contracts for the sale and purchase of property, gift agreements and issuance of inheritance certificates (subpara. "b" of subpara. 168.4.5 of the TCU and subpara. 173.3 of the TCU);

- *banking institutions* – from passive income (interest on current and / or deposit (deposit) bank account, registered savings (deposit) certificates) (subpara. 14.1.268 of the TCU), as specified by the Letter of the State Fiscal Service dated 05.07.2017 No. 1000/6/99-99-13-02-03-15/IIIK) (*On taxation of certain types of income, 2017*);

- *credit unions* – from deposits, payment (interest) on distributed share membership fees of members of such a union (subpara. 14.1.68 of the TCU);

- *insurance companies* – from income in the form of insurance payments and insurance compensation;

- *professional securities trader* – from investment income as a result of transactions with the taxpayer's investment assets (subpara. 170.2.9 of the TCU);

- *asset management companies* – from investment income as a result of transactions with the taxpayer's investment assets (subpara. 170.2.9 of the TCU);

In the future, we will find out what tax prospects await us when the Tax Code of Ukraine is amended to enact Law 2074. In the course of the legal analysis of the Draft Law 7150, among other things, our attention was drawn to paragraph 10, which provides for amendments to Article 170 by one paragraph and five subparagraphs, in particular, as follows:

«170.2-1. *Taxation of profits from transactions with virtual assets. 170.2-1.1. A tax agent that accrues (pays) to a taxpayer income from transactions with virtual assets shall not withhold tax at source when paying (accruing) such income and shall reflect such income in the tax calculation, the submission of which is provided for in subparagraph "b" of paragraph 176.2 of Article 176 of this Code.» (Draft Law On Amendments to the Tax Code of Ukraine on Taxation of Transactions with Virtual Assets, 2022).*

3. Taxation of acquiring operations with virtual assets before the entry into force of Law 2074. The issue of taxation of service providers remains open in the context of our study

(Hrytsai, 2022b), acting at their discretion before the entry into force of Law 2074, which may include both legal entities and individual entrepreneurs (Hrytsai S. O., 2022f).

If a person purchases certain property for cryptocurrency, he or she will have to pay more taxes, because cryptocurrency is not a means of payment in Ukraine (Hrytsai S. O., 2022b).

Only the hryvnia is legal tender in Ukraine (On the National Bank of Ukraine, Pub. L., 1999). Article 99 of the Constitution of Ukraine defines the hryvnia as the currency of Ukraine. Ensuring the stability of the currency is the main function of the central bank of the state, the National Bank of Ukraine (The Constitution of Ukraine, Pub. L., 1996). According to Article 1 "Definition of Terms" of the Law of Ukraine "On Currency and Currency Values" [...]. the terms are used in the following meanings: [...] 6) national currency (hryvnia) (On currency and currency transactions, Pub. L., 2018).

In the above case, the acquired property may be qualified by the tax authorities as income from the sale of cryptocurrency in a non-monetary form.

A barter (commodity exchange) transaction is a business transaction that involves making payments for goods (works, services) in kind under one agreement (subpara. 14.1.10 of the TCU).

In case of accrual of income in any non-monetary form, the tax base is the value of such income calculated at arm's length prices, the rules for determining which are established in accordance with the Tax Code, multiplied by a coefficient. The coefficient is calculated using the following formula $K = 100 : (100 - SP)$, where K is the coefficient; SP is the tax rate set for such income at the time of its accrual (for the 18% tax rate, the coefficient is 1.21951). Such income is also subject to military duty at the rate of 1.5%. However, the application of the "natural" coefficient for the military fee is not provided. In the tax calculation for the 1DF form, column 3a "Amount of accrued income" reflects (for the reporting quarter) the income accrued to an individual in accordance with the income characteristic. This provision is stipulated by clause 164.5 of the Tax Code, paragraphs 3.2, 3.3 of Section III of the "Procedure for Completion and Submission by Tax Agents of the Tax Calculation of the Amounts of Income Accrued (Paid) in Favor of Individuals and the Amounts of Tax Withheld from Them", approved by Order of the Ministry of Finance of Ukraine No. 4 dated January 13, 2015 (Employee has been accrued income in kind: reflection in the calculation of the 1DF form (2023) 2023).

5. Conclusions

1. In fact, there is a legal paradigm in Ukraine regarding the recognition of virtual assets as means of payment. On the one hand, formally, at the legislative level, it will not recognize virtual assets as a means of payment after the entry into force of the relevant Law 2074. On the other hand, from a practical point of view, before the entry into force of Law 2074, virtual assets are increasingly accepted as a means of payment in Ukraine. And we do not see any obstacles in the existing methodology of acquiring operations, and further after the entry into force of the relevant Law 2074.

2. Prior to the entry into force of the cryptocurrency-specific Law 2074, banks and cryptocurrency exchanges must act as tax agents for acquiring operations in Ukraine.

3. The widespread direct use of cryptocurrencies in payments for goods and services in Ukraine, i.e. not through official acquiring operations, before the entry into force of the cryptocurrency-specific Law 2074 may have certain negative tax consequences for businesses involved in this transaction. The tax inspectorate equates non-monetary settlements to a barter transaction and entails the application of an increased coefficient to the tax base of 1.21951.

4. If Draft Law 7150 is adopted to enact Law 2074, the concept chosen by the legislator provides that when paying income to an individual from transactions with virtual assets, tax agents should not withhold tax at the source of payment. This direction of legislative activity set forth in the Draft Law 7150 will not contribute to timely and full tax revenues to the budget in the form of taxes from transactions with virtual assets conducted by individuals, including non-residents.

Proposal. In order to ensure full and timely tax withholding, banks (financial institutions) and service providers (cryptocurrency exchanges) that conduct acquiring transactions should be obliged to withhold taxes from such transactions. To this end, the Tax Code of Ukraine should be amended accordingly before Law 2074 enters into force.

Virtual asset market participants may try to proceed from the fact that cryptocurrencies have the official status of an object of civil rights in Ukraine since the end of 2023 (Article 179-1 of the Civil Code of Ukraine). This means that such an asset may be subject to exchange. The subject of such an exchange may be real estate, cars, goods, etc. And based on this legal position, trying to defend your rights in Ukrainian courts against the claims (position) of the tax authority regarding the qualification of such sales/exchanges involving cryptocurrencies as in-kind transactions and the need to apply an increased coefficient of 1.21951 to the primary tax base of such transactions – although a stable court practice in this direction has not yet been formed, but the probability of success is not high until the relevant cryptocurrency Law 2074 comes into force.

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