

## Cryptocurrencies in the Netherlands

By:

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10 June 2019

### Virtual money



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### Key points

- Bitcoin was the first decentralised cryptocurrency.
- How should cryptocurrencies be classified in annual accounts of businesses that use them?
- The Netherlands classified them as intangible fixed assets, inventory or other investment.
- The intent or object of the user governs which classification to use.

A cryptocurrency is a digital or virtual money that uses encryption techniques to secure and verify its transactions, to control the generation (mining) of additional currency units, and to verify the transfer of funds and thus operate independently from a centralised bank. Cryptography itself describes the practice and study of techniques for secure communication in the presence of third parties. In contrast to traditional forms of fiat money that are controlled using centralised banking systems – national currencies whose value is not tied to a commodity such as gold – cryptocurrencies use decentralised control.

### Blockchain

The decentralised control of a cryptocurrency works through a blockchain. This lists records or entries, called blocks, that are linked using cryptography. In terms of accounting principles, it can be compared with a general ledger updated and accounted for by each participant (or node) though connected to a larger network, creating what is referred to as the distributed ledger. Every single node on the network processes every transaction, coming to its own conclusions, on the

basis of the underlying cryptography, and then voting on those conclusions to make certain the majority agrees with the conclusions.

Once there is this consensus, the distributed ledger is updated, and all nodes maintain their own identical copy of the ledger. This architecture allows for a verification process that cannot be altered, thus ruling out the possibility for fraud.

### **Bitcoin versus ethereum**

Bitcoin was the first decentralised cryptocurrency and released as an open-source software in 2009. Since then the number of cryptocurrencies has increased dramatically and, to date, the market has grown to more than of 2,250. Bitcoin has the highest market capitalisation – US\$147bn – and is followed by ethereum with a market cap of US\$27bn.

Like bitcoin, ethereum is powered by the same principle of distributed ledgers and cryptography, but the two have several differences. In particular, the purpose of ethereum differs from that of bitcoin.

Bitcoin was a reaction to centralised banking systems and offered an alternative to fiat money, but ethereum was developed as a platform that can be used for peer-to-peer smart contracts. In contrast to a standard contract that outlines the terms of a relationship – which is typically enforceable by law – a smart contract enforces the relationship by virtue of the program executing exactly as it has been set up to by its creators.

### **Dutch accounting principles**

In the Netherlands, guidelines and commentaries for Dutch accounting principles are governed by the Dutch Accounting Standard Board (*Raad voor de Jaarverslaggeving*) (DASB). This independent organisation has set itself the goal of promoting the quality of the external reporting of Dutch non-listed organisations and companies. The guidelines for annual reporting and commentaries are published for this purpose.

The increasing popularity of blockchain and cryptocurrencies and their adoption by mainstream industry has led to more questions about how they should be classified in the annual accounts. As a result, on 4 October 2018 the DASB published its considerations on cryptocurrency and accounting principles.

### **Classification of a cryptocurrency**

The DASB finds that cryptocurrencies do not qualify as cash and cash equivalents or as financial assets. Therefore, they cannot be included in the annual accounts as such.

Cash and cash equivalents are instruments in the form of cash in hand or cash in bank (non-cash items). This money is issued by a government or by an institution under the supervision of the government. In the case of cryptocurrency, neither is the case. Therefore, it can be concluded that cryptocurrencies do not classify as cash or cash equivalents. Further, the ownership of any cryptocurrency does not create the contractual rights to receive current assets or another financial asset. Consequently, cryptocurrency does not qualify as a financial instrument.

Different from fiat money, a cryptocurrency can therefore not be presented as a cash or cash equivalent in the annual accounts. The intent of the owner needs to be assessed to determine a suitable classification. Cryptocurrencies can, for example, be held for a longer period, for research purposes, for trade in the ordinary course of business or as an investment.

Depending on the intent and objective to possess a cryptocurrency, the DASB considers it should be classified as:

- an intangible fixed asset;
- inventory; or
- other investment.

#### **Intangible fixed asset**

The DASB defines an intangible asset as an 'identifiable non-monetary asset without physical substance'. A cryptocurrency has no physical attributes and will be in the scope of this definition, unless it is being held for sale in the ordinary course of business or is considered to be another investment.

Initially, intangibles are valued at the historical cost so, when specified conditions are met, the asset may be valued at fair market value. When applicable, the conditions relating to the distinction between fixed and current assets, impairments and the recognition of a revaluation reserve must be taken into account.

### **Inventory**

An entity can classify a cryptocurrency as inventory if it is for sale in the ordinary course of business. A cryptocurrency held as inventory should initially be valued at the historical cost; afterwards the inventory may be valued at market value when that price falls below the historical (acquisition) cost.

### **Other investment**

Based on DASB publications, other investment can be defined as an asset that is held for the purpose of realising revenue or capital appreciation or both and is not used for production, providing goods or services, for management purposes in the ordinary course of business, or for sales as part of the ordinary course of business.

When cryptocurrencies are held as an other investment the Dutch civil code requires that they are valued at fair market value and any changes in value presented directly into the entity's profit and loss account. However, when the other investment has no frequent market quotation it should first be recognised through the revaluation reserve in equity and when realised recognised in the profit and loss account. For cryptocurrencies in general, it is not possible to determine whether there is a frequent market quotation. This, though, is not the case for bitcoin and ethereum since they are listed.

### **Presentation and notes**

The DASB provides that cryptocurrencies can be presented as a separate item on the balance sheet, bearing in mind the standard distinction between current and fixed assets. It is also necessary to provide all the information for making an accurate evaluation. Similar to any other balance sheet item, the (relative) size of the item plays a role in the level of details of the information which has to be disclosed in the notes to the annual accounts.

As we have seen, depending on the intent or object of the asset, cryptocurrencies may be classified under several balance sheet items. The DASB therefore recommends including in the notes to the annual accounts which other classifications could have been used and for what amount that would have been the case. In any case, the owner of a cryptocurrency is required to apply its chosen valuation and income recognition consistently. Further, the purpose of holding it and the considerations underlying the chosen classification should be stated. The DASB also states that the legal entity should issue an explanation detailing the risks associated with the cryptocurrency and the business purposes the holding cryptocurrency serves.

### **International perspective**

The DASB guidelines for determining the relevant classification of a cryptocurrency seem in line with the international accounting standards. The main difference in presentation of a cryptocurrency between Dutch GAAP and International Financial Reporting Standards (IFRS) concerns the applied valuation method and subsequent measurements of inventory and intangible assets. This is not restricted to cryptocurrencies and more or less constitutes the main difference between IFRS and Dutch GAAP.

### **In conclusion**

Based on the DASB guidelines it may be concluded for Dutch GAAP purposes that cryptocurrencies do not meet the definition of cash and cash equivalents or financial assets. Depending on the purpose for which they are being held, it could be intangible assets, inventories or other investments. Unless a cryptocurrency is used for the buying or selling of the delivery of goods or

services in the scope of normal business it will, in general, be accounted for as other investment and valued at market value. Depending on whether there is a frequent market quotation, the fluctuations in value should first be recognised through the revaluation reserve and, on realisation, in the profit and loss account.

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