



Taxation of crypto currencies

Tony Nunes

February 2018

KELLY + PARTNERS

TAX CONSULTING

What's all the fuss about...

- + Blockchain technology represents a type of next-generation business process improvement software.
- + Blockchain technology is a means to record the truth without a trusted intermediary like a bank.
- + A public blockchain is an online, open-source database of transactions that is managed by a network rather than just one entity.
- + Blockchain technology relies on a network of “miners” (or nodes) to verify transactions in a block. What happens on a blockchain cannot be subsequently corrupted or changed unless the network agrees to the change, which the network is not incentivised to do.
- + Miners share the responsibility for verifying transactions through a consensus (or proof of work) process, which is based on cryptography
- + Cryptocurrencies are based on blockchain technology.
- + The internet took almost 20 years to attract significant investment and mass market uptake.
- + The market capitalization of block chain projects (mainly crypto currencies) was at \$158.5 billion at August 2017
- + <10 years after the launch of Bitcoin in 2009

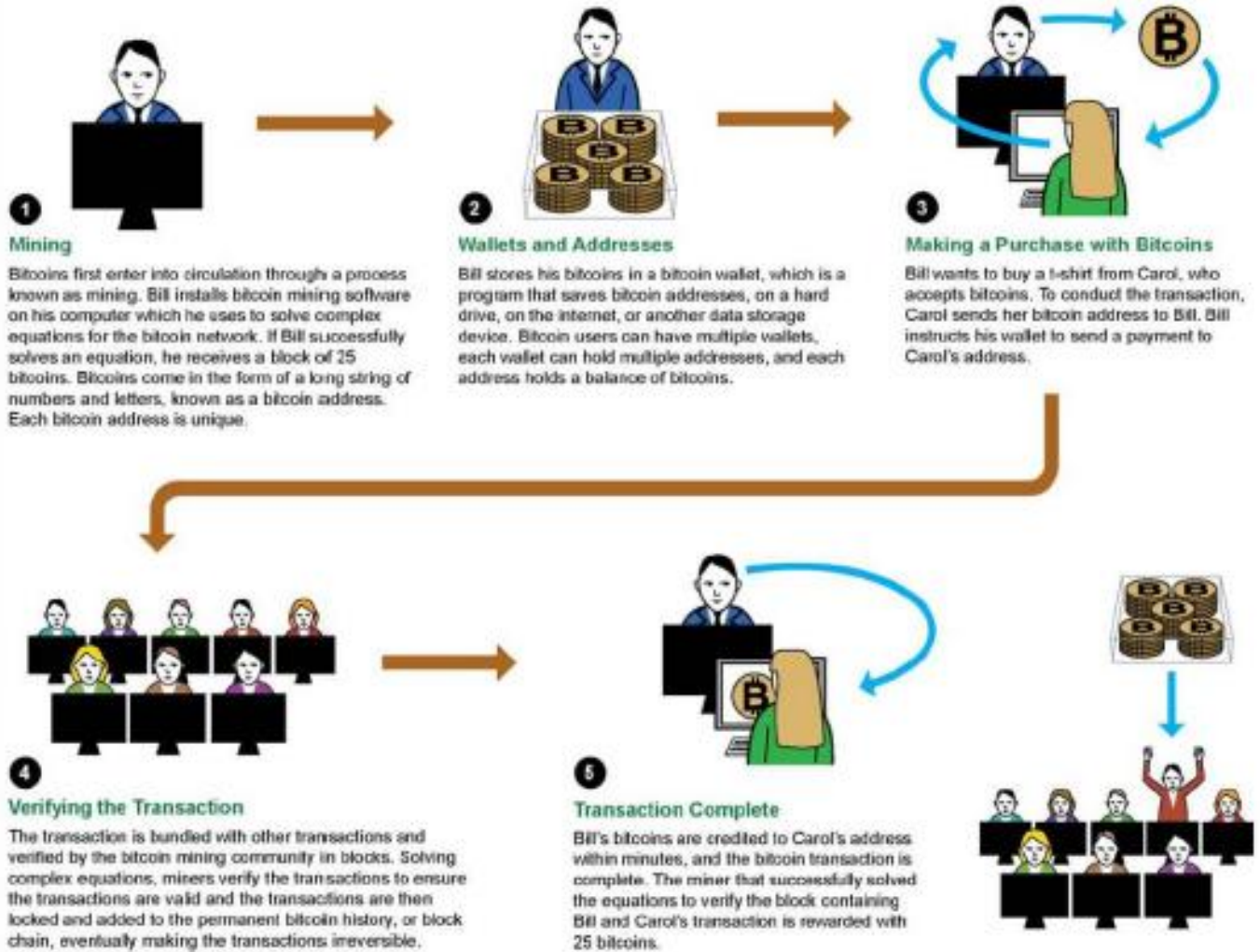
How Bitcoins Enter Circulation and Are Used in Transactions



Bitcoins enter into circulation through a process known as mining.

Bitcoin Addresses

A bitcoin address comprises a paired private key and public key. The private key is stored in a wallet and known only to the bitcoin address owner, who uses the private key to conduct a transaction. The public key associated with the bitcoin address is public information. Bitcoin miners use the public key to verify a transaction is valid, which avoids double spending of a bitcoin.



Source:
 Public Discussion Draft
 BEPS Action 1: Address the tax
 challenges of the digital
 economy, 24 March 2014 – 14
 April 2014

ATO's views on Bitcoin

- + Bitcoin is not a 'foreign currency' for income tax purposes
- + Bitcoin is a 'CGT asset' (ie Disposing of Bitcoin may be treated as a capital gain/loss.)
- + A Bitcoin can be a personal use asset where it costs \$10,000 or less (ie no tax implications)
- + Bitcoin is trading stock, where taxpayer is in the business of mining Bitcoin or runs a Bitcoin exchange.
- + Any income derived from the mining of Bitcoin is to be included in assessable income
- + Using Bitcoin in business entitles you to a deduction for purchases.
- + The provision of Bitcoin by an employer to an employee in respect of their employment is a property fringe benefit for Fringe Benefits Tax purposes
- + From 1 July 2017 – Sales and purchases of Bitcoin are not subject to GST

1. See <https://www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-bitcoin/>

2. See TR 1999/6, TD 1999/34, PSLA 2004/4 and *Payne v. FC of T* (1996) 66 FCR 299; 96 ATC 4407; (1996) 32 ATR 516



Examples

Example of ATO's approach

- + On June 1 2017, Jane purchased five Bitcoins for \$6,000 (\$1,200 each Bitcoin).
- + On November 1, 2017, she used one Bitcoin to purchase \$2,000 worth of merchandise via an online Australian-based retailer.

Jane should recognized an \$800 gain on the transaction. The merchandise may be subject to GST, depending on whether the online retailer is registered for GST.

- + Jane purchased four Bitcoins on 2 February 2017 for \$1,120 per Bitcoin and three on 20 April 2017 for \$1,990 per Bitcoin. She exchanges her Bitcoin as follows: ten Ethereum coins on 10 March 2017 for \$320 per coin, and 65 Litecoins on 5 July 2017 for \$65 per coin.

Jane needs to keep track of the basis and sales price for each cryptocurrency transaction in order to properly calculate the gain or loss for each transaction. In addition, if Jane purchased Bitcoins at different dates and at different prices, at sale, Jane would have to determine whether she would be selling a specific Bitcoin or use the first-in, first-out (FIFO) method to determine any potential gain or loss

Discussion Example 1

- + In 2010 Chris bought computer equipment for \$16,000.
- + He used the computers to mine for Bitcoins.
- + He has mined 16 Bitcoin, but stopped mining in 2012, as his equipment was no longer suitable to the task.
- + He has used his initial 16 Bitcoin to trade in other crypto currencies – he does about 2 or 3 trades per week.
- + In January 2018 his Bitcoin were worth \$800,000.

Discussion example 2

- + Matt bought 1 million Syscoin in 2014 for \$5,000.
- + He has held onto these coins and not traded with them.
- + The current value of Matt's Syscoin is \$1.6m
- + A new online exchange is being set up and allowing him to operate one Master Node server per 100,000 Syscoin – Matt plans to set up 10 Master node servers
- + Matt will earn 1/1000th Syscoin per transaction processed on his Master Node servers.
- + Over time he expects to earn several million Syscoin per month

Discussion example 3 – Second Life

- + Second Life is an online virtual world, launched on June 23, 2003. By 2013 Second Life had approximately 1 million regular users.
- + Second Life has an internal economy and internal currency, the Linden dollar (L\$).
- + L\$ can be used to buy, sell, rent or trade land or goods and services with other users.
- + The "Linden" can be exchanged for US dollars or other currencies on market-based currency exchanges.
- + Residents of Second Life are able to create virtual objects and other content.
- + Second Life is unique in that users retain all the rights to their content which means they can use Second Life to distribute and sell their creations, with 2.1 million items listed on its online marketplace.
- + L\$ can be purchased using US dollars and other currencies on the LindeX exchange provided by Linden Lab, independent brokers or other resident users.

1. Source: https://en.wikipedia.org/wiki/Second_Life

Discussion example 3 – Second Life (cont.)

2006 saw Second Life's first real-world millionaire: Ailin Graef, better known as Anshe Chung (her avatar), converted an initial investment of \$9.95 USD into over one million dollars over the course of two and a half years. She built her fortune primarily by buying, selling, and renting virtual real estate.

Major tech corporations have tried to use Second Life to market products or services to Second Life's tech-savvy audience.

- + For example, IBM purchased 12 islands within Second Life for virtual training and simulations of key businesses processes.
- + Musicians, podcasters, and news organizations (including CNET, Reuters, NPR's The Infinite Mind, and the BBC) all established a presence within Second Life.
- + Virtual goods include buildings, vehicles, devices of all kinds, animations, clothing, skin, hair, jewelry, flora and fauna, and works of art.
- + Services include "camping", wage labor, business management, entertainment, and custom content creation (which can be broken up into the following six categories: building, texturing, scripting, animating, art direction, and the position of producer/project funder).

1. See Taxation of virtual property, Mark Macrae ATIA, The Tax Specialist Vol 11 No. 5 June 2008

KELLY + PARTNERS

TAX CONSULTING

Thank You



Tony Nunes

Kelly Partners Tax Consulting

tony.nunes@kellypartners.com.au

