Our Reference Liam Hennessy 202229634
Direct Line +61 7 3114 0291
Email liam.hennessy@gadens.com

gadens

ABN 30 326 150 968

ONE ONE ONE
111 Eagle Street
Brisbane QLD 4000
Australia

GPO Box 129
Brisbane QLD 4001

T +61 7 3231 1666
F +61 7 3229 5850

gadens.com

31 January 2023

Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Attention: Alan Raine

Dear Mr Raine

Inquiry into *Treasury Laws Amendment (2022 Measures No. 4) Bill 2022* [Provisions]

Gadens, in collaboration with academics from the QUT Law School, appreciates the opportunity to make a submission in relation to the *Treasury Laws Amendment (2022 Measures No. 4) Bill 2022* (**Bill**) introduced on 23 November 2022.

Gadens is a leading law firm which advises Australian and global financial institutions, exchanges, funds, token issuers, financial intermediaries and fintechs on digital assets and financial services regulation. Liam Hennessy, Partner, is a leading specialist in financial services regulation and academic at Griffith University. Lionel Hogg, Partner, is the head of the Corporate Advisory Group and is one of Australia's leading corporate lawyers. Anna Fanelli, Associate, is a lawyer in financial services regulation.

Lachlan Robb is an academic in the QUT School of Law, focusing on the socio-legal dimensions of technology. Lachlan's PhD is an investigation into a blockchain start-up and how the technology potentially disrupts legal and normative orders. Lauren Bellamy is a researcher in the QUT School of Law.

While the Bill offers important amendments generally, our submission focuses on the legal status of digital currencies (including various cryptocurrencies).

Need for effective regulation

1. The proliferation of digital assets has created challenges for regulators worldwide. This has never been more evident than the last few months which have seen regulation introduced throughout the world, notably in the United States, the United Kingdom, and New Zealand. In each case, the approach is different.

2. Australia does not have an agreed regulatory approach and appears to be tackling issues incrementally without first having settled that approach. Although various interim steps may be required whilst these issues are being considered, it remains evident that more holistic decisions are required for systemic integrity (level of regulation of participants), which affects business certainty, and consumer protection. It is not even clear that there are good instrumental reasons for government facilitating a market in non-fiat cryptocurrencies.

Bill

3. The proposed Bill is symptomatic of this greater malaise, reacting to an external threat detached from the broader problem. The Explanatory Memorandum identifies the Republic of El Salvador's recognition of bitcoin as unrestricted legal tender as creating the possibility that bitcoin, and other digital currencies, could be a 'foreign currency' for the purposes of the *Income Tax Assessment Act 1997* (Cth). It further notes that "bitcoin and other similar digital currencies were never

intended to be foreign currencies for Australian income tax purposes".[1] This may be so, and we are agnostic as to the position, however defining what bitcoin is not begs the question of what it is, the broader proposed taxation (and other) treatment, and the appropriate means of that treatment.

4. The Bill proceeds on the unreliable assumption that cryptocurrency is a form of property.

   (a) The Explanatory Memorandum states that the amendments will maintain the policy status quo that "if an investment in bitcoin is held on capital account, gains or losses arising from the disposal of bitcoin would be subject to the capital gains tax rules".[2] The clarification is said to be necessary to prevent "uncertainty about the status of these assets for Australian income tax purposes".[3]

   (b) This position is predicated on bitcoin being a form of property to which capital gains tax attaches.

   (c) For the reasons set out below, it is far from clear that bitcoin and other cryptocurrencies are property. The legislation is grounded on a brave assumption.

   (d) We note that the Board of Taxation is separately undertaking a Review of the Tax Treatment of Digital Assets and Transactions in Australia.[4] Again, this is premised on the assumption that cryptocurrency is a form of property.

5. To be clear:

   (a) The Bill clarifies the narrow issue of whether bitcoin is a foreign currency for ITAA purposes, which is a policy choice.

   (b) Clarification of the narrow issue does not address the real uncertainties, including legal uncertainties, about cryptocurrencies in the Australian economy.

   (c) An approach premised on a category assumption of cryptocurrency (that it is a form of property at law), without resolving that classification, inevitably gives rise to difficulties if the assumption proves to be incorrect and is no basis for making policy decisions as to appropriate regulation of the sector.

   (d) None of this is difficult to fix, whatever level of regulation one decides is appropriate, but addressing the fundamental issue is a precondition of any satisfactory resolution.

Property in Australia

6. There is not a static definition of property in Australia. The concept of property has changed over time and includes something that can be owned, sold, created, or taken, both tangible and intangible. Property should be considered as the bundle of rights that attach to an object or asset, rather than the physical thing itself.

7. This is particularly relevant in the context of cryptocurrency as it is an intangible digital asset that eludes simple classification.

8. While some digital assets hold market value, it is important to consider that this alone does not create property rights. Relevantly in the context of new assets, Gageler J stated in 2018 that "we have not treated as property all that can be monetised."[5]

---

[1] Explanatory Memorandum 2.3.
[2] Explanatory Memorandum 2.10.
[3] Explanatory Memorandum 2.5.
[4] Explanatory Memorandum 2.4.
[5] *Commissioner of State Revenue v Placer Dome Inc* [2018] HCA 59 at [172].

9. Some digital assets are plainly capable of being property, such as those that unlock and provide "rights" that can be bought and sold in the 'real world'. Such assets may include tokens that enhance participation in online games and generate further rights within the game, as well as assets that validate title to physical property. These are distinct from cryptocurrencies.

10. There is no current Australian statute that anoints cryptocurrency with property status. Accordingly, to be treated as a form of property, the status must derive from common law.

11. Digital assets such as cryptocurrencies are notional payment tokens without connection to the physical world and are unlikely to meet the threshold required to be capable of legal ownership at common law.

    (a) The common law recognises two forms of personal property, choses in possession (tangible things) and choses in action.[6] The former is a subset of the latter, in the sense that the law will vindicate rights to possession of physical things, usually through the law of tort.

    (b) Possession at law is the relationship between a person and a physical thing.[7] Cryptocurrency cannot be possessed within the meaning of the law, given there is no relationship with physical objects.

    (c) Cryptocurrency is simply a form of digital information. All that is provided to the "purchaser" is the confidential information in the encryption key. Mere information is incapable of physical possession and has long been held to not meet the definition of legal property, even in circumstances where it holds value.[8]

    (d) Cryptocurrency does not generate a right against another person, nor is it the product of a right conferred by another person. [9] This differs fundamentally from a chose in action, money held in a bank account, or shares held in a company.

    (e) The fact that some statutes treat intangible things as property-like (for example, for the purposes of theft, such as computer hacking, or for regulatory purposes) or specifically anoint property rights in intangibles of social utility (such as patents and copyright) is not reason that legal property concepts can or should be extended to cryptocurrency. Indeed, it is confirmation that (but for the applicable statutes) they cannot.

12. There are several overseas cases in which it has been held that cryptocurrencies are property.[10]

    (a) They are all single judge decisions. No apex court has determined the issue.

    (b) Many make assumptions about the proprietary nature of cryptocurrency without hearing argument.

    (c) Significantly, none of these decisions has identified any intangible property recognised by the common law (as opposed to by statute) which is neither a chose in possession nor a chose in action.

    (d) "No appearance from the Respondent" are the five most common words in these cases. The cases were conducted *ex parte* and the court did not hear submissions that may

---

[6] Blackstone, *Commentaries on the Laws of England* book 2, c. 25, p. 389; *Fulwood's Case* 4 Rep. 65a; 76 E.R. 1031 (1591) (Coke); *Colonial Bank v Whinney* (1885) 30 ChD 261, 285 (Fry LJ), approved in House of Lords (1886) 11 App. Cas. 42
[7] See generally Pollock and Wright, *An Essay on Possession in the Common Law* (Oxford, 1888).
[8] See, for example, *Phipps v Boardman* [1967] 2 AC 46, 127 (Upjohn LJ) (HL).
[9] W. N. Hohfeld, *Fundamental Legal Conceptions As Applied in Judicial Reasoning* (1919).
[10] See for example: *AA v Persons Unknown & Ors, Re Bitcoin* [2019] EWHC 3556 (Comm); *Ruscoe v Cryptopia Ltd (In Liquidation)* [2020] NZHC 728; *Tulip Trading Limited v Van Der Laan & Others* [2022] EWHC 667 (Ch); *Wang v Darby* [2021] EWHC 3054 (Comm); *Vorotyntseva v Money-4 Ltd* [2018] EWHC 2596 (Ch); *Shair.Com Global Digital Services Ltd v Arnold* 2018 BCSC 1512; *Osbourne v Persons Unknown* [2022] EWHC 1021.

assist the defendants, including that they have not dealt in property. Proper consideration requires proper argument and appellate review.

(e) The cases, of course, cannot be ignored. However, they are highly unstable foundations for important legislative policy. The history of the common law is that it has been reluctant and slow to recognise new categories of personal property.

13. In short, as the law in Australia currently stands, standalone crypto assets, such as cryptocurrencies, are not classified as property. Digital assets that are tethered to rights in action could be personal property, depending on the circumstances.

Regulatory determinations

14. It should be noted that "assets" do not need to be proprietary in order to be regulated for what government regards as socially desirable purposes (for example, taxation, anti-money laundering, consumer protection etc.). For example, already the Commissioner of Taxation claims to be empowered to tax the profits of crypto trading activities, AUSTRAC has extant rights to obtain reports of large crypto transactions, and corporations and financial services legislation may require licensing of some exchange and investment activities.

15. However, the basis of regulation must have strong foundations. If, for example, the power to regulate is grounded on the regulation of "property", there will be no power because cryptocurrency is not property. If the power to regulate defines cryptocurrency without reference to property concepts, the difficulty evaporates.

16. Regulatory guidance is insufficient to confer regulatory power. The fact that a regulator assumes it has powers to tax or licence, and issues guidance accordingly, does not validate the guidance.

17. Internationally, New Zealand and the United States have made determinations that cryptocurrencies are classified as property.

New Zealand

(a) The Inland Revenue Department has issued guidance stating that cryptocurrency is classified as property for tax purposes.

(b) The Financial Markets Authority has issued guidance stating that cryptocurrency should be considered property for the purposes of regulation.

United States

(a) The Internal Revenue Service has classified cryptocurrency as property for tax purposes.

(b) The Securities and Exchange Commission has issued statements and guidance that indicates that cryptocurrencies should be considered securities and subject to relevant securities legislation.

(c) The Commodity Futures Trading Commission has classified cryptocurrencies as commodities and subject to relevant regulations.

(d) The Financial Crimes Enforcement Network has classified virtual currency as a monetary instrument and subject to Bank Secrecy Act regulations.

18. As noted at paragraph 16, these determinations are wholly ineffective unless the underlying statutory powers authorise the regulation of the "assets".

Cryptocurrency as a separate asset type

19. For regulatory purposes, cryptocurrency would best be considered as a new category, distinct from currency and property, and subjected to a regulatory framework that is adequately tailored to its inherent characteristics and risks.

20. Such an approach would not be unique to Australia. The United Kingdom, for example, has appointed an independent body, made up of high court judges, lawyers, and law professors, to study digital assets and recommend how they ought to be governed. Professor Sarah Green, the Law Reform Commissioner for Commercial and Common Law, has recommended a new category of property to be created.

21. This approach forms part of efforts from then-Chancellor of the Exchequer (and now Prime Minister) Rishi Sunak to "make the UK a global hub for cryptoasset technology… [and] help to ensure firms can invest, innovate and scale up."[11]

22. It is our view that Australia should aim to be at the global forefront of cryptoasset technology, and appropriately regulating would help to cultivate the sector and ultimately draw innovation and investment.

23. In our opinion, there is no doubt that cryptocurrency regulation is required to counter money laundering, for consumer protection, and for financial market regulation. However, in each case, the "assets" being regulated need to be clearly defined. Further, separate consideration should be given to whether some form of proprietary status is necessary or desirable to effect the policy outcome, and the status should be limited to the purpose.

24. Beyond these market-based interventions, if society thinks it is valuable, there may be instrumental reasons for statutory classification, to facilitate (for example) ownership, succession rights, security rights and so on. However, this must be assessed on a case-by-case basis. There may be a case for wider consumer protection, but the social utility of creating an artificial economy around a Ponzi scheme is questionable, as is the desirability of environmental impacts of the data centres required to support it.

25. We note the 'Draft Principles on Digital Assets and Private Law' released by the International Institute for the Unification of Private Law in January 2023, which considers the classification of digital assets as property or a similar concept, but also permits the creation of a new category of asset.[12]

Summary

26. The Bill clarifies the narrow issue of whether bitcoin is a foreign currency for ITAA purposes, which is a policy choice. However, the clarification of the narrow issue does not address the real uncertainties, including legal uncertainties, about cryptocurrencies in the Australian economy, which is the pressing issue for markets and consumers.

27. Moreover, we are concerned that the government is tinkering at the edges and ignoring a very real legal issue of the status of cryptocurrencies. If no action is taken and a court were to decide that cryptocurrencies are not property, the downstream consequences would be potentially catastrophic.

    (a) Regulations based on a false premise would not be enforceable. This includes taxation powers.

    (b) Consumers may be left without adequate recourse against financial intermediaries.

28. Whilst the policy issues are nuanced, none of the major problems is particularly difficult to fix. However, what is required is a legislative focus on what needs to be done rather than an assumption that it has been. Clarity on the legal status of digital currencies in Australia in different operational settings is long-overdue and needed as a matter of priority, particularly as digital assets and currencies increasingly become part of everyday life. It is simply not enough for the current legal status to be left open to provide the government with "flexibility to provide … clarity

---

[11] HM Treasury, 4 April 2022, 'Government sets out plan to make UK a global cryptoasset technology hub'.
[12] International Institute for the Unification of Private Law, January 2023, 'Draft UNIDROIT Principles on Digital Assets and Private Law', generally, but particularly Principle 3(1).

and certainty".[13] Doing so does the opposite and leaves stakeholders looking to common law to resolve disputes.

We would welcome considered legislation and regulation that provides Australians, including the growing 'crypto' industry, clarity and certainty as to the treatment of digital assets going forward. We would be happy to contribute further to the ongoing discussion.

Please do not hesitate to contact the writers to discuss the matters further.

Yours faithfully

[redacted]

Liam Hennessy
Partner, Gadens

[redacted]

Lionel Hogg
Partner, Gadens

[redacted]

Lachlan Robb
Lecturer, QUT School of Law

[redacted]

Anna Fanelli
Associate, Gadens

[redacted]

Lauren Bellamy
Researcher, QUT School of Law

[13] Page 50 of explanatory note.