



THE TAX INSTITUTE

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Dr Kathleen Dermody
Committee Secretary
Senate Standing Committees on Economics
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Dear Dr Dermody

Digital currency inquiry

The Tax Institute welcomes the opportunity to make a submission to the Senate Economics References Committee (**the Committee**) in relation to its Inquiry into digital currency.

Overview

1. Given the broad terms of this Inquiry, we have limited this submission to the tax issues relating to digital currency.
2. The majority of our submission refers specifically to Bitcoin, which is the most valuable and widespread digital currency and therefore the most significant from a tax perspective. We comment on other digital currencies in paragraphs 244 to 300 below.
3. It is the Tax Institute's view that Bitcoin should be treated as currency for tax purposes. This view is not currently shared by the Australian Taxation Office (**ATO**), who have recently issued guidance treating Bitcoin as property but not money or foreign currency for tax purposes. This gives rise to additional administrative costs and the potential for anomalous tax outcomes. We recommend that the Committee consider the merits of a legislative change to clarify that Bitcoin is currency for tax purposes.
4. We also recommend that the Committee consider the red-tape burden and tax administration issues involved in ensuring compliance with the tax treatment of digital currencies.

5. The Tax Institute would be pleased to assist the Committee further, either by providing additional details on matters set out in this submission or by appearing as a witness before the Committee.

Tax law definition of digital currency

6. The ATO currently interprets the tax law in a way that results in digital currencies (like Bitcoin) being treated as a form of intangible property and not currency for tax purposes. An alternative interpretation of the existing tax law is that Bitcoin is treated as foreign currency. It is our view that this alternative interpretation is desirable from a tax policy perspective. For certainty and consistency of treatment, we recommend that the Committee consider the merits of a legislative change to confirm that Bitcoin is currency for tax purposes.

GST

7. The most pressing issue from a taxation perspective in relation to digital currencies is the way that the GST system applies to Bitcoin transactions. Earlier this year, the ATO issued a draft GST Ruling (GSTR 2014/D3) which treats transactions involving Bitcoin as barter transactions, resulting in payments of Bitcoin being taxable supplies in their own right, and subject to GST. This approach causes an unnecessary red-tape compliance burden for businesses, including the need to issue two tax invoices for a single transaction, and anomalous outcomes for unregistered parties such as consumers transacting in Bitcoin. Most notably, Australian individuals who are not registered for GST who buy Bitcoin from an Australian supplier must bear the cost of GST on what is in substance a foreign exchange transaction which should be an input taxed supply. The Tax Institute would be happy to provide further examples of the practical problems caused by the current ATO interpretation if required.
8. The GST applies to supplies and not to consideration for supplies. The operation of the GST in this way is supported by the broad inclusive definition of “money” in s 195-1 of *A New Tax System (Goods and Services Tax) Act 1999 (the GST Act)*. It is our view that Bitcoin should be treated as “money” under this broad definition. A payment of “money” is not subject to GST unless it is a money exchange transaction.
9. The operation of the GST Act is based on the widest possible definition of “supply” together with the application of a number of exclusions. One of the most important exclusions is to exclude “money” from being a supply and from being an acquisition (except for money exchange transactions).
10. A supply of money is outside of the GST system in order to prevent GST from inappropriately being applied twice to one transaction. The Explanatory Memorandum to the Bill introducing the GST Act states at para 3.7:

“Money that is provided as consideration (payment) for a supply is not in itself a supply – subsection 9-10(2). Otherwise money supplied as payment for a supply could be a taxable supply in itself.”

11. A fundamental premise of the GST system is that the payment of money for a supply should not in itself be treated as a supply. The GST system is not intended to apply to consideration that is, in the context of the transaction, nothing more than a medium of exchange which facilitates the transaction. Therefore, the operation of the GST system requires a sensible interpretation of the definition of money.
12. The only use of Bitcoin in a transaction is as a medium of exchange. The purpose of Bitcoin is to function as money within the economy. It has no other purpose or use. Although the technology on which Bitcoin is based has a range of other potential uses, the only uses of Bitcoin are consistent with those traditionally associated with money, as a medium of exchange, store of value and unit of account.
13. Finally, under the ATO interpretation, an anomalous situation would arise if any foreign country decided to adopt Bitcoin as legal tender. Bitcoin would then clearly fall within the meaning of ‘currency of a foreign country’ and ‘currency other than Australian currency’. Bitcoin would then automatically be required to be recognised as foreign currency for income tax and GST purposes, and money for FBT purposes. It is anomalous that such a situation could arise independently and outside the control of the Australian legislature or government bodies.

Fringe Benefits Tax

14. The ATO’s treatment of Bitcoin as property rather than money also results in payments from employers to employees in Bitcoin being treated as a non-cash benefit which is subject to FBT (see TD 2014/D14). A non-cash benefit is defined as property or services in any form except money: s 995-1 of the *Income Tax Assessment Act 1997 (the Tax Act)*.
15. If Bitcoin is treated as money, payments by employers to employees in Bitcoin would, in most cases, be treated as salary and wages and therefore not subject to FBT. Instead, employers would be required to withhold under the PAYG withholding regime.
16. The Tax Institute urges the Committee to consider recommending legislative change to clarify that, where Bitcoin is paid as salary and wages, it is not a fringe benefit. This would have a number of positive outcomes including:
 - (i) being more consistent with the substance of the arrangement where salary and wages are paid in Bitcoin;

- (ii) preventing an anomaly where an employer must pay FBT at 47% (49% from 1 April 2015) on Bitcoin provided as wages to an employee who is on a lower marginal tax rate;
 - (iii) being more familiar to employers and reducing compliance costs especially for small businesses for whom an FBT return may not otherwise be necessary; and
 - (iv) allowing innovative and startup businesses more flexibility to attract and retain Australian employees, and remain in Australia, in an increasingly competitive global market for talent.
17. We understand that an increasing number of technology businesses that operate internationally and pay employees in Bitcoin. The current FBT treatment makes it unfeasible for such businesses to employ Australian workers.

Income Tax

18. The ATO also currently treats Bitcoin as property rather than currency for income tax purposes (see TD 2014/D11, D12 and D13). In relation to income tax, the treatment of Bitcoin as property results in CGT and trading stock rules applying to transactions involving Bitcoin. Bitcoin can fluctuate in value and treatment as property means that there is less clarity as to how these fluctuations in value should be brought to account for tax purposes.
19. If Bitcoin is treated as foreign currency, there is a specific code within the Tax Act to deal with these fluctuations, in Division 775. Division 775 is a comprehensive set of rules which take into account not only foreign exchange transactions but transactions which have a similar effect, including rights and obligations which are denominated in foreign currency.
20. The Tax Act defines foreign currency to be “currency other than Australian currency”: s 995-1. The term “currency” is undefined in the Tax Act. It is our view that Bitcoin can fall within the ordinary meaning of “currency”, and thus be treated as a “foreign currency” for income tax purposes.
21. Ideally there should be consistency of the treatment of digital currencies across taxes. For example, if Bitcoin is treated as foreign currency for GST purposes, that treatment should also apply for FBT and income tax purposes.
22. As discussed above, it is our view that the existing tax law defines currency and money in broad enough terms to include Bitcoin. However, as indicated by the ATO’s recent guidance, the law as currently drafted could also support the contrary view that such a widely used digital currency is property.
23. In the interests of certainty and consistency, we recommend that the Committee consider the merits of a legislative change to clarify that the terms money and currency in the tax law include Bitcoin.

Digital currencies other than Bitcoin

24. There are a number of digital currencies (over 500 by some estimates¹) in existence, with more being created on a regular basis. However, these other digital currencies do not have the wide use, acceptance or value of Bitcoin at this stage. As at November 2014, Bitcoin represents approximately 90% of the total value of all digital currencies².
25. An issue arises as to whether the tax law should be amended in a way which could accommodate these other digital currencies, should they become as widespread as Bitcoin in future, or as a matter of policy consistency.
26. If the Committee considers it appropriate to recommend legislative change to clarify the treatment of digital currencies under the tax law, we recommend that the Committee also consider the merits of a legislative change to define digital currency.
27. The options to define digital currency for tax purposes include:
- (i) limit any definitional changes to Bitcoin alone;
 - (ii) encompass Bitcoin and all other digital currencies;
 - (iii) limit to digital currencies which meet a certain overall value, use or acceptance threshold; or
 - (iv) delegate responsibility to make this decision to a government body such as the ATO, Treasury or ASIC.
28. Our preferred course of action is Option (i). Although such a legislative change would not incorporate digital currencies other than Bitcoin, it deals with the immediate issue facing tax practitioners and their clients in relation to digital currencies. If other digital currencies were to become as popular as Bitcoin in future, they could be treated in the same way as Bitcoin through a legislative instrument or Option (iv).
29. At this point, Bitcoin is the only digital currency being used in commerce to any significant extent. For example, the most popular non-Bitcoin digital currency is Litecoin. Only a handful of merchants accept Litecoin³ and its total value is approximately \$121 million compared to Bitcoin's \$4.9 billion.
30. The alternative 'principles based' approach in Options (ii) and (iii) may become uncertain, complex and difficult to administer. Accordingly, we propose that any definitional change be limited to incorporate Bitcoin specifically.

¹ www.coinmarketcap.com, www.coingecko.com/en

² As above

³ <https://coinreport.net/top-5-businesses-accept-litecoin-payments/>
<http://uselitecoin.com/>

Tax administration of digital currency

31. We recommend that the Committee examine the ability of the ATO to enforce the tax outcomes intended for digital currencies, and the resources required to do so. In particular, resources may need to be allocated to developing systems to effectively read and monitor the blockchain (the record of all Bitcoin transactions), in combination with traditional cash-economy tax auditing techniques.
32. We also recommend that the Committee consider the concept of a 'voluntary Bitcoin register' on which individuals or companies could register a Bitcoin public address (or a number of addresses) as belonging to them.
33. This register would assist in proving that the entity owns the Bitcoin held at those addresses. This could assist in tax compliance (as well as auditing requirements for disclosing entities), as the register could be used by a business to substantiate the date and value of their transactions in and holdings of Bitcoin. The entity would be able to prove the date and amount of payments sent and received from these addresses, which could assist in showing that allowable deductions were incurred, or confirm when amounts of income were received.
34. This register could be administered by an existing government agency (for example ASIC or the ATO) which could serve as the regulator/licensing authority for businesses dealing with Bitcoin. This register should not be public due to privacy concerns i.e. a public Bitcoin register would be analogous to publicly disclosing an entity's bank statement.

Conclusion

The Tax Institute would be pleased to assist the Committee further, either by providing additional details on matters set out in this submission or by appearing as a witness before the Committee.

Please feel free to contact either me, or Tax Counsel, Thilini Wickramasuriya

Yours sincerely,

Michael Flynn
President