# The Taxing Business of Taxing Bitcoin

**The Australian Taxation Office recently handed down draft determinations on the tax consequences of the use of Bitcoin in Australia. David Rountree provides an overview of the draft rulings and the implications for domestic businesses operating with Bitcoin.**

## Introduction

On 20 August 2014, the Australian Tax Office (***ATO***) released several draft tax determinations considering the tax consequences of the use of Bitcoin.

The draft determinations and guidelines are significant for several reasons. First, it is the first serious and in-depth consideration of the digital currency (and its many associate cryptocurrencies) by an Australian regulator. They involved careful consideration of the tax consequences of using Bitcoin, and demonstrated that the ATO has taken steps to understand and come to grips with its unique technical aspects.

Despite this, the draft determinations issued are a disappointing outcome for Bitcoin in an Australian context. Fundamentally, the view of the ATO was that for the purposes of Australia's tax laws, Bitcoin is not to be considered "money" or foreign currency, but as simply property. The outcome of these rulings will pose serious challenges for the use of Bitcoins in the course of doing business in Australia, and may result in pushing Bitcoin entrepreneurs offshore.

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## What is Bitcoin

For the uninitiated, Bitcoin is a form of decentralised digital currency, which is powered and protected by cryptography, and operates and is effected through a network of users. Effectively, it operates as software as cash,[1] which through the strength of its programming and its decentralised nature can be securely and anonymously exchanged. There is no central authority or entity which issues a Bitcoin, or regulates and clears transactions. Instead, every user of the Bitcoin network has a distributed copy of the Bitcoin "blockchain", which is used to verify transactions and prevent double spending. Bitcoins are obtained by the process known as "mining", or by purchasing pre-existing Bitcoins from marketplaces or exchanges which have developed.

There are hundreds of cryptocurrencies available, but Bitcoin is by far the most widely used and valuable.[2] While its value has fluctuated wildly over its short history, at the time of writing one Bitcoin is currently worth AUD$439.53, and was even worth more than US$1000 at one stage.[3]

The anonymous nature of Bitcoin has attracted significant attention for its potential use in illegal transactions, highlighted by its use by Silk Road, the former online black market. However, over the last year, more and more businesses in Australia and across the world have started to accept Bitcoin as a legitimate mechanism for payment, including significant web vendors like Expedia.[4] A range of start-up businesses have sprung up, both in Australia and overseas, operating Bitcoin exchanges, point of sale technology and other Bitcoin related services. Investment in Bitcoin and Bitcoin related start-ups has also increased greatly this year, with total investment expected to reach US$250 million.[5]

## What are the tax rulings

The draft determinations by the ATO consider Bitcoin in a number of different taxation contexts. However, the fundamental questions considered by the ATO were:

- is Bitcoin property?;
- is Bitcoin foreign currency?; or
- is Bitcoin money?

### Is Bitcoin "property"?

The ATO considered whether Bitcoin was "any kind of property" in the context of the *Income Tax Assessment Act 1997* (***ITA Act***) and the concept of "CGT asset".[6]

Unsurprisingly, the draft rulings considered that Bitcoin was "property". In doing so, the ATO considered definitions of what "property" is, as provided by the High Court in several judicial pronouncements.[7] Acknowledging that there is no single test for identifying whether a set of rights and relationships are "proprietary", the ATO considered that the following factors were relevant to considering Bitcoin as "property":

(a) the rights of control exercised over a Bitcoin in a Bitcoin wallet (eg the capacity to trade Bitcoin for other value or use it as payment);

(b) Bitcoin is treated as a valuable, transferable item of property by members of the community; and

1 There are other uses for the blockchain technology underpinning cryptocurrencies and the innovation of creating digital scarcity. However, this article will focus on the use of Bitcoin as a money or currency, which was the prime consideration of the ATO.

2 See http://www.cryptocoincharts.info/coins/info for a list of different cryptocurrencies currently available. These coins have varying legitimacy, and range from the genuine to the genuinely amusing. One of the most popular cryptocurrencies outside of Bitcoin is Dogecoin, which, due to its association with the "Doge" internet meme, has made it a popular phenomenon, as have its catch phrases "Wow. Very currency. Many coin."

3 November 2013. See: Garrick Hileman, 'Bitcoin Price Hits $1,000 After Doubling in 7 Days. What Next?', *CoinDesk* (27 November 2013) <http://www.coindesk.com/bitcoin-price-1000-doubling-7-days/>.

4 Joon Ian Wong, 'Expedia Will Accept Bitcoin for Hotel Bookings', *CoinDesk* (11 June 2014) <http://www.coindesk.com/expedia-will-accept-bitcoin-hotel-bookings/>.

5 John Heggestuen, 'Bitcoin Startup Funding Is On Track More Than Double This Year', Business Insider Australia, 12 July 2014.

6 Australian Taxation Office, *Income tax: is Bitcoin a CGT asset for the purposes of subsection 108-5(1) of the Income Tax Assessment Act 1997?*, Draft Taxation Determination TD 2014/D12 (2104); *Income Tax Assessment Act 1997* (Cth), s 108-5(1).

7 See ATO, TD 2014/D12, 2-4.

(c) Bitcoin is inherently excludable due to the nature of the software restricting control to the person in possession of the "private key".

Due to Bitcoin's decentralised nature, the ATO considered that the proprietary rights "do not amount to a chose in action as a Bitcoin holding does not give rise to a legal action or claim against anyone."[8] For example, when a Bitcoin is mined, this is a function of software, and does not give rise to rights against any natural or corporate person.

The conclusion that Bitcoin is property is not earth-shattering, though it does have consequences for capital gains tax, as set out in section 4 below.

#### Is Bitcoin "foreign currency"?

The ATO also considered whether Bitcoin was a foreign currency for the purpose of the ITA Act.[9]

First, the ATO considered whether, at general law, Bitcoin could be considered a currency. The draft determination acknowledged that there were arguments that Bitcoin satisfied the meaning of "money" at general law, as it could be considered a medium of exchange, a unit of account and a store of value. However, the Commissioner did not consider that current use and acceptance of Bitcoin through the community was sufficient to satisfy the test put forward in case law, such that it was accepted as a means of discharging debts and making payment.[10]

Secondly, the term "foreign currency" was considered in the context of the ITA Act itself. In the ITA Act, foreign currency is defined as a "currency other than Australian currency". The Australian dollar is recognised in the *Currency Act 1965 (Cth)* (the ***Currency Act***) as the "currency" of and the only legally recognised form of payment in Australia.[11] A currency of a country other than Australia must therefore be a currency legally recognised by another countries laws.[12] The ATO's determination interpreted the meaning of "foreign currency" in the same manner for the purposes of ITA Act. Therefore, as Bitcoin is not recognised as the currency of any foreign nation, it is not a "foreign currency".[13]

#### Is Bitcoin "money"?

Alongside the rulings on the ITA Act, the ATO also published a draft Goods and Services Tax Ruling (GSTR2014/D3) on the question of whether Bitcoin is money for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (***GST Act***). This is an important question, as a supply of "money" is exempt from the concept of a "supply for consideration" on which GST is payable.

The term "money" is expressly defined in section 195-1 of the GST Act as including the following:

(a) currency (of Australia or another country);
(b) promissory notes and bills of exchange;
(c) any negotiable instrument used or circulated as currency;
(d) postal notes and money orders; and
(e) whatever is supplied as payment by way of:
 (i) credit or debit card;
 (ii) crediting or debiting an account; or
 (iii) creation of transfer of debt.[14]

The Commissioner's view was that Bitcoin did not meet any of these requirements.

The currency analysis was consistent with the draft determination on the ITA Act.[15] The draft ruling also decided that Bitcoin did not fall within any of the meanings in sub paragraphs (b) to (e).

This analysis included rejecting an interpretation that Bitcoin use was akin to "crediting and debiting an account" (subparagraph (e)(ii)). Arguably, the decentralised Bitcoin ledger can be considered an "account", which is credited and debited with the transfer of Bitcoins from one Bitcoin wallet to another. However, the ruling took the term "account" to have its legal meaning, consisting of a "chose of action which the account holder can enforce against the account provider".[16]

The draft ruling also considered that the treatment of Bitcoin as money was not sufficient to make something money "in the absence of an 'exercise of monetary sovereignty by the State concerned'".[17] The draft ruling also sets out that a supply of a Bitcoin is not a "financial supply" for the purpose of the GST Act.[18]

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### What are the tax implications of the rulings?

#### CGT

For the purpose of the ITA Act, the ruling that Bitcoin (and other cryptocurrencies) are considered property will mean that they will be a CGT asset. This is particularly relevant for Bitcoin, with its history of rapidly fluctuating prices.[19] If, on the disposal of a Bitcoin, it is sold for an amount greater than it was purchased for, then this will be a capital gain on which capital gains tax may be payable.[20] This is not a controversial position, and practically may not make a difference for users of Bitcoin who wish to purchase goods and services using the cryptocurrency, as the personal use exception will apply, unless the value of a Bitcoin is greater than $10,000.[21]

#### GST

The analysis of the GST consequences of the draft ruling is far more complicated. The effect of the draft ruling regarding the status of Bitcoin is that that the supply of Bitcoin by a business will be a taxable supply and subject to GST.[22] Under the GST Act, a supply of "money" is exempt from the definition of a taxable "supply".[23] As Bitcoin is not considered to be money, a supply of Bitcoin will be treated as equivalent to a barter transaction, which will be subject to GST.

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8 Ibid, 4.

9 Australian Taxation Office, *Income tax: is Bitcoin a 'foreign currency' for the purposes of Division 775 of the Income Tax Assessment Act 1997?*, Draft Taxation Determination TD 2014/D11 (2014), 4.

10 Ibid, 6.

11 *Currency Act 1965* (Cth) ss 8, 9 and 11.

12 ATO, TD 2014/D11, 8.

13 Ibid.

14 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ('GST Act') s 195-1.

15 ATO, TD 2014/D11.

16 Australian Taxation Office, *Goods and services tax: the GST implications of transactions involving bitcoin*, Draft Goods and Services Tax Ruling GSTR2014/D3 (2014), 14 para 64.

17 Ibid, 16 para 73.

18 Ibid, 18 para 80.

19 Timothy Lee, 'These four charts suggest that Bitcoin will stabilize in the future', *The Washington Post*, 3 February 2014.

20 *Income Tax Assessment Act 1997* (Cth) ('ITA Act') s 104-10.

21 ITA Act s 118-10(3).

22 ATO, GSTR2014/D3; GST Act s 9.5.

23 GST Act s 9.10(4).

This will be the case for business who are seeking to use Bitcoin as a means of transacting, as well as business which seek to supply Bitcoin to consumers (such as a Bitcoin exchange).

While this article will not go into detail on the operation of GST, given the availability of input tax credits to businesses, the actual impact of the imposition of GST on a supply of Bitcoin by a business will often be nil. Indeed, the ATO has itself stated that it does not expect to receive any significant additional revenue from this ruling.[24] However, the compliance and administrative burden associated with a business transacting using Bitcoin are greatly increased.

This draft ruling also results in some peculiar results. While a business making a supply of Bitcoin will be subject to GST, when an individual person who uses Bitcoin to purchase goods and services, this will not be subject to GST. Only when a person or company is registered for GST will it be required to pay GST on the supply.[25] This leads to the peculiar result that, where an individual purchases a computer from an Australian retailer using Bitcoin, this will not be subject to GST, but where a business registered for GST in Australia purchases a computer from that same retailer using Bitcoin, the supply of that Bitcoin will be a taxable supply, and subject to GST.

### Other tax consequences

The ATO made two further draft tax rulings. These held that:

(a) the supply of a Bitcoin by an employer to an employee in respect of their employment is a property fringe benefit, subject to fringe benefits tax;[26] and

(b) where a business that retains Bitcoin for the purpose of sale of exchange in the course of its business, then such Bitcoin will be considered "trading stock" for the purpose of section 70-10(1) of the ITA Act.[27]

## What are the practical impacts on businesses

There will be a number of important practical impacts of the tax rulings for Australian businesses seeking to use Bitcoin within their business operations. Such businesses will have to undergo careful consideration of how they are structuring their use of Bitcoin.

Some considerations are as follows:

(a) Businesses accepting Bitcoin for goods and services will need to include the Australian-dollar value of the Bitcoin received as part of their ordinary taxable income. The ATO suggests that this is the market value of the Bitcoin.[28] However, given the constantly fluctuating value, this represents some practical difficulties and questions for the business as to when to make such an assessment.

(b) Bitcoin exchanges - For Bitcoin exchanges seeking to operate as an Australian business, the ruling will impose a 10% premium on the price of the Bitcoins that they can offer. Since every supply of a Bitcoin (within Australia) would be a taxable supply, Australian based Bitcoin exchanges will have to charge an additional 10% to their Australian customers in order to offset the GST that would be owed. This places them at a major competitive disadvantage.

(c) Additional compliance burdens – the introduction of GST on supplies of Bitcoin will add additional compliance burdens on some Bitcoin transactions, where a similar transaction using money would not be subject to such obligations. These include obligations around supplying GST compliant invoices and including Bitcoin supplies in accounting for GST. This may prove a disincentive to use Bitcoin over traditional forms of value.

(d) Potential differential treatment of customers – where a business is accepting Bitcoins, it may need to consider differential treatment of customers, as accepting certain transactions may result in a GST supply, while other transactions may not.

## What happens next

The result of the rulings has made the position for Australian businesses seeking to use or focus a business around Bitcoin a challenging one. One likely consequence of the ruling is that any businesses seeking to be closely involved with Bitcoin may seek to structure their operations to avoid these consequences – particularly by structuring their businesses so they are not operating in Australia. Given the essentially stateless nature of the internet and the abstract and incorporeal nature of Bitcoin, this will likely result in business facing their operations and having their infrastructure and services based and delivered outside of Australia. Indeed, while the US has reached a similar regulatory position on Bitcoin as being "property", not money,[29] the UK has gone the opposite direction, ruling that Bitcoin is money and not subject to VAT.[30] Indeed, the UK government has spoken about providing an open regulatory environment to encourage innovation, including for Bitcoin.[31] This raises the likelihood of forum shopping from people seeking a favourable taxation outcome (a well-trodden path by many bigger players along the way).

While disappointing for Bitcoin in Australia, the result of these rulings is not set in stone. Indeed, one of the central planks of the assessment of whether Bitcoin was money at general law was based on a factual assessment of the current usage of Bitcoin. The ATO has acknowledged that this may change over time.[32] There is also a prospect (even if remote), that some sovereign state may, for its own reasons, decide to adopt Bitcoin as its currency. If this were to occur, Bitcoin may become foreign currency overnight.

The ATO is not the only regulator who has Bitcoin on its horizons. On 2 October, the Australian Senate announced that it was undertaking an inquiry into digital currency, with a report due on 28 March 2015.[33] The Interim Report into the Financial System Inquiry also considered crypto-currencies (including Bitcoin).[34] The cautious view expressed in the Interim Report was that, while regulatory standards were important, the full weight of regulation may not be usefully applied to small players and start-ups, for the risk of stifling innovation. Ironically, the effect of the tax rulings may be to do just that, at least within Australia, for the time being. Bitcoin is still in its embryonic stage, and it is hard to predict what will happen next. Whatever it is though – it probably won't happen in Australia.

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24 Fran Foo, 'Bitcoins to be taxed like shares: ATO', *The Australian*, 20 August 2014.

25 GST Act s 9.5(d).

26 Australian Taxation Office, *Fringe benefits tax: is the provision of Bitcoin by an employer to an employee in respect of their employment a property fringe benefit for the purposes of subsection 136(1) of the Fringe Benefits Tax Assessment Act 1986?*, Draft Taxation Determination TD 2014/D14 (2014).

27 Australian Taxation Office, *Income tax: is Bitcoin trading stock for the purposes of subsection 70-10(1) of the Income Tax Assessment Act 1997?*, Draft Taxation Determination TD 2014/D13 (2014).

28 Australian Taxation Office, *Income Tax: Barter and Countertrade Transactions*, Taxation Ruling No. IT 2668 (2014), 4.

29 United States Internal Revenue Service, 'Virtual Currency Guidance', Notice 2014-21.

30 HM Revenue & Customs, 'Tax treatment of activities involving Bitcoin and other similar cryptocurrencies', Revenue & Customs Brief 09/14.

31 Nermin Hajdarbegovic, 'UK Financial Regulator's New Initiative Encourages Bitcoin Innovation', *CoinDesk* (3 June 2014) <http://www.coindesk.com/uk-financial-conduct-authority-fca-launches-bitcoin-initiative/>.

32 Paul Farrell, 'Bitcoin could be considered legal tender, Australian tax official says', *The Guardian*, 29 August 2014.

33 Senate Standing Committees on Economics, a http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Digital_currency

34 Financial System Inquiry, Interim Report, 4-46 (2014).