HopgoodGanim
LAWYERS

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Mr Anthony Klein
Chair of the Working Group of the Board of Taxation re Review of the Tax Treatment of Digital Assets and Transactions

By email: TaxDigitalAssets@taxboard.gov.au

Our ref: Saxon Rose

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Dear Mr Klein

Review of the Tax Treatment of Digital Assets and Transactions

Thank you for the opportunity to make a submission to the Board of Taxation (**Board**) in relation to its current Review of the Tax Treatment of Digital Assets and Transactions (**Review**).

HopgoodGanim Lawyers (**HopgoodGanim**) has recently launched its digital assets practice and is seeking to assist its clients in the digital assets sector navigate the regulatory landscape which itself will need to evolve to provide the appropriate certainty and protections in this emerging sector, as acknowledged recently by the new Federal Government.[1]

As the Senate Select Committee on Australia as a Technology and Financial Centre noted in its 20 October 2021 report (**Bragg Report**)[2], the scale and speed with which cryptocurrencies and other digital assets have progressed in recent years has surprised governments, regulators and policy makers. With a global market now totalling in the trillions of dollars, the tremendous potential of blockchain technology and decentralised finance is becoming recognised by mainstream institutions and investors.

HopgoodGanim is interested in seeing that Australia's regulatory framework appropriately accommodates this emerging sector and the opportunities it presents, being a framework that:

- provides appropriate levels of tailored regulation to ensure innovation and competitiveness are not stifled; and

[1] The Hon Dr Jim Chalmers, Treasurer Media Release 22 August 2022 "Work underway on crypto asset reforms" accessible at https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/work-underway-crypto-asset-reforms

[2] Accessible at https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/AusTechFinCentre/Final_report

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- features the highest level of certainty and simplicity, entailing the least compliance costs, lest other jurisdictions come to be favoured by digital asset businesses and investment providers.

The recent emergence of cryptocurrencies and other digital assets, as well as the emergence more recently of decentralised finance means that some of our existing tax law frameworks are not well equipped to cope with this new burgeoning asset class and with the tax consequences associated with the complexities of digital asset transactions more broadly, including decentralised finance transactions.

This submission focusses on certain deficiencies, or at least uncertainties, within the existing law and guidance concerning the taxation of gains and losses from the investment and trading in digital assets, including particularly cryptocurrencies like Bitcoin.

Possible legislative responses are put forward in underlined text, that the author believes could go towards ensuring that greater certainty and appropriateness with respect to taxation outcomes can be achieved, in turn ensuring that Australia is able to capitalise on its well-earned reputation as a centre of funds management expertise as new digital asset classes and types of investment are sought by retail, wholesale and institutional investors alike.

This submission has been prepared by Saxon Rose, Special Counsel, Taxation within HopgoodGanim's digital assets practice. The comments and submission points below are the author's own and do not necessarily represent the views of the partners at HopgoodGanim.

Taxation of gains and losses from cryptocurrencies and other digital assets

It was pleasing to see that the Bragg Report recommended that the CGT regime be amended so that digital asset transactions only create a CGT event when they result in a "clearly definable capital gain or loss"[3].

This may require the creation of a new CGT asset or event class that enables specific concessions or exemptions to be applied.

Alternatively, the adaption of existing rules concerning the taxation of foreign currencies (**Forex**) in Division 775 or taxation of financial arrangements (**TOFA**) Division 230 may provide a more appropriate framework.

The ATO and present Government unfortunately do not seem at this time inclined to countenance the adoption of those existing frameworks though, given:

- the ATO's guidance that cryptocurrencies (at least non-government issued ones) are not "foreign currencies" and the release of draft legislation to that effect by the Government[4]; and

- the publication by the ATO of private ruling guidance that gains and losses from the holding of cryptocurrencies and certain other arrangements where rights and obligations to receive or provide financial benefits are settlable in cryptocurrency do not fall within the TOFA framework[5].

[3] Recommendation 6, Bragg Report
[4] *Treasury Laws Amendment (Measures 4 for Consultation) Bill 2022*: *Taxation treatment of digital currency, released 6 September 2022*
[5] See for example Edited private binding ruling advice 1051972615838 dated 12 April 2022

As such, to the extent that these positions are not reviewed, a special purpose regime (or sub-regime within the existing CGT regime) may be desirable.

I further note that the explanatory materials accompanying the draft legislation referred to above state that while the income tax treatment of digital currencies depends on the circumstances of the taxpayer, nonetheless[6]:

> *an investment in bitcoin is typically held on capital account. If this is the case, gains or losses arising from the disposal of bitcoin would be subject to the CGT rules.*

The import of this observation is uncertain, given that whether assets are held on capital or revenue account are determined by the circumstances of the taxpayer, viewed through the lens of an abundance of applicable case law in the area.

That said, if the Government were inclined to put in place a discrete regime or statutory code that provided that cryptocurrencies were held on capital account, this would be most welcome, as it would provide certainty and dispense with the need for taxpayers to assess their own circumstances by reference to that case law, which is often a difficult and arduous undertaking.

This attractive feature is already enshrined within the Managed Investment Trust (**MIT**) and Corporate Collective Investment Vehicle (**CCIV**) frameworks within the existing law, which are discussed in the context of fund taxation in the section below.

Crypto fund taxation and ability to access tax treatments available to MITs / CCIVs

In its December 2011 report[7] (**Board's CIV Report**), the Board of Taxation made a number of recommendations that sought to enhance Australia's status as a leading regional financial centre and support growth and employment in the Australian managed funds industry.

Given the $2.8 trillion AUD aggregate market value of the digital asset ecosystem as noted by the Bragg Report[8] and Australia's well regarded and sizeable funds management industry, as well as renowned expertise, it would be a shame if funds and other vehicles offering exposure to digital asset investments were not afforded the same basis of taxation as other funds, including those funds that qualify for concessional tax treatment under the specifically introduced regimes discussed below.

The Board's CIV Report recommended the creation of new collective investment vehicle which provide tax neutral outcomes for investors, to increase the competitiveness of Australia's managed funds industry internationally to attract offshore investment.

Ultimately, in legislation enacted on 22 February 2022, a new framework for Corporate Collective Investment Vehicles (**CCIVs**) was created that provided that such vehicles, established as corporate entities with deemed sub-trusts, are taxed on a flow-through basis, with the general tax treatment of CCIVs and their members aligned with the existing tax treatment of Attribution Managed Investment Trusts (and their members) (**AMITs**), more well-known domestically in Australia.

[6] Para 1.9 Exposure Draft Explanatory Materials accompanying *Treasury Laws Amendment (Measures 4 for Consultation) Bill 2022*: *Taxation treatment of digital currency, released 6 September 2022*
[7] Board of Taxation *Review of Tax Arrangements Applying to Collective Investment Vehicles* December 2011
[8] Bragg Report, para 2.22

The original Managed Investment Trust (**MIT**) regime was introduced in 2010, following the release of an earlier Board of Taxation report[9] (**Board's MIT Report**) and has provided, since 2010, along with flow-through taxation, for the CGT regime to apply exclusively to the disposal of eligible assets[10], as well as a concessional withholding tax regime[11].

Notably, however, the flexibility and benefits of classification as a MIT or CCIV noted above are not available to investment vehicles that are "trading trusts" within the meaning of Division 6C of the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**).[12]

Further, the eligible assets in respect of which capital account treatment can be adopted where a fund qualifies as a MIT only extends to "covered assets", being broadly shares in companies, non-share equity interests in companies, units in unit trusts, land and options to acquire and dispose such assets (section 275-105 ITAA 1997).

Accordingly, to ensure parity with qualifying MITs investing in such assets, section 275-105 should be amended to clearly include cryptocurrencies, sovereign digital currencies and other similar crypto-assets.

Further, in order to provide certainty that such crypto funds are able to access the flow-through taxation treatment that the Board has regarded as an important design feature of an attractive fund manager regime, investment and trading in cryptocurrencies, sovereign digital currencies and other similar crypto-assets should be expressly included as a type of "eligible investment business", such that a public unit trust does not become a "public trading trust" within the meaning of Division 6C[13].

Further, and in the alternative, the Board may consider that this review provides an opportunity for the Board to consider a repeal of Division 6C, or at least a narrowing of its operation.

In this regard, Division 6C was brought into remove the tax advantages of trading businesses raising funds in a unit trust structure and then operating such businesses in a trust, or at least those tax advantages that existed in 1985, at the time its introduction was announced[14].

In particular, at that time:

- Australia had a "classical" taxation system, meaning that company profits were taxed once in the company's hands (at 46%) and separately in the shareholders' hands, without the benefit of dividend imputation; and
- certain institutional investors (including superannuation investors) were exempt from tax.

The policy settings underpinning the original introduction of Division 6C were reversed many years ago as a result of the following changes:

- the introduction in 1988 of tax rules to impose taxation on superannuation funds;
- the introduction of dividend imputation in 1987; and

[9] Board of Taxation Discussion Paper, *Review of Tax Arrangements Applying to Managed Investment Trusts* October 2008
[10] Division 275 ITAA 1997
[11] Division 840 ITAA 1997
[12] Sections 275-110, 276-10, 195-135 ITAA 1997
[13] Sections 102M and 102R ITAA 1936
[14] *Commonwealth of Australia, Parliamentary Debates, House of Representatives*, *Official Hansard, No.144, 19 September 1985* at [1352] (Hon. Paul Keating, Treasurer)

- the ability (since 2000) for certain investors (in particular, superannuation funds) to obtain a refund for excess imputation credits.

Against this background, there is an argument that Division 6C has outlived its original purpose and should, like in the case of its sister division, Division 6B, be repealed, as it was following the Board of Taxation's recommendation, in 2016[15].

Thank you for considering my submission.

Yours sincerely,

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[15] repealed by *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016,* which also introduced the AMIT regime in Division 276 ITAA 1997.