

## **Board of Taxation -Review of the Tax Treatment of Digital Assets and Transactions**

### **Current tax treatment of crypto assets**

**Is the current tax treatment of crypto assets clear and understood under the Australian tax law? If not, what are the areas of uncertainty that may require clarification?**

On a basic level the taxation of cryptocurrency transaction while being highly illogical in reasoning ultimately the transactions are very straight forward. Australian dollar value at the time of disposal less Australian dollar at the time of acquisition. What becomes questionable is where the transactions start deviating from normal spot trading activities. NFTs and ERC 20 tokens that are integral part of gaming infrastructure begins to raise questions about the ATO overly simplified view of these transactions. Defi also gives rise to a number of complexities and there seems to be significant confusion for investors where the disposal events occur in such transactions.

**Do crypto assets and associated transactions feature particular characteristics that are 'incompatible' with current tax laws? If yes, what are these and why are they incompatible?**

Cryptocurrency in my view has been incompatible with current tax law since the day the idea was conceived. Our outdated laws have made it extremely difficult for the ATO to administer effectively and taxpayers to maintain compliance with reporting requirements.

The view that every trade is a CGT event is fundamentally flawed in its logic. It effectively seeks to raise revenue off a transaction where the real-world value is indeterminate at the time by imposing arbitrary but unrealistic analysis to the transaction. The risk of unfairly penalising taxpayer is far greater than the potential of someone to infinitely defer their tax liability.

Trading Asset A for Asset B where both are sitting on a cryptocurrency exchange gives a taxpayer no realistic reliable value. As the value of this investment can drastically change over a 24 period. There are simply too many matters beyond the control of the tax payer in this scenario. This has to do with macro market factors that impact how all trading is conducted in this investment class.

Exchange based Limitations- While it is arguable that there are some exchanges based in Australia out of the options available, they are certainly a minority in number. The flow on effect to this is that there is no readily available method to convert back to Australian dollars allocate the appropriate amount of tax many exchanges solely use stable coins or have fairly high withdrawal levels for foreign currency including AUD. Having traded for many years I can think of many transactions where I sold to Litecoin or XRP transfer said cryptocurrency to my Australian based exchange sold it to Australian dollars and then transferred it out to my bank account. The process causes difficulty in tracking records and subsequent difficulty in administration. The current information the Australian Tax Office receive only relates to the transaction on the Australian exchange not the preceding events. This effectively means the ATO data will be incorrect for anyone who has used a foreign based exchange or a Layer 2 protocol. Sale of a PUA used in gaming is not identifiable by the ATO all they can identify is the Australian exchange transaction which the taxpayer is then required to prove this income is not taxable.

Capital Vs Revenue Account- Staking gives rises to a number of issues . On face value it all seems logical Cryptocurrency earned is taxable at the Australian dollar value at the time of receipt. Considering the real-world applications here;

Where the cryptocurrency is not a stable coin the value of these assets can significantly fluctuate and providing for tax out of every payment creates unnecessary cascading taxation consequences. If

the value is a stable coin what happens if the stable coin value collapses like we have seen with Terra you have a significant capital loss but it is unable to be applied against any of your previously earned revenue. Classifying the entire amount as capital with staking diluting the initial cost base seems to be a far more reasonable approach.

Gaming Infrastructure- Several questions exist as gaming infrastructure based on blockchain evolves. There are a myriad of scenarios where ERC-20 tokens are used in gaming ecosystems. The current ATO view doesn't provide enough clarity around play to earn scenarios and what may constitute ordinary income in these scenarios. Traditionally currency spent in a game has never been regarded as taxable income but now we have scenarios where these currencies can be converted into traditional currencies. The ATO currently looks at every cryptocurrency transaction through the same lens and this results in numerous unfair outcomes when it comes to gaming-based assets. Airdrops relating to NFT ownership are currently viewed as taxable income (although we acknowledge the shifting ATO view here) which has resulted in some questionable tax outcomes in the past.

Defi- Defi can be defined as decentralised finance where investors engage in borrowing and lending of digital assets for an interest reward. Depending on the platform that is used investors can unintentionally trigger a CGT event where their tokens are swapped depending on how the smart contract is executed. By definition CGT event A1 has occurred but there is a delay in the investor obtaining any reward and due to the way the contract has executed they may have a tax liability if the funds used for lending have increased in value from their original acquisition price. On the flip side this could potentially be used by investors to reduce taxation liabilities by "disposing" of assets via a defi lending platform that they will eventually reacquire after a certain period. While it may be arguable that such a transaction is effectively a wash sale there seems to be a lot of legal uncertainty on how to treat these transactions on a number of levels and it would seem a far more logical approach to view the outcome of the overall transaction under the smart contract then each individual aspect from both a compliance and enforcement perspective.

### Awareness of the tax treatment of crypto assets

**Do entities which carry on a business in relation to crypto assets or accept crypto assets as a form of payment, have a comprehensive awareness of the current tax treatment of crypto assets and their tax obligations?** There is definitely a degree of confusion amongst taxpayers about the tax implications of holding cryptocurrency. Cost base attribution and assigning the correct Australian dollar value to transactions still seems to provide significant difficulty for business dealing in cryptocurrency transactions. This can be further compounded when events like forks and airdrops occur to assets which they are holding. The distinction between funds held on capital account and revenue account can also get easily blurred especially for smaller business who may lack appropriate record keeping tools for such transactions.

**Are retail investors aware of the current tax treatment of crypto assets? To what extent are they receiving professional tax advice?** It is a point of concern the amount of reliance investors are placing on cryptocurrency reporting software while a significant portion are seeking advice there has always been a deterrence to seek professional costs due to the volume of analysis that is required to effectively determine a client's tax position. While software has progressed there are still very few if any which I would deem 100% effective. For instance, to my knowledge no current software works well with Layer 2 Protocols on the Ethereum network this means that there is still significant manual

intervention required to calculate the correct tax liability in even the best performing software. While retail investors are predominantly aware of the tax treatment of cryptocurrency assets, they tend to have an oversimplified view.

### **How can taxpayer awareness of the tax treatment of crypto assets be improved?**

This comes down to more proactive engagement by the regulator such as publishing tax consequences of events that can affect large numbers of taxpayers with cryptocurrency assets for example the Ethereum Fork or the stable coin collapses earlier this year. The ATO also needs to engage on more platforms traditional media simply isn't enough. The internal guidance given by the ATO in the past has been confusing and simply referring a taxpayer to already published advice that doesn't address the specific circumstance they are enquiring has a negative impact on awareness. By the ATO taking a more proactive interest in reporting around the asset class it encourages more awareness in the taxpayer community.

### **Characteristics and features of crypto assets**

#### **How should the tax transparency of crypto assets be improved, including what information tax administrators need to know about transactions for purposes of compliance and enforcement?**

There has always been a significant issue with transparency of crypto assets. Although many blockchains contain significant amounts of publicly available data there still is a requirement to link wallet addresses with users. The issue of transparency is further complicated by the operation of numerous exchanges both centralised and decentralised which operate outside the legal jurisdiction of Australia. This makes monitoring transactions for the purpose of obtaining taxation information inherently difficult. While most cryptocurrency investors are not engaged in illegal activity, even those engaging in completely legal behaviour may use blockchain networks such as Monero or other obscuring techniques like moving funds through platforms like Tornado Cash in order to increase their privacy on otherwise public blockchains. While information is necessary to enable effective compliance and enforcement there also needs to be a balance with the protection of personal privacy. A program that allows taxpayers to submit wallet addresses voluntarily may aid in compliance however it is arguable that only those already doing the right thing are likely to submit this information. While this has the potential to reduce the size of the population that is needed to be targeted by enforcement activities the benefits seem limited solely to this.

### **International tax treatment of crypto assets and experience**

#### **What lessons can Australia draw from the taxation of crypto assets in other comparable jurisdictions, including novel ways of taxing these transactions?**

Germany treats cryptocurrency as private money which granted varies from the current ATO view in several regards, however this results in an interesting outcome as under Section 23 of the German Income Tax Act speculative transactions with private money where the cumulative profits are less than 600 Euros the income is tax free. It is debatable whether such a low threshold would encourage aggressive tax planning behaviour by investors in order to minimise profits around tax time. From a positive aspect this decreases compliance costs to an extent for small investors and allows enforcement activity to better target taxpayers not declaring larger sums of income. It's questionable it would decrease compliance costs for those with a large number of trades as they

would still need to establish their cumulative profits were below the reportable threshold. The United States Virtual Currency Fairness Act also aims to establish a similar concept.

### **Changes to Australia's taxation laws for crypto assets**

**What changes, if any, should be made to Australia's taxation laws in relation to crypto assets, whilst maintaining the integrity of the tax system? If changes are required, please specify the reasons.**

There should be serious consideration to moving to a concept of the taxation of real value in these transactions. To define taxing real value in my view this would be taxing the transaction only when converted to physical goods or to a traditional currency. This would require specific legislation however it arguably results in fairer outcomes. The ATO takes a view that this creates the potential to defer the taxing point indefinitely whether this subsequently creates more complex record keeping requirements should be another consideration. To counter the ATO view on deferral of taxation the concept only has its value to a point in time. The Taxpayer is going to eventually convert the digital asset to a physical good or currency. By deferring the taxation each year, the taxpayer would effectively be diluting their cost base and increasing their tax liability where the profitability of the asset increased if the law was designed in a logical way. Designing the law in this way would drastically decrease enforcement and monitoring costs. The fact that there is only a need to target conversion to physical items or traditional currency allows the utilisation of existing technology and agencies to effectively monitor and has limited impact on the privacy of investors. It is my view that this would not decrease compliance costs for investors and would more than likely require the adaption of current software offerings. To detail my view of an effective approach to taxation I have provided a simple example below:

Taxpayer invests \$10,000 in ETH this grows in value to \$12,000 he disposes of the \$6,000 worth for ENG. After another 2 months the ETH is worth \$5,000 and the ENG is worth \$7,000. The Taxpayer disposes of half of the ENG for \$3,500 Australian. 30 June passes.

The Taxpayers cost base is calculated by considering the investment and diluting the cost base based on the transactions that occurred appropriately. The original investment was \$10,000 the cost base transferred to the ENG when half the ETH was sold was \$5,000 so half of this cost base is \$2,500. The Capital Gain on the transaction would then be \$1,000. Of course, the above is a very simplified scenario it is obvious in most cases investors would require software to effectively calculate their cost base and resulting capital gains, but it simplifies the taxation of digital assets from an overall reporting aspect. It also removes unfair consequences from activities such as staking, airdrops, airdrops and defi transactions which all can have unfair and unintended tax consequences under the current ATO view.

Failing the above being a viable further consideration would needed to be given to the following: Gaming NFTs and associated ERC20 tokens only being regarded as disposed of once outside of the gaming/metaverse economic structure. This avoids unnecessary tax consequences for minors engaging in these games and adults for that matter, profit derived outside of the game from these ERC20 or NFTs should be taxable but not when being utilised for personal use and enjoyment. The same should apply to airdrops received within these games that there are only tax consequences after withdrawing the asset from the game or metaverse. '

Defi Transactions should be viewed as the consequence of the overall smart contract not taxed on the individual transactions that occur as part of that contract. This would avoid unfair tax

consequences purely associated with Defi transactions which are effectively prohibitive to people utilising this form of investment.

Costbase Attribution should be considered differently to ensure fairness and bring tax treatment more in alignment with shares. Where a taxpayer receives staking income, instead of being regarded as ordinary income consideration should be given to diluting the cost base of the existing asset this would avoid unfair tax outcomes like what will happen to a number of investors who have had algorithmic stable coins staked in the past 12 months. Where a hardfork occurs, a new asset is created leaving the cost base attributed to the original chain can have a number of unintended and unfair tax consequences, the most appropriate approach would be to apportion the existing cost base over a 5 day trading period similar to what can be done with shares in listed companies when the right circumstances are met. Granted assets would trade at different values on different exchanges however this issue could be easily overcome by using global average pricing which is easily accessible.

Further consideration should also be given to relax the FBT Act in relation to payment of cryptocurrency as part of an employee's wages. As long as the correct amount of PAYGW is withheld from the employee's total wage. It seems restrictive to impose a penalty on a tax payer simply for opting to be paid in cryptocurrency and not in alignment with the purpose of the FBT Act which was ultimately to capture non cash benefits this would be the equivalent to applying FBT to employee share schemes.

### **How could tax laws be designed to ensure that they keep pace with the rapidly evolving nature of crypto assets?**

The simplest idea here is to give the ATO more power when such issues arise, talking to a number of senior ATO staff who were involved in the initial cryptocurrency review I gained the impression that the structure of the current CGT legislation and being bound by Treasury unwillingness to make any direct changes relating to a specific asset class as explained to me in correspondence by the Hon. Stuart Roberts who was Assistant Treasurer at the time had not allowed the ATO to take the achieve the most productive outcome, especially considering the taxpayer funds that would have been spent on undertaking this review. The commissioner should have a delegated authority to make special provisions related to the taxation of evolving asset classes like digital assets. For obvious reasons there should also be process to challenge such provisions via the courts or an oversight committee.

### **Administration of Australia's taxation laws for crypto assets**

**How can the existing tax treatment of crypto assets be improved to ensure better compliance and administration?** The existing compliance and administration can be improved through a more proactive flow of information and better engagement with taxpayers as well as standards for cryptocurrency reporting software. There needs to be an easier way for the taxpayer to obtain guidance from the ATO around these evolving asset class that is correct and easy to understand. Some digital asset classes have existed for years before the ATO has issued any relevant guidance such as NFTs.

Software should have some form of standardization to meet specific ATO requirements and ensure reports and calculation are as compliant as possible with Australian Tax Law. This would potentially allow the ATO to utilise the same software or at least one built to the same standardizations to check taxpayer calculations.

**What data sources are available to assist taxpayers in completing their tax obligations and/or the ATO in implementing its compliance activities?**

There are a broad range of data sources available most exchanges have downloadable transaction data via an API or in CSV format that can easily be loaded in to reporting software. Further to this transfer of funds and some transactions can also be obtained from public block chain data, the amount of data available is dependent on the blockchain that you are reviewing, and the way assets are held on the exchange used by the taxpayer which somewhat limits the accuracy of publicly available data. The key is obtaining the taxpayers wallet address that is ultimately the only way to link up all the accounts they own from a compliance perspective. The ATO should have the legal right to request this information under current information gathering powers. Once wallet addresses are known there is also software that can track movement of funds from wallets which could easily be used to find any hidden accounts as well.

**Are there intermediaries (such as exchanges) that are involved in particular crypto asset transactions that could play a role in the administration of the tax laws? If so, what would their involvement look like?**

There is certainly an ability to involve Australian based or registered exchanges in such a program similar to the ASX or the bank currently do with income reporting or withholding for foreign investors. There are varying degrees that this could be extended to from simple reporting through to actual ability to withhold on transactions (this could be both mandatory or voluntary). Industry consultation would be needed with exchanges to understand how this type of reporting could be integrated into their systems and the extent of the functionality. There is ultimately no major reason apart from the development of appropriate legislative requirements as to why exchanges shouldn't have similar requirements as share registries or banks to obtain TFNs and report the income or withhold. This could greatly assist in administration and enforcement activities.

**How can taxpayers be further supported to understand their tax obligations in relation to crypto assets?**

Both the ATO and Treasury need to be far more proactive in issuing guidance and making decisions around these evolving classes of assets. Gaming based NFTs have been around since late 2017 yet I haven't seen any appropriate guidance from the ATO as the taxation treatment of such assets to date they have just tried to push people towards their normal cryptocurrency guidance which fails to address the underlying nature and purpose of these assets.

A standard needs to be established with cryptocurrency reporting software to better aid advisers and tax payers at the moment I can run 7 different pieces of software and end up with 7 different calculations some of which can differ drastically. In my view this software and its sale should be subject to the same provisions as anyone else providing taxation advice and firms should be required to have a qualified tax agent involved in the software development process to ensure that the calculations are accurate and concept such as purchase time and cost base allocation is aligned with Australian tax law.

**What additional support can be provided to the tax adviser community to assist them in advising their clients in relation to the tax treatment of crypto assets?**

Advice and guidance from the regulator should be more proactive and consider actual market events for example with the recent Ethereum merge I saw over 10 different tax agents post a run down of how this would impact Australian Tax Payer, however no guidance was issued by the ATO. This was

the same scenario when there was a number of stable coin collapses during the year, advisers were issuing guidance on LinkedIn nothing published by the ATO this was despite the fact it was raised with the media unit at the ATO.