

TO Anthony Klein and Tanya Titman
The Board of Taxation
Langton Crescent
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By email: TaxDigitalAssets@taxboard.gov.au

CONFIDENTIAL

28 OCTOBER 2022

Dear Anthony and Tanya

Review of the Tax Treatment of Digital Assets and Transactions in Australia

We refer to the Board of Taxation's Review of the Tax Treatment of Digital Assets and Transactions in Australia and the related consultation process commenced by the consultation guide release in August 2022 (**Consultation Guide**).

As part of this consultation process, King & Wood Mallesons provides the written submission attached at Annexure 1. This submission is formed from both our direct experience to date with certain matters and discussions with clients. Therefore, the submission provides insights from both the technical and market perspective.

For avoidance of doubt, we provide this submission on a non-confidential basis.

Should the Board of Taxation wish to discuss our submissions in further detail, please do not hesitate to reach out using our details below.

Yours sincerely



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Annexure 1 King & Wood Mallesons' Submission

This Annexure 1 contains the submission of King & Wood Mallesons for the Board of Taxation's (**Board**) consultation process in respect of the *Review of the Tax Treatment of Digital Assets and Transactions in Australia* pursuant to the consultation guide released in August 2022 (**Consultation Guide**).

This submission, and our summary observations therein, is divided into the five topics as set out in the Consultation Guide. Specifically:

1. Current tax treatment of crypto assets;
2. Awareness of tax treatment of crypto assets;
3. Characteristics and features of crypto assets;
4. International tax treatment of crypto assets and experiences; and
5. Changes to Australian taxation laws for crypto assets.

As a preliminary note, although the review is "...of the Tax Treatment of Digital Assets...", the Board of Taxation adopted the term "crypto assets" in the Consultation Guide. As such, and in line with our understanding of market terminology, we have followed suit.

All legislative references are to the *Income Tax Assessment Act 1997 (1997 Act)* or the *Income Tax Assessment Act 1936 (1936 Act)* unless stated otherwise.

1 Current tax treatment of Crypto Assets

King & Wood Mallesons acknowledges that the Australian Taxation Office (**ATO**) has released a series of guidance (including private binding rulings, tax determinations and general advice on the ATO's website and community forum) based upon the existing tax regime.

However, despite recent developments in the law specifically in relation to crypto assets and transactions,¹ a key issue with the current ATO guidance is that it largely addresses the industry as at 2014. The use of blockchain technology and crypto assets has significantly increased and developed over the past eight years and will likely continue to do so. A lack of guidance in light of this rate of adoption and development renders the existing guidance less useful and prone to misapplication as taxpayers and professional advisers are forced to either make decisions based on examples that are becoming gradually more dissimilar to market practice, or make interpretations and decisions without any analogy or guidance from the ATO.

We have had the opportunity to assist in preparing and in reviewing a number of submissions already lodged with the Board, including for FinTech Australia. Accordingly, for the sake of brevity, we have summarised the key areas where we are of the view that there is a need for higher priority guidance, and support the submissions of FinTech Australia in respect of the following items where mentioned in those submissions:

1. [**DAOs**] Decentralized autonomous organisations (commonly referred to as "**DAOs**"), including the determination of their tax residency and legal characterisation.
2. [**NFTs**] Non-fungible tokens (commonly referred to as "**NFTs**"), including guidance where their use is more novel (for example, NFTs evidencing receipt of grain at a warehouse).
3. [**Capital raising**] The applicability and/or extension of CGT exemptions (for example, in relation to CGT event D1) on capital raisings.

¹ For example, the GST regime and the *Treasury Laws Amendment (Measures for Consultation) Bill 2022: Taxation Treatment of Digital Currency* currently being considered.



4. **[Wrapping and bridging]** The tax treatment of wrapping and bridging transactions, including whether there has been a disposal of an asset under Australian tax law; and if so, at what value. There is also the question of whether wrapped assets can constitute derivatives.
5. **[Staking]** The tax implications of staking (including those transactions that are similar in nature, if not already captured by the term, such as those related to lending pools, yield farming and lending/borrowing protocols). In the specific context of decentralised lending protocols and lending pools, there is also the question of whether loans of crypto assets should receive similar treatment to securities loans as set out in section 26BC of the 1936 Act.
6. **[Eligible investment business]** Consideration should be given to expanding the definition of “eligible investment business” to including crypto assets to enable Australia to retain its global competitiveness in the funds management sector. We note that the fact that Australian blockchain funds can only offer investments in companies, or entities taxed like companies, is likely to deter investors from Australia and steer them towards offshore flow-through LLPs and LLCs, resulting in Australia losing investment manager income opportunities.
7. **[TOFA Regime]** It is currently understood that certain crypto assets such as bitcoin (which is not pegged to cash reserves or is readily convertible into cash) are not considered “cash settleable” and therefore the TOFA regime cannot apply. This is notwithstanding that such crypto assets may be classed as derivatives and have the dominant purpose of investment or hedging risk. This application of the regime may require further consideration. Further thought should also be given to crypto assets that provide the ability for the right to redeem from the issuer for their equivalent value in the fiat currency (e.g. stablecoins).
8. **[GameFi]** The tax consequences, transparency and awareness of GameFi should be prioritised. This is especially needed given our broad concern that many players are playing recreationally and/or are minors, and may not be actively turning their mind to the tax implications despite technically having an intention to earn crypto assets and eventual income. Specific guidance on the following would be helpful and will especially help minors commence their interactions with the tax system in a positive manner:
 - a. when a gamer is considered to be “carrying on a business” or engaging in a hobby;
 - b. factors to assist in delineating when a gamer is playing these games as an investor or as a trader (and therefore, when the CGT regime and trading stock definition could be applicable);
 - c. consideration of whether there is a difference between crypto assets earned or otherwise received at different points through a game;
 - d. record keeping obligations for both players and game developers; and
 - e. consideration of the application of tax laws to minors specifically.

2 Awareness of tax treatment of Crypto Assets

From our experience with business and those investors with whom we interact, we have observed an increase in sophisticated taxpayers seeking professional tax advice. This demonstrates an awareness of and desire for engagement with the tax issues in this sector/industry. Over the last 12-18 months, we have seen a particular rise in the more specialised clients (e.g. VCs, angel investors, fintech hubs) seeking professional tax advice.

In summary, we are seeing an expansion in the type of clients becoming aware of the need to consider the tax issues when dealing with crypto assets.

3 Characteristics and features of Crypto Assets

In respect of tax transparency, we note that the sheer volume of transactions (particularly in the context of traders) that occur make it difficult for taxpayers to obtain and store all information



required to calculate the underlying tax that may be paid. Equally, it may be difficult for the same reason for the ATO to undertake compliance programs where it is required to obtain, store and review masses of data.

Further, given recent data leaks, it may not be appropriate from a policy perspective for the ATO to hold such data. One option might be for the ATO to rely on the collection and storage of data by intermediaries (for example, crypto exchanges and tax specific software providers), and to seek access to such data through applicable programming interfaces or APIs. However, balanced against this is the need to consider the compliance costs and potential liability for intermediaries in allowing access to such data to a regulator. Further work and discussions between intermediaries and regulators such as the ATO should be undertaken in this regard.

Finally, again for brevity, King & Wood Malleons supports the submissions of FinTech Australia under the heading “Improvements to better ensure compliance” under this topic.

4 International tax treatment of Crypto Assets and Experiences

In addition to the international developments set out in the Consultation Guide, King & Wood Malleons refers the Board to the following developments in comparable jurisdictions with respect to the taxation of crypto transactions and its administration for consideration. For avoidance of doubt, King & Wood Malleons does not necessarily endorse the approaches set out below; however, submits that they may be used to stimulate discussion and debate amongst the members of the Board for the purposes of the review.

4.1 New Zealand

On 30 March 2022, a new definition of “cryptoasset” was introduced in both the Goods and Services Tax Act 1985 (NZ) and Income Tax Act (NZ) which does not cover non-fungible tokens.² This new definition addresses the GST treatment of crypto assets and application of the financial arrangement rules. Similar to Australia, the reform excludes the supply of “cryptoassets” from the definition of services, effectively treating “cryptoassets” like money for GST purposes and the supply of non-fungible tokens remains subject to GST if supplied by a registered person.

Notably, the new definition treats most crypto assets, other than those that are similar to loans, as excepted financial arrangements such that the Financial Arrangement rules will not apply, meaning that unrealised gains and losses will be outside of the tax net, but realised gains will be subject to tax. As noted above, the application of the TOFA regime with respect to crypto assets and transactions is unclear and the Board should consider whether similar reforms are appropriate, including whether the NZ approach is appropriate from a policy perspective for all Australian taxpayers.

4.2 United Kingdom

The HM Revenue and Customs (HMRC) Cryptoassets Manual provides detailed and contemporaneous guidance on the taxation of crypto assets and transactions which is developed in consultation with industry experts and professional bodies. King & Wood Malleons considers that the ATO could adopt a similar model for its guidance.

Notably, the HMRC takes the position with respect to airdrops that, for individuals, airdropped tokens may not be taxable on receipt where no nexus with some action can be established (i.e. the airdrop is not related to any services rendered) and the tokens are not received as part of a trade or business.³ King & Wood Malleons considers that the Board and the ATO, as appropriate, should have regard to the HMRC’s position in the development of guidance which addresses circumstances

² The *Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill* received royal assent on 30 March 2022.

³ HM Revenue and Customs, *CRYPTO21250 - Cryptoassets for individuals: Income Tax: airdrops*, <<https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto21250>> (accessed 17 October 2022).



where airdrops have properties that resemble gifts or where airdrops involve the unwanted or undesirable receipt of tokens.

4.3 Singapore

The Internal Revenue Authority of Singapore (IRAS) e-Tax Guide Income Tax Treatment of Digital Tokens provides guidance on the income tax treatment of “payment tokens”, “utility tokens” and “security tokens”.

We note that GST guidance for “payment tokens” is separately contained in the IRAS e-Tax Guide GST: Digital Payment Tokens and broadly aligns with Australia’s current concept of “digital currency”.

4.4 United States

With respect to tax transparency, decentralised exchanges will be required to report their customers’ annual crypto gains and losses to the Internal Revenue Service (IRS) starting 1 January 2023, similar to stock brokerages. As part of these reforms, it has been reported that the IRS is developing a new tax form for decentralised exchanges to capture individual annual crypto activity subject to taxation.⁴

It is also anticipated that the IRS will publish rules which would bring foreign holders of crypto assets into the scope of *Foreign Account Tax Compliance Act 2010* (US) tax reporting in line with US Treasury proposals.⁵

Finally, the IRS recently released further draft guidance on crypto assets providing uniform consideration of “digital assets”, a term within which the IRS specifically includes NFTs.⁶ This brings NFTs in line with other crypto assets.

5 Changes to Australian taxation laws for Crypto Assets

King & Wood Mallesons considers that any recommendations should address the treatment of crypto assets in the following way:

1. Where existing tax laws can sufficiently address the desired policy outcome, adequate and timely ATO guidance should be issued to explain how the existing tax laws apply to crypto assets/transactions; and
2. Where existing tax laws cannot achieve the desired policy outcome, timely new legislation should be enacted, supported by detailed ATO guidance.

In our view, amendments or additions to the tax law should only occur where necessary.

King & Wood Mallesons also suggests that consideration should be given to the establishment of a working group comprised of industry members as well as tax practitioners to assist the ATO in issuing guidance on the taxation of crypto assets in a timely manner so as to provide greater certainty to the industry as well as practical and workable recommendations.

⁴ Forbes, *The IRS Is Working On A New Tax Form To Capture Your Crypto Activity* (1 August 2020) <<https://www.forbes.com/sites/shehanchandrasekera/2022/08/01/the-irs-is-working-on-a-new-tax-form-to-capture-your-crypto-activity/>> (accessed 17 October 2022).

⁵ US Treasury, *Greenbook* (28 March 2022) <<https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf>> (accessed 17 October 2022), 100-101.

⁶ IRS, 1040 (and 1040-SR) Instructions (Tax Year 2022) (6 October 2022) <<https://www.irs.gov/pub/irs-dft/i1040gi--dft.pdf>> (accessed 20 October 2022).