

26 October 2022



Law Council
OF AUSTRALIA

Office of the President

Mr Anthony Klein and Ms Tanya Titman
The Board of Taxation
Langton Crescent
PARKES ACT 2600

By email: TaxDigitalAssets@taxboard.gov.au

Dear Mr Klein and Ms Titman

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

1. This submission to the Board of Taxation (**Board**) is made by the Taxation Committee of the Business Law Section of the Law Council of Australia (the **Taxation Committee**) and the Charities and Not-For-Profits Committee of the Legal Practice Section of the Law Council of Australia (the **Charities Committee**).

Key points

2. The key matters the Taxation Committee wishes to bring to the Board's attention are as follows:
 - (a) Digital assets, their nature, use, and application are constantly and rapidly evolving. In some cases, the digital assets and digital transactions are fundamentally different to the existing classes of 'things' and the presumed structure of transactions in the existing tax law. Given their evolving nature, how the Australian legislative framework is applied—whether existing laws, or the manner in which they are interpreted by the ATO, the courts or taxpayers—may not always be clear or consistent, or be able to provide appropriate tax outcomes.
 - (b) To date, taxpayers and the ATO have been left to formulate their own positions on how the tax legislation should be applied without adequate policy guidance from Government. The ATO has issued guidance that is general in nature, lacks details, clarity and certainty, and taxpayers are left unclear on how tax laws should apply.
 - (c) Before there can be any meaningful discussion regarding law design, there needs to be clear policy decisions from Government on emerging digital assets and transactions, and whether and how they should be taxed. Clear policy decisions enable proper consultation and consideration of the legislative approach and decisions on how to best implement policy.

- (d) In the short term, the establishment of a law design working group and tax advisory committee consisting of subject matter experts, technology experts, professional bodies, tax professionals, and industry bodies may assist the ATO and/or Treasury in their work, given the pace of change of the technology and the uncertainty regarding the application of existing tax laws. The two could work in conjunction—both at Treasury and ATO level—so that there is less of a time lag, and taxpayers and their advisors have a clear model.

Endorsement of submission made by Joint Bodies dated 11 October 2022

- 3. The Taxation Committee agrees in principle with the matters expressed at pages 1–3 and the first three pages of Appendix A (pages 5–7) to the submission dated 11 October 2022 made to the Board by the Joint Bodies. In particular, it agrees that:
 - (a) the current tax treatment of digital assets is uncertain generally, and the level of knowledge of most taxpayers and tax practitioners of both the technology and the tax laws that may apply is limited;
 - (b) the existing ATO guidance on digital assets is general in nature, lacks detail and clarity, and is inconsistent; and
 - (c) there is a reliance by the ATO on web guidance that changes from time to time, with little notice to taxpayers and tax practitioners. In any event, the web guidance lacks the level of detail necessary for readers to understand the basis for the Commissioner’s application of existing tax laws to digital assets, and commonly employs general conclusory statements.

Potential approaches to law design

- 4. From a law design perspective, the Taxation Committee has identified three main issues/approaches:
 - (a) whether existing taxation laws could be applied to digital assets and transactions, and to what extent, before considering whether any new laws or amendments to existing laws should be enacted; and/or
 - (b) whether there is a need for legislating a separate Division or Code in the Tax Acts to deal with emerging digital assets and transactions; and/or
 - (c) whether some form of advisory committee should be established to work in consultation with Treasury and the ATO, as an acknowledgement that the technology is emerging and is developing faster than the legislation can develop.
- 5. In considering these issues, The Taxation Committee unanimously concluded that there is an earlier and more fundamental question that needs to be answered before there can be any meaningful discussion regarding law design.
- 6. That is, what is the Australian Government’s policy on emerging digital assets and transactions and how they should be taxed?
- 7. The starting point of the conversation should be moved away from whether existing tax laws may or may not apply, or whether emerging digital assets are incompatible

with those laws. The conversation should begin with policy decisions to be made by the government of the day as to whether crypto and other digital assets should be taxed in a similar way to traditional or existing assets and transactions, or whether they should be treated as a special category to encourage investment and innovation.

8. The Taxation Committee is aware of examples of financial investors and financial institutions seeking advice to invest in digital assets in 'friendlier' offshore jurisdictions such as Singapore, Dubai, or North America because of the lack of regulatory certainty in Australia.

The definitional problem with applying 'existing' tax laws

9. There is a real difficulty in applying existing tax law to emerging digital assets and transactions because they are not fit for purpose, and the term "digital assets" is broad and comes in many different forms with different uses. Cryptocurrency is fundamentally different to a Non-Fungible Token (**NFT**) and fundamentally different again to a governance token in a Decentralised Autonomous Organisation (**DAO**).
10. These different types of digital assets should not necessarily be taxed in the same way. Tax laws cannot be applied or formulated for 'digital assets' and their 'transactions' without a clear definition of what different types of digital assets exist, and how they should be classified from a legal and regulatory perspective.
11. It may well be necessary to expand existing definitions to ensure that digital assets are dealt with under the most appropriate regime, and consistent with the legal or regulatory treatment.
12. For example, in Australia, the ATO takes the view that most of the investment in crypto should be treated on capital account and only on revenue account by exception. The proposition that the capital gains tax (**CGT**) regime applies to most digital assets appears to be mainly accepted but the unique qualities of some digital assets may make some CGT concepts such as "absolute entitlement" and "beneficial ownership" difficult to apply.¹
13. As far as possible, any tax and regulatory frameworks should be developed together, rather than separately, so that they work together with similar policy-driven outcomes.

Priority tax policy issues

14. The Taxation Committee has identified a list of tax issues that may require priority consideration by the Government in respect of tax policy and its application to digital assets:
 - (a) Whether the CGT regime requires amendment to confirm certain digital assets are 'CGT assets' within the meaning of s 108-5 *Income Tax Assessment Act 1997 (ITAA 97)*.
 - (b) Whether certain digital assets should be included in the definition of 'eligible investment business' in s 102M of the *Income Tax Assessment Act 1936 (ITAA 36)* for the purpose of Division 6C, which deals with public trading trusts.

¹ See, for example, the UK Law Commission digital assets [consultation paper](#) and its proposal to recognise a distinct category of personal property under the law called "data objects".

- (c) Whether certain digital assets should be included in the definition of 'financial arrangement' in ss 230-45 and/or ss 230-50 of the ITAA 97 for the purpose of the Taxation of Financial Arrangements (**TOFA**) rules in Division 230.
 - (d) Whether certain digital assets should be included in the definition of 'tainted assets' in s 317 of the ITAA 36 for the purpose of the Controlled Foreign Company (**CFC**) provisions in Part X.
 - (e) Whether the GST provisions require amendment or special rules to deal with emerging digital assets given their unique characteristics. Currently, the GST provisions seek to include 'digital currency', but only deal with one aspect. There are issues with the nature of the supply and where it occurs.
 - (f) Whether there should be some form of legal recognition of DAOs, noting that they do not fall neatly within the statutory or common law principles of a partnership or unincorporated association.
 - (g) Insofar as the majority of retail investors and accountants rely upon intermediary services such as Koinly or CryptoTaxCalculator to assist with their tax calculations, whether there should be some process available to those software providers to verify their software with the ATO and/or share information.
15. In the Taxation Committee's view, policy decisions need to be made about the above matters before there can be meaningful engagement with any law change that may be necessary to give effect to them.

The donation of digital assets to deductible gift recipients

16. The Charities Committee submit as follows in relation to donations of digital assets to deductible gift recipients:
- (a) The article, by Eileen Liu, Bridgid Cowling and Shaun Cartoon, entitled 'Donating Digital Money to Deductible Gift Recipients: Decrypting the Australian Tax Implications' (2021) 50(4) *Australian Tax Review* 249 explains the income tax and governance issues that arise when a taxpayer makes a gift of cryptocurrency to a deductible gift recipient (**DGR**). While the article is focussed on one form of digital assets, cryptocurrency, most of issues identified in it are also relevant to other types of digital assets. The Charities Committee commends this article to the Board.
 - (b) The ATO should be encouraged to provide specific guidance regarding the valuation process of gifts of property that is or involves digital assets and timing, given the asset's fluctuations.
 - (c) The ATO should be encouraged to provide specific guidance regarding the valuation process of NFT gifts, NFT of cultural items, certificates of authenticity, and timing.
 - (d) The Ministerial Guidelines for Private Ancillary Funds and Public Ancillary Funds should be altered to include provisions about digital assets in relation to investment strategy or investment limitations and distributions in digital assets.

- (e) It is likely that Distributed Ledger technologies will be able to streamline the operations of DGRs and charities that operate overseas, and the ATO and/or the Australian Charities and Not-for-profits Commission (**ACNC**) should consider providing guidance in relation to prudent governance in relation to fraud, money laundering, and terrorism financing. It may be that ACNC governance standards require amendment to cater for such developments which are proportionate to the risk and do not hamper beneficial innovation.
- (f) The Board should also consider the principles of taxation for new legal forms associated with DAOs that are formed for altruistic purposes akin to what are known as giving circles (groups of individuals who donate money and/or time and have a say in the distribution of these resources).

The challenge with drafting new laws

17. Depending upon the policy positions taken by the Australian Government, it may be that established tax frameworks such as the capital/revenue distinction or the CGT regime can still be relevant to taxing emerging digital assets and transactions, with some amendment, rather than introducing wholesale law change.
18. As overseas models and international norms develop,² the Australian Government may wish to develop its own special framework for the taxation of digital assets and transactions that departs from established Australian tax frameworks. This will be a significant undertaking that will require a clear policy direction from the Australian Government.
19. In terms of the development of any new laws, there is a tendency in modern-day drafting to prefer a 'principles-based approach' over a 'rules-based approach'.
20. With a principles-based approach to the drafting of legislation, the 'detail' around the provisions, if any, is typically contained in a document, or documents, such as the Explanatory Memorandum accompanying the legislation or a Law Companion Ruling and/or Practice Statement issued by the ATO.³
21. The Taxation Committee sees two limitations with this approach:
 - (a) Until the Courts consider the provisions, the Explanatory Memorandum, Law Companion Ruling, and Practice Statement assume greater significance in the interpretation of the legislation with the latter two being the views of the revenue collection authority (in effect, 'lore' becomes more important than law); and
 - (b) The approach of the Courts in interpreting legislation is set out by the High Court in *FCT v Consolidated Media Holdings Ltd* (2012) 250 CLR 503 at [39]:

² See, for example, the OECD Crypto-Asset Reporting Framework (CARF) and Amendments to the Common Reporting Standard report developed in response to a mandate by the G20 in April 2021.

³ If this approach is to be taken, The Taxation Committee's preference is for as much guidance to go into the Explanatory Memorandum as possible rather than relying on the ATO to fill that void with its own products, albeit acknowledging that with appropriate consultation products such as ATO Law Companion Guides can be useful.

‘... the task of statutory construction must begin with a consideration of the [statutory] text. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself.’

22. There are a number of examples in the tax law where a principles-based approach has led to overreliance on the Explanatory Memorandum and lengthy ATO companion documents on the meaning of generalised terms in the legislation. This can lead to uncertainty for taxpayers and tax advisors until the Courts are able to consider the legislation, which can take many years after the relevant law has been introduced. For example, this occurred with the introduction of the GST in the early 2000s and more recently with the introduction of Subdivision 328-G (restructures of small business) in the ITAA 97.
23. On the other hand, there is also an ongoing challenge to developing a rules-based approach to emerging digital assets and transactions because of the speed of technological innovation, and the challenges of having and maintaining the technical and practical knowledge to understand it.
24. The Taxation Committee supports the Australian Law Reform Commission’s (ALRC’s) position that any regulation should be technology neutral,⁴ and its legislative hierarchy model.⁵
25. While it is a matter for the Australian Government, both regulatory and taxation regimes need to be internationally competitive if Australia wishes to facilitate the use of the technology in an Australian business environment. From a tax policy perspective, there is a risk if Australia creates a regime that is inconsistent with overseas treatments, overly complex, or administratively burdensome, that business trading and revenues that derive from the new technology, as well as expertise in the technology, will move overseas at the longer term cost to Australia.

Establishment of a tax advisory committee

26. The Taxation Committee supports the establishment of:
 - (a) a working group comprising the ATO, the Board, Treasury, professional associations, tax professionals, and technology experts to collaborate on law design; and

⁴ Australian Law Reform Commission, *Legislative Framework for Corporations and Financial Services Regulation: New Business Models, Technologies and Practices* (October 2022) www.alrc.gov.au/publication/fsl7/ at [59] – [74].

⁵ *Ibid*, described at FN [188]. Noting at [173] the ALRC posits the possibility that the impact of technology will result in a move away from a prescriptive, rules-based approach to regulation in favour of a principles-based approach that is supported by clearer outcomes and can better accommodate new technologies and practices.

(b) a tax advisory committee consisting of tax professionals and subject matter experts to assist the ATO in the development of its guidance. This committee could work similarly to an ATO stakeholder reference group.

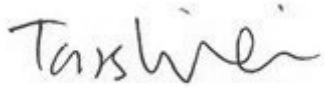
27. The establishment of these committees would assist the ATO and/or Treasury in their work, given the speed of change of the technology and the uncertainty regarding the application of existing tax laws.

Conclusion and further contact

28. The Taxation Committee would be pleased to discuss any aspect of this submission.

29. Please contact the Chair of the Taxation Committee Angela Lee on (03) 8600 1777 or Taxation Committee member Tuan Van Le, on 0414 943 881, if you would like to do so.

Yours sincerely

A handwritten signature in black ink that reads "Tass Liveris". The signature is written in a cursive, slightly slanted style.

Mr Tass Liveris
President