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16 October 2022

The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600
by email: TaxDigitalAssets@taxboard.gov.au

Dear Director

Coinstash's submission to "Review of the Tax Treatment of Digital Assets and Transactions in Australia"

Thank you for providing the opportunity for us to make our written submission to the Review of the Tax Treatment of Digital Assets and Transactions in Australia. We appreciate the Board of Taxation making a conscious decision to consult with industry participants such as Coinstash, as we believe our input will assist the Board's final report.

About Coinstash

TWMT Pty Ltd trading as Coinstash AU ("Coinstash") is a registered digital currency exchange provider that was incorporated in September 2017. Coinstash was among the first DCEs to be registered with AUSTRAC and is also the controller of an Australian Financial Services License.

Overview

Our submission is around three key areas:

1) Treat certain staking rewards and airdrops as capital in nature;
2) The CGT roll-over reliefs should be expanded to include restructures and reorganisations involving crypto assets; and
3) Application of the correct GST treatment by all registered DCEs.

Treat certain staking rewards and airdrops as capital in nature

- Staking rewards should be considered capital or of a capital nature. Any taxable outcome should be deferred until a CGT event happens in respect of the staked assets.

- The cryptocurrency market is highly volatile. This is reflected in the higher risk-to-reward ratio of staking activities which generally generate higher returns compared to traditional interest-bearing assets, but also carries a higher risk of the principal (the staked assets) losing value. The market value of the staked assets can drop drastically during the staking period, resulting in a loss on the investor's overall portfolio even after taking into account the staking rewards.

- Similarly, certain 'airdrops' (i.e. tokens that are given to investors for free, simply due to the fact that the investor held a particular token at the time of the airdrop event) can carry significant value, particularly at the initial price discovery phase, resulting in a taxable event in ATO's view. However, these airdropped tokens can also decrease in value significantly over a short period of time once market forces determine the market price .

- The current view of the ATO is that staking rewards and airdrops should be considered ordinary income derived at the time the tokens are received. There are some practical concerns with this approach.

- It is not uncommon that the investor will not be able to fund the tax payment on the derivation of staking rewards or airdrops. At times, it is not practicable or even possible to sell staked assets, as there can be lockup periods for staking. Even if liquidity is not an issue, the mismatch in the revenue treatment of staking rewards versus the capital loss treatment when the investment is eventually realised can create absurd tax outcomes.

- An example is the recent collapse of Luna and UST. Investors who held UST were typically generating staking rewards in the range of 20% per annum. However, with the collapse of the Terra Luna/UST ecosystem, UST also dropped significantly in value (more than 99%). As such, a typical investor may have started with $100,000 in capital, earned $20,000 in staking rewards where income tax of say $6,000 is levied, but have a portfolio of less than $1,000 following the collapse. This is also due to the fact that the staking rewards are also paid out in UST. In this situation, the investor's tax bill is higher than their entire portfolio.

- In early September, the ATO released non-binding guidance which distinguished between airdrops that are an 'initial allocation', which they consider to be capital in nature, and airdrops of the same token, which they consider to be income. We submit that whilst this is a step in the right direction, the capital / revenue distinction between new vs existing token is unnecessarily rigid and also leads to absurd outcomes

- An example is USD denominated stablecoins tokens such as AMPL and OUSD that attempt to maintain 1:1 price parity with the USD dollar based on a 'rebase' mechanism. The rebasing mechanism maintains price parity by increasing the quantity of tokens in users' wallets (via an airdrop) when the price of each token is greater than $1. Conversely, when the price of each token is less than $1, the amount of tokens in a user's wallet decreases until price parity is achieved. The supply adjustments are proportional and non-dilutive such that if a user owns Y% of the network before a rebase, the user will always own Y% of the network unless the user buys or sells more AMPL.

- An absurd tax outcome would clearly arise where a user is taxed on revenue account when receiving airdropped AMPL under a rebasing mechanism , when the sole purpose of the airdrop is to devaluate the asset value (i.e. generate a capital loss).

- We submit that the Board should recommend in its final report that staking activities involving higher risk cryptocurrency assets should be treated as capital in nature. This means the staking rewards derived from the activities should fall under the CGT regime, rather than being treated as ordinary income.

- Additionally, if a taxpayer can demonstrate that he or she is carrying on a business on revenue account, then both the staking rewards and the gains/losses from fluctuating market values should be on revenue account.

The CGT roll-over reliefs should be expanded to include restructures and reorganisations involving crypto assets

- As noted in the Board of Taxation ("BoT") consultation paper on the review of CGT roll-overs released in December 2020, a fundamental feature of the CGT regime is its realisation basis and the roll-over policies have been introduced to neutralise the 'lock-in' effect to allow efficient business activities. The BoT acknowledged the need to reform in this area to reduce complexity and developed policy principles to underpin roll-overs for general business restructures. In particular,

"Principle 2: Roll-over should be available to relieve inefficient asset 'lock-in' for business where there is strict continuity of economic ownership

Application of roll-over where investors have the same economic exposure to the same economic assets in the same proportion (i.e. merely the legal form of the ownership is changing) can be justified on the basis that there is continuity in the investment and, in pursuit of business efficiencies, businesses are simply rearranging the structure through which that investment is made or managed."

- The same principle should apply to investors of cryptocurrency assets. Where an investor swaps a crypto asset for another with the same characteristics where they have the same economic exposure for the purposes of reorganising a holding structure and allowing flexibility / beneficial economic activities (as opposed to exchange a crypto asset into fiat currency or a completely different crypto asset class), a CGT roll-over relief should be allowed to defer any capital gain or loss arising from that transaction.

- By way of an example, consider bitcoin (BTC) and wrapped bitcoin (WBTC). WBTC is an ERC-20 token backed one to one with BTC held in custody by the BitGo trust. The price for BTC and WBTC are correlated. An investor may swap BTC to WBTC to use it in the Decentralised Finance (DeFi) ecosystem (with BTC as collateral). The underlying economic exposure and assets the same for the investor but holding WBTC gives them flexibility and liquidity into the DeFi ecosystem. In these circumstances, the direct swap from BTC to WBTC should not give rise to a taxable gain or loss to the investor.

- In contrast, when an investor swaps BTC to a stablecoin such that the investment fundamentally changes, it should be considered an actual realisation event.

- Further guidance or legislative instrument can be released (revised and expanded in the future) to specify which crypto asset classes are considered eligible for the roll-over reliefs.

Application of the correct GST treatment by all registered DCEs

- Under the A New Tax System (Goods and Services Tax) Act 1999 (Cth), the supply of digital currency assets is an input taxed supply.

- However, there are clear legislative commentary as well as ATO guidance that the provision of 'brokerage services', whether it relates to shares, cryptocurrencies, or other financial assets, is a taxable supply.

- The majority of DCEs in Australia charges a trade fee as well as a spread when facilitating the trade of cryptocurrencies. For example, a DCE may sell Bitcoin at a 1% markup to cost, as well as charging a trade fee of 0.6%.

- It is undisputed that GST should be remitted to the ATO that equates to 1/11th of the GST inclusive trade fee, which is 0.6% in the example above.

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- Further, because most DCEs also generate some of their turnover from the spread, an apportionment is needed to determine what percentage of input tax credit they can claim on their operating expenses.

- With many new entrants into the market, some of which are international exchanges seeking to expand their businesses into Australia, it is extremely important for the ATO to educate these exchanges to adhere to the Australian GST legislation. This will help build confidence in the industry that there is a level playing field

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We thank you for the opportunity to provide our submission.

Please contact Ting Wang at ting@coinstash.com.au should you have any questions.

Ting Wang

Co-founder and CEO