

Shifting digital currency definitions: current considerations in Australian and US tax law

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Digital currency as an intangible asset is designed in part, to circumvent the reach of regulatory bodies. As such, the emergence of this asset in global markets requires tax regulators to be particularly nimble with respect to regulation.

This article reviews the rapidly shifting regulatory landscape and concludes that the regulation of digital currency needs to be increasingly proactive, as the placement of new market products under an existing definitional framework leads to inconsistencies in regulatory application. While tax administration will not drive stabilisation of the digital marketplace, tax administrators might consider that regulation of digital currency, as a new hybrid intangible asset in a global marketplace, may provide an opportunity to consider forward thinking global harmonisation.

: taxation, digital currency, regulation, bitcoin, intangible assets

Digital currencies are 'distributed, open source, maths based, peer-to-peer currencies'

for digital currency is high,¹¹ a variety of regulatory agencies including the Australian Taxation Office (ATO) and the US Internal Revenue Service (IRS) are increasing enforcement activities.¹²

Taxing regimes often move more quickly than other regulatory schemes to define certain transactions as taxable events to ensure that the government is both fairly and equitably taxing citizens' activities, and that the coffers of the government are not being shorted by failing to collect tax on taxable activities.¹³ The taxation of digital currencies and digital currency transactions are no exception.

The current governmental taxation framework in Australia and the US are two stable governmental systems, with worldwide taxation reporting requirements for their citizens. Thus, citizens (tax residents) of the US and Australia are required to report their income regardless of income source and location.¹⁴

Tax law in both countries generally dictates filing on an annual basis. Due to the need to describe a taxable event with a discrete valuation, tax laws work best for both taxpayers and assessing agents when terms are specific, measurable, and reducible to a numerical value.¹⁵

Further, because all governments are funded in large part by taxes, governments are generally vested in anti-avoidance regulations and act in fairly rapid fashion to changing market trends. Thus, as tax professionals must read, on an annual basis, to new governmental directives on behalf of their clients, the effects of changing tax regulations are a matter of immediate implementation.

As digital currency becomes a well-known investment vehicle and trading commodity, extreme change is occurring in the financial industry,¹⁶ an industry that is both highly regulated and particularly risk averse. As such, governments that monitor and regulate financial markets have taken initial steps to define and regulate digital currencies. With the release of new products, consumers and businesses face new considerations in risk

¹¹ Cryptocurrency holders are likely to be impacted by increasing IRS scrutiny around the cryptocurrency activities; see, e.g., Laua Shin, 'Financial Spring Clearing For Bitcoin, Save All Records', (11 April 2017), available at <https://www.foxbusiness.com/sites/lauashin/2017/04/11/financial-spring-clearing-for-bitcoin-save-all-records/#3061cd15e01> (accessed 9 January 2019).

¹² See, e.g., recent US litigation based on a 'John Doe' subpoena, *John Doe v. Coinbase*, (US District Court, N. Dist. Ca. 2017) 2017 WL 4652121, 413 CV-416-17 cv-01431-JSC, requesting Coinbase provide information relating to transactions over USD 20,000 where 1099 reports have not been filed.

¹³ See, e.g., Australian Taxation Office 'Diverted Profits Tax', <https://www.ato.gov.au/general/new-legislation-in-detail/direct-taxes/income-tax-for-businesses/diverted-profits-tax/?=redirected> (accessed 9 January 2019); Organisation for Economic Co-operation and Development, *OECD Taxonomy of Digital Assets*, (2018), available at <https://www.oecd.org/tax/digital-assets/>.

of Division 75²⁵ of the Income Tax Assessment Act 1997, states that bitcoin is not a foreign currency. This Determination considered whether bitcoin is foreign currency, or 'currency' for income tax purposes in circumstances where the term is not defined in the tax Assessment Acts.

In reaching the conclusion that digital currency is not foreign currency, the Commissioner considers the legal meaning of the term 'currency' with reference to the Currency Act.²⁶ The term was explained in the case of ²⁷ and judicial commentary of the term 'currency' focuses on the notion that 'currency' consists of notes or coins of denomination expressed as units of account of a country and issued under the laws of that country for use as a medium of exchange of wealth.²⁸ With reference to the Currency Act, the Commissioner notes that the 'critical character of the Currency Act's concept of "currency" is State recognition and adoption of a monetary unit under law.²⁹ That is, bitcoin is not a monetary unit recognised and (legally) adopted by foreign states and can therefore not be 'foreign currency' for the purposes of Division 75 of the Income Tax Assessment Act 1997. The Commissioner, as a result, confirms and concludes that 'bitcoin does not constitute "currency" nor "foreign currency" in the context in which those terms operate for the purposes of Australian tax law.³⁰

In relation to GST, the Commissioner initially ruled in GSTIR 2014/3 'Goods and services tax: the GST implications of transactions involving bitcoin (withdrawn December 2017)³¹ that as bitcoin was not defined as money, the exclusion in the Currency Act (GST Act) for supplies of 'money' did not apply and that, as a result, the supply of bitcoin would be taxable. In this Ruling the Commissioner also determined that the supply of bitcoin was not a financial supply, or any other type of input taxed supply.

While there are many tests as to what may constitute property and proprietary rights, the Commissioner states that, in relation to bitcoin, neo

b) the bundle of rights (hereafter referred to as 'Bitcoin holding rights') ascribed to a person with access to the bitcoin under the Bitcoin software and by the community of Bitcoin users.³²

Property generally is capable of ownership and the ownership rights of property are transferable. That is, the owner can deal with an item in the manner in which they wish, and property rights detail the legal relationship over that item.³³ A determination of whether something constitutes property requires a weighting of various factors, being

An earlier investigation into Craig Wright was undertaken in 2016 by the Australian Federal Police and the ATO in relation to alleged substantial transactions in gold, software and bitcoin but, as of early 2018, he has not yet faced charges.⁵⁵

Further, and from a more general perspective, even in the absence of criminal charges in relation to the use of digital currency, there are undoubtedly illegal transactions being facilitated by the use of digital currencies.⁵⁶ The authors note that 'banks, who are deeply sensitive about any suggestion that their systems

There were, however, definitional restrictions on the inclusion of digital currency within the existing framework.

The AML Act operates to regulate 'money', a term within which digital currencies could be included for the purposes of regulation. The AML Act had defined money to include 'e currency', which is defined to be an 'internet based, electronic means of exchange that is based either directly or indirectly by precious metal, bullion or anything prescribed by the AML/CIF Rules and is not issued by or under the authority of a government body'.⁶¹

The current legislation includes e currency in the definition of money, and e currency is further defined to include digital currency.⁶² In conclusion, recommendations were

Sept. 18, 2014 (holding that an investment of Bitcoin, a virtual currency, meets the first prong of **Reg. 1.1223-1(a)(1)**); **910 F.2d at 574** (“[T]he ‘investment’ may take the form of ‘goods and services’, or some other ‘exchange of value’.”) (citations omitted).

In December 2017, in released public remarks, the Chairman of the SEC, **Jay Clayton**, noted that no initial coin offerings have been registered as securities transactions.⁴⁹ His statement highlights that a weak regulatory environment can be both good and bad for an investor: With the weak regulatory environment, much volatility comes into digital currency value. While most investors and regulators are experienced with the tax

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This article concludes that the regulation of digital currency needs to be increasingly proactive, as the placement of new market products under an existing definitional framework for regulation leads to inconsistencies in regulatory application. Examples