Taxing Bitcoin

Cryptocurrencies, like Bitcoin, are independent and not regulated by any central authority. Until recently, these digital currencies were not treated in the same way as cash for tax purposes in Australia. New legislation passed by Parliament recently seeks to change all of that by removing GST from currency exchanges.

How are cryptocurrencies taxed?

Under GST law, a 10% GST applies to supplies of goods and services. Money receives special treatment because it's a medium of exchange and not something for final private consumption. Up until recently, the Australian Taxation Office (ATO) took the view that cryptocurrencies did not meet the definition of 'money' because they have an independent value rather than being a debt, credit or promise to make a payment, and they don't meet the definition of money under GST law. The impact was that when people used digital currencies as payment, this could trigger GST twice; once on the goods or services being purchased, and also on the supply of the digital currency to the other party. So, the Government has changed the definition of money for GST purposes from 1 July 2017. Now, trades of cryptocurrency are disregarded for GST purposes, unless the trade is for a payment of money or digital currency (for example you are in the business of trading cryptocurrencies). Cryptocurrencies are now taxed in a similar way for GST purposes to foreign currency.

But it's not just GST to consider. Income tax and capital gains tax (CGT) issues might also arise in transactions involving cryptocurrency depending on how and why you are using it.

Individuals trading in cryptocurrencies

If you hold cryptocurrency for your own personal use and you paid $10,000 or less to acquire the digital currency, then there is generally no tax impact when you dispose of the currency. However, if the cryptocurrency is not held for your personal use and enjoyment then there are some tax issues that can arise.

If the cryptocurrency is held as an investment (i.e., not for personal use and enjoyment) or the cost is more than $10,000 then CGT might apply when you sell or exchange the currency. Sometime in Oct 2017 the price of Bitcoin was just under US$6,000 – up from just under US$1,000 at the beginning of 2017 (and just over $13 at the start of 2013). The taxing point for CGT purposes is normally when a contract is entered into. If there is no contract (which is often the case with digital currencies) the taxing point is when ownership changes.

The line between personal use and investment can be very thin. It will be difficult to argue that you hold cryptocurrency for personal use if you use it irregularly to purchase goods and services and you made a large gain from holding and trading it.

Businesses trading in cryptocurrencies

If your business accepts cryptocurrency as payment for goods or services, these payments are treated in the same way as any other. That is, if your business is registered for GST, the price paid by the person paying in the digital currency should include GST. Likewise, if you purchase goods or services for use in your business then you should generally be able to claim GST credits on the transaction in your activity statement, even if you used digital currency to make the purchase.

If you are in the business of trading cryptocurrencies and your business is registered for GST, you charge GST on the exchange of the currency and claim the GST credits in your activity statement. The new legislation does not prevent GST from applying to the supply of cryptocurrencies in exchange for a payment of money or digital currency.

It is also possible that someone could hold cryptocurrency as trading stock if it is held for the purpose of sale or exchange in the ordinary course of a business. Any gains from the trades are then taxed in the business's income tax return (or individual tax return for sole traders). CGT concessions and exemptions are not generally available in this case. If you are in the business of trading cryptocurrencies, that is, you approach the trading in a business-like manner, then you can generally claim losses and other business expenses.

The tax laws can be complex in this area and it's important to ensure that you get the right advice.

Can your SMSF invest in cryptocurrencies?

Arguably, an SMSF can invest in cryptocurrencies but there are several factors to take into account before investing. Cryptocurrencies are a high risk product as they are blockchain driven and unregulated. While there have been numerous stories in the media about massive gains made on the currency by early investors, the price fluctuates, cryptocurrencies face new competitors, and "hard forks" occur - where the blockchain is split and forms a permanent divergence from the original. Bitcoin, for example, has broken into Bitcoin, Bitcoin Cash and now Bitcoin Gold. The danger is that you end up on the wrong fork. There is also the danger of hacker's breaching your fund's digital wallet and stealing your investment.

Trustees of the fund need to ensure that any investment in cryptocurrency is in line with the investment strategy of the fund, the Trust Deed allows for it at the time the investment is made, and it is an appropriate investment. In particular, the sole purpose test in the *Superannuation Industry (Supervision) Act 1993* requires that the fund is maintained for the sole purpose of providing retirement benefits to your members, or to their dependants if a member dies before retirement. Trustees need to ensure that the risk associated to these currencies is in the best interests of the fund. A minute documenting the decision to invest in the cryptocurrency would be beneficial.

For tax purposes, gains and losses in the fund are treated in the same way as other assets in the fund. That is, CGT may apply to any gains made on the sale or exchange of the currency.

If your fund invests in cryptocurrency, there are a few practical issues. Your SMSF auditor needs to confirm the ownership, existence, and value of the cryptocurrency. As a result, the digital wallet for your currency should be in the name of your fund or the corporate trustee. You need to ensure that your personal assets, and the assets of your fund, are kept separate at all times. Once money is deposited into your fund, it may not simply be a case of being able to withdraw these amounts, and they may be 'stuck' in the fund until a condition of release is met, which usually means attaining retirement age. And, you need to be able to trace your transactions to identify trades, the value of the trade, and the time and date they occurred.

Documentation to keep the ATO happy

If you are using cryptocurrencies for whatever purpose, it's important to keep records of the transactions to ensure that if the ATO challenges your tax treatment of the currency, you can prove your position.