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# AUSTRALIAN TAX ALERT

## BITCOIN AND CRYPTO-CURRENCIES: WHY THE GST LAW SHOULD CHANGE

The ATO released a draft ruling on the GST treatment of bitcoin transactions on 20 August 2014. A final version of that ruling, GSTR 2014/3, was released on 17 December 2014. While the ruling deals specifically with bitcoin, the principles set out in the ruling will also be relevant for other crypto-currencies.

Subsequent to the release of the ATO's draft ruling, the Senate initiated an inquiry into Digital Currency. Submissions to the inquiry were due on 28 November 2014 (prior to the release of the ATO's final ruling).

This article summarises the Commissioner's views on the GST treatment of bitcoin transactions. It also summarises the reaction of the Digital Currency industry to those views and the reasons why, in the author's opinion, the GST law needs to be amended to specifically address bitcoin and other crypto-currencies.

### WHAT IS CRYPTO-CURRENCY?

Crypto-currencies may also be referred to as "digital currencies" or "virtual currencies". These

currencies use complex encryption techniques to regulate the issuance and transfer of currency units. Unlike fiat currency, crypto-currencies are not issued by the Australian Government or a foreign government.

Bitcoin is the most well-known crypto-currency. However, there are many others including dogecoin, litecoin and XRP (also known as "ripples").

The Commissioner provides a summary on the workings of bitcoin at paragraphs 40 through 50 in GSTR 2014/3.

For readers interested in more details, the Australian Digital Currency Commerce Association also provides useful guidance on bitcoin transactions on its website >> <http://adcca.org.au/about-dc>.

### THE COMMISSIONER'S VIEW ON BITCOIN TRANSACTIONS

Consistent with the draft ruling, the final ruling makes it clear that in the Commissioner's view:

- Bitcoin is not "money" as that term is defined in s 195-1 of the GST Act; and
- A bitcoin exchange transaction conducted in Australia will not be an input taxed supply under the GST rules relating to foreign exchange transactions (item 9 in Reg 40-5.09(3) of the GST Regulations).

### THE PRACTICAL IMPLICATIONS

For GST registered entities that engage in bitcoin transactions within Australia, the implications of the Commissioner's views are as follows:

- As bitcoin is not "money", a payment for goods or services using bitcoin is a barter transaction and a taxable supply that is subject to GST. In contrast, payments involving fiat currency are exempt as "money" and do not trigger a GST liability (s 9-10(4) of the GST Act).
- An entity that exchanges a bitcoin for Australian or foreign currency in Australia is making a taxable supply that is subject to GST. In contrast, foreign exchange transactions are an input taxed supply and exempt from GST.

Critically, the GST outcomes are very different for cross border transactions:

- The supply of a bitcoin (either as a payment or part of an exchange transaction) to a non-resident entity that is outside of Australia should be a GST-free supply (item 2 in s 38-190(1) of the GST Act).
- As a bitcoin is not a tangible good, the purchase of a bitcoin from a non-resident entity will not be a taxable importation (Div 13 of the GST Act).

Of course, GST will not apply to bitcoin payment or exchange transactions where the entity supplying the bitcoin is not GST registered, or required to be GST registered.

### THE GROWING DIGITAL CURRENCY INDUSTRY

The acceptance of crypto-currencies as an alternative to fiat currencies has steadily increased in recent months. By way of example, one of the largest companies to accept bitcoin payments (from US customers) is Dell Computers. Dell states that

it accepts bitcoins for the following reasons (see <http://www.dell.com/learn/us/en/uscorp1/campaigns/bitcoin-marketing>):

*"Bitcoin is a new payment option intended to offer even more flexibility for customers. Bitcoin payments can be made easily from anywhere in the world, and offer reduced payment processing costs."*

This increased acceptance has created new opportunities for bitcoin "gateway" businesses in Australia and elsewhere. Such businesses include bitcoin exchanges (including bitcoin ATM operators) and bitcoin payment facility providers.

### REACTION TO THE COMMISSIONER'S VIEWS ON GST

The Commissioner's views on the GST treatment of bitcoin transactions have not been well received by the Digital Currency industry. There have been two principal concerns:

- Firstly, some "bitcoin exchanges" operate by purchasing and selling bitcoin as principal (as opposed to matching third party buyers and sellers). For Australian based exchanges, this model is no longer viable. A local exchange that sells a bitcoin to an Australian customer is liable for GST, whereas a non-resident exchange that sells a bitcoin to an Australian customer is not liable for GST. This creates a pricing disparity and encourages Australian customers to buy bitcoins from overseas exchanges in preference to local exchanges.
- Secondly, confusion about the differences in the GST treatment of bitcoin transactions as compared to fiat currency transactions may discourage local businesses from accepting bitcoin payments for goods or services. This could further hamper growth of the local Digital Currency industry.

As a result of the Commissioner's views on GST, Australia's largest bitcoin exchange, CoinJar, has recently relocated its business operations to London. Prior to its relocation, 32,000 Australian customers were using CoinJar's services and the company had processed AUD \$50 million in bitcoin exchange transactions (UK lures Bitcoin firm offshore. *Australian Financial Review*, 2 December 2014, page 20).

In its submission to the recent Senate Inquiry, CoinJar stated ([http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Digital\\_currency/Submissions](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Digital_currency/Submissions)). See Digital Currency Submission No 12, page 8):

*"The current Australian Taxation Office's guidance that Bitcoin gateway companies charge customers GST has rendered us uncompetitive against non-Australian rivals."*

## THE SENATE INQUIRY INTO DIGITAL CURRENCY

In mid-October 2014, the Senate initiated an inquiry into digital currency. The Senate Economics References Committee is due to report to the Senate on the inquiry by the first sitting day in March 2015.

While the scope of the inquiry is broad ranging, it is focussed primarily on regulatory issues. Tax and GST issues were not expressly mentioned in the terms of reference for the inquiry.

Notwithstanding this, of the 45 submissions that the Committee received, 21 make reference to the GST treatment of bitcoin. This highlights the importance of the GST treatment of bitcoin transactions for the Digital Currency industry.

Some of the submissions that referred to GST disagreed with the Commissioner's views (as set out in the draft ruling) and called for the Commissioner's views to change in the final ruling. Further, the ATO also directly received submissions during the consultation period for the draft ruling. Nonetheless, the Commissioner's views did not change when the final ruling was released.

Other submissions to the Senate inquiry accepted the Commissioner's views and instead called for the GST law to be amended.

## WHAT IS THE BASIS FOR THE COMMISSIONER'S VIEW?

Put most simply, the Commissioner is of the view that bitcoin is not "money" as defined in the GST Act on the basis that bitcoin is not fiat currency issued by the Australian Government or a foreign government.

An alternative view (raised in a number of submissions to both the Senate inquiry and ATO) is that the definition of "money" in the GST Act is not restricted to fiat currency, but includes anything that may be recognised as "money" at law. The Commissioner does not accept this alternative view.

In relation to foreign exchange transactions, item 9 in Regulation 40-5.09(3) of the GST Regulations provides that the supply of an interest in "Australian currency" or "the currency of a foreign country" is input taxed and not subject to GST.

Again, the Commissioner is of the view that because bitcoin is not "Australian currency" or the currency of a "foreign country", it does not meet the foreign exchange exemption requirements.

Some critics have argued that if a foreign country decides to accept bitcoin as its currency, the Commissioner would need to reconsider his view on the above issues.

## IS THE COMMISSIONER CORRECT?

I personally agree with the Commissioner's views. However, those views do not produce desirable outcomes for the Digital Currency industry and the GST law should be amended as result. Of course, that is a separate policy matter for Government and outside the remit of the Commissioner.

In particular, I agree with the Commissioner's view that the definition of "money" in the GST Act does not extend beyond fiat currency. This should not be surprising given that the most popular cryptocurrency, bitcoin, was not released as open-sourced software until 2009. The GST Act was introduced into Parliament as a Bill in 1998 - well before crypto-currencies were a reality.

If the Commissioner accepted that the definition of "money" extends beyond fiat currency, in the absence of an express provision to that effect, this would open the way for other things to be treated as "money" (and therefore exempt from GST when used to make a payment).

For example, in its submission to the Senate Inquiry, Ripple Labs Inc stated that its payment protocol "enables free and instant payments in any currency - including... loyalty points" (see Digital Currency Submission No 21, page 4).

Presently, GST applies to a supply of loyalty points in Australia that is made for consideration. If a

practice was to develop of loyalty points being used to make payments for goods or services, would it be the right policy outcome for loyalty points to instead be viewed as "money" and therefore exempt from GST?

I do agree that the Commissioner would need to revisit his views (in relation to both the definition of "money" and the foreign exchange rules) if bitcoin does ever become the currency of a foreign country. However, even if that were to occur, it would only potentially address GST issues for bitcoin. It would not resolve the GST issues for the plethora of other crypto-currencies which are not the currency of a foreign country.

### **AMENDMENT OF THE GST LAW**

In my view, the GST law should be amended to exempt crypto-currency transactions. This is principally for the following reasons:

- Due to the global nature of crypto-currencies, applying GST to transactions that occur within Australia will generate little (if any) revenue. Rather, transactions can readily be structured to occur on a cross-border basis so that GST does not apply.
- The current GST rules disadvantage Australian Digital Currency businesses, causing businesses to relocate offshore. While such businesses are presently a very small part of the economy, it is nonetheless desirable to retain those businesses in Australia for employment and skill development reasons.
- The growing acceptance of crypto-currencies as an alternative to fiat currency appears set to continue. There is no compelling reason why such currencies should not be treated in the same manner as fiat currencies for GST purposes.
- Introducing specific amendments for crypto-currencies limits the risk that other things, such as loyalty points, could be viewed as "money" (as defined in the GST Act) and exempt from GST when used to make a payment.

### **IMPLICATIONS OF THE OECD VAT GUIDELINES**

It is interesting to note that on 18 December 2014, the OECD released discussion drafts of 2 additional

elements of the OECD's VAT Guidelines. One of those elements relates to supplies of services and intangibles by a non-resident supplier to a consumer. The draft guidelines recommend the adoption of the "destination principle", which would see services and intangibles subjected to GST in the country where customers are located (rather than where the supplier is located). If those guidelines were to be adopted in Australia, and the GST treatment of crypto-currencies is not resolved first, this could result in non-resident suppliers (such as non-resident exchanges) becoming liable for GST on sales of bitcoins and other crypto-currencies to Australian customers. This could further detrimentally impact the acceptance of bitcoin in Australia (with flow-on implications for associated businesses in Australia).

### **SHOULD DOMESTIC CRYPTO-CURRENCY EXCHANGE SERVICES BE GST-FREE?**

An issue which was not raised in any of the submissions to the Senate Inquiry is whether domestic crypto-currency exchange transactions should be treated as a GST-free supply (if the Government decides to amend the GST law).

Treating domestic crypto-currency exchange transactions as an input taxed supply would provide consistency with domestic foreign exchange transactions. Local businesses that engage in input taxed foreign exchange transactions are not entitled to full input tax credits for GST incurred on business expenses (such as rent and other overheads).

If domestic crypto-currency exchange transactions are treated as GST-free supplies, full input tax credits would be available for GST incurred on business expenses associated with those transactions.

On one view, this would provide crypto-currency exchanges with a GST advantage not available to foreign exchange businesses.

Nonetheless, treating domestic crypto-currency exchange transactions as a GST-free supply may assist in attracting Digital Currency businesses to Australia. Unlike traditional foreign exchanges businesses which require some local presence (at least for physical cash sales), crypto-currency exchanges can readily operate from outside of Australia. If business costs are lower in a foreign

jurisdiction (as a result of full VAT / GST credits being available for business expenses), there may be little incentive for exchanges to operate locally in Australia if full credits are not similarly available here.

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