27 September 2022

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

To the Board,

Comment on the Review of the Tax Treatment of Digital Assets and Transactions

We write to provide our feedback and recommendations on the current tax issues arising from the crypto economy.

We are a group of tax practitioners, lawyers and academics seeking to advocate for the tax profession in respect to the uncertainty and challenges faced by the developments occurring within the digital economy.

Our attached feedback is set out in two parts. Firstly, we outline broad reflections on the tax treatment of digital assets and transactions. We then provide a compilation of specific responses to the Board of Taxation's (BoT) consultation questions outlined in the August 2022 Consultation Guide. We also include as an appendix a recent submission made by Joni Pirovich to the UK HMRC Call for Evidence on the taxation of DeFi involving lending and staking of crypto assets.

If you have any concerns or questions, please contact Elizabeth Morton by email at Elizabeth.morton@rmit.edu.au.

Yours faithfully,

Members of the tax profession
Dr. Elizabeth Morton, RMIT Blockchain Innovation Hub.
Ms. Lisa Greig, Perigee Advisers.
Mr. James Carey, Prime Partners.
Ms. Veronika Komarenko, Optimize Business Advisory.
Ms. Maryna Kovalenko, Kova Tax.

Acknowledgement is also given to the following contributors
Ms. Joni Pirovich, Blockchain & Digital Assets Pty Ltd.
Mr. Shane Brunette, CTC Ledger Pty Ltd.
Mr. Devan Bishop, MGI Dobbyn Carafa.
Mr. Rafael Franco, Tax On Chain.
Mr. Nicholas Christie, Syla.

1. Broad Reflections on the Tax Treatment of Digital Assets and Transactions

1.1 Token mapping: property, currency, equity, or debt

Recognising the broad nature of regulatory reform and consultation being considered in respect to blockchain technology, there is a clear need to consider the token mapping exercise being carried out to consider how that will impact the application of existing tax laws and whether tax reform should be taken in step with broader regulatory reform, or earlier or later.

We need a sound legal position on (1) token characterisation and (2) decentralised entity characterisation to appropriately determine the tax treatment on behalf of taxpayers for a dynamic crypto / digital economy. Without this initial framing, any tax reform will not be helpful in easing the advice and compliance burden, nor sustainable.

At the time of writing, a token mapping exercise has been flagged by the Government.[1] Whilst the Hon Jim Chalmers and The Hon Dr Andrew Leigh indicated that such an exercise had not been done elsewhere, we highlight that the United Kingdom undertook a token mapping exercise of sorts in 2019[2] to provide clarity on the Financial Conduct Authority's (FCA) regulatory perimeter that could serve as an initial foundation. The categories of cryptoasset identified in the FCA's work were exchange tokens, utility tokens and security tokens which can each be used as a means of exchange, for investment or to support capital raising and/or the creation of decentralised networks. The FCA's work did not go into the rights and obligations represented by tokens generated from interactions with blockchain-based protocols such as Maker, Compound or Aave, which can also represent liabilities or encumbrances over tokens.

As such, we highlight the need for:

- Consideration to be given to both asset and liability characteristics of tokens.
- Consideration to be given as to the characterisation of the issuer, e.g., DAO.
- Consideration should be given to alignment or non-alignment with other regulatory frameworks, including accounting standards under the conceptual framework and the AFSL regime.[3] We note the current discussion at international levels to depart from international accounting standards on the basis that the accounting treatment of tokens is not being prioritised by those bodies such that accounting standards will not reflect the economic reality of token activities or holdings.

More recently, the UK *Law Commission* proposed a third category of property, described as distinct from 'things in possession' and 'things in action'. This third category instead focuses on *data objects* that meet certain criteria thus recognising idiosyncrasies within the technology.[4]

[1] Hon Dr Jim Chalmers and Hon Dr Andrew Leigh, 'Work underway on crypto asset reforms', (Media Release, 22 August 2022) <https://ministers.treasury.gov.au/ministers/stephen-jones-2022/media-releases/work-underway-crypto-asset-reforms>.

[2] See Financial Conduct Authority, 'PS19/22 Guidance on Cryptoassets Feedback and Final Guidance to CP19/3' (Online, July 2019) <https://www.fca.org.uk/publication/policy/ps19-22.pdf>.

[3] A number of submissions to the CASSPr consultation made reference to these issues, including the submission by Joni Pirovich and by members of the RMIT Blockchain Innovation Hub. These can be supplied on request.

[4] Law Commission, 'Digital Assets: Consultation Paper' (Online, Law Com No 256, 28 July 2022) <https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2022/07/Digital-Assets-Consultation-Paper-Law-Commission-1.pdf>.

If Australia took the same approach, this could allow for not only a new CGT event or CGT asset category,[5] but instead allow for a distinct regime for token realisation events outside of the debt equity rules, foreign currency and CGT regimes.

It is recognised that this represents a significant approach to tax reform, and there is an immediate need for increased certainty for tax practitioners and taxpayers in meeting their compliance obligations.

1.2 Self-lodgement system principles

The tax system in Australia operates on a self-assessment basis. The onus is on the taxpayer, aided by data capturing through the prefill report. Whilst tax compliance can be completed through tax agent services, an increasing number of taxpayers lodge their own return using myTax.[6]

A significant barrier to compliance is the complexity and uncertainty in the rapidly evolving digital economy. There is a real and increasing risk of taxpayer non-compliance. Contemplating the sentiment of Adam Smith,

> *The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt.*[7]

The risk characteristics differ between individual taxpayers and wholesale/institutional participants. We press upon the need to consider the characteristics of (1) those lodging their own tax returns with small quantum of exposure and (2) those significantly involved in the crypto economy.

Recognition is needed of the level of expertise / understanding of complex tax law and the potential for youth or the inexperienced to be participating in the online activities, such as GameFi as monetising a leisure activity or gambling as a game of chance.

Even when lodging through a registered tax agent having knowledge and skill in digital assets, the time required to comply with tax laws may exceed the resultant tax liability or loss for the taxpayer in meeting their self-assessment obligations.

Any reform contemplated should be directed at ensuring the continued simplification and convenience of the lodgement process, whilst ensuring rights, equity and fairness are maintained.

Overall, there is a core education problem that needs to be attended to in combination with any tax reform proposed/enacted. This education relates to all key stakeholders: taxpayers, tax practitioners, and the tax authority itself.

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[5] As outlined in the Select Committee on Australia as a Technology and Financial Centre, 'The Senate Select Committee on Australia as a Technology and Financial Centre' (Final Report, October 2021) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/AusTechFinCentre/Final_report>.

[6] For example, see the discussion in Philip King, 'Shift away from tax agents "holds pitfalls for crypto, gig workers"', *Accountants Daily* (Online, 11 August 2022) <https://www.accountantsdaily.com.au/tax-compliance/17403-shift-away-from-tax-agents-holds-pitfalls-for-crypto-gig-workers?utm_source=Accountants%20Daily&utm_campaign=11_08_22&utm_medium=email&utm_content=1&utm_emailID=9968c2e857ba1094968c49b803f4d49946bfd356077f48450708791bf05822d0>.

[7] Adam Smith, *The Wealth of Nations* (W. Strathan and T. Cadell, London, 1776).

1.3 Tax policy objectives

Tax should not in principle distort market behaviour unless there is a clear policy objective for incentivising or disincentivising. The Australian government has an opportunity for positive economic reform and global leadership (or at least keeping pace with progressive jurisdictions like the UK) in an increasingly digitalised economy.

We are concerned that the current system does not have sufficient neutrality in respect to the crypto-economy and therefore entrepreneurship and innovation is at risk of moving offshore.[8] We are also concerned that in an increasingly digitalised economy, blockchain technology offers digital alternatives to traditional counterparts; however, they do not yield sufficiently equivalent tax treatment.

Consideration should be given to the benefits of blockchain technology, including its capacity for transparency and scrutiny as well as commodification,[9] that not every transaction ought to represent an onerous taxing point.

As such, the BoT should recognise that as well as an education problem, there is a need to ensure tax obligations are not obscure, nor inappropriate. We also recognise that any tax reform should not shift the imbalance or distortion into a counter position, that could lead to inequality in considering the off-chain equivalents activities. Neutrality should consider both on-chain and off-chain burdens and benefits.

We do recognise, however, that there needs to be adequate consideration of both harm to taxpayers[10] as well as the risk to the revenue base of the Government.

1.4 Practicality of reform and guidance

The Government, particularly the Australian Taxation Office (ATO) in respect to administering the tax system, needs to recognise the difficulties that arise in lagging reform and lagging guidance, as well as guidance issued too quickly without consideration of the full facts of the scheme or consultation with developers and industry experts.

These can have a detrimental impact to the effectiveness and efficiency in compliance, which in turn can have negative consequences to taxpayer's (tax practitioners) meeting their obligations under the tax law (TASA Code of Professional Conduct).

We have already observed in recent times the resources that can be wasted through adjustments to tax returns with respect to changing prefill data. For example, in July 2022 it was reported that:

[8] Regarding Australia's global competitiveness, see the Select Committee on Australia as a Technology and Financial Centre (n 5).

[9] See for example, Elizabeth Morton and Michael Curran, 'Understanding Non-Fungible Tokens and the Income Tax Consequences' (SSRN Paper, 12 April 2022) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4174666>.

[10] See Aaron M. Lane, 'Crypto theft is on the rise. Here's how the crimes are committed, and how you can protect yourself', *The Conversation* (Online, 3 February 2022) <https://theconversation.com/crypto-theft-is-on-the-rise-heres-how-the-crimes-are-committed-and-how-you-can-protect-yourself-176027>.

> *…12,000 returns had to undergo manual review by a compliance officer while 170,000 had been amended before a notice of assessment could be issued.*[11]

The reasons relating to these adjustments include data availability in prefilling. Thus, this can be described as a process/timing mechanism creating an inefficiency issue.

For the crypto economy, challenges are much more complex and nuanced. Appreciation is needed for tax practitioners / taxpayers seeking clarity of more complex and unusual issues arising from crypto activities.

The quality of the data accessed by the ATO has a level of uncertainty and cannot be relied upon. Data matching has been based on name only and not attributed to the correct taxpayer. Belated certainty in this space is likely to see much greater impacts to efficiency and effectiveness of the self-lodgement system. The ATO has taken the position of querying any discrepancies based on a standard treatment compared with the taxpayer self-assessing their exposure based on current available information and a reasonably arguable position.

Moreover, the ATO needs to be mindful of their responses to where tax practitioners and taxpayers may ultimately get it "wrong" or where their position is inconsistent with the ATO's interpretation whilst clarity lags. On this point, we highlight our earlier statement that there is an education problem. In this respect, the focus on administration should be educational rather than punitive unless there is evidence of intentional, undesirable behaviour.

It is important to recognise the cost / benefit of tax compliance for the crypto economy. The cost of tax practitioners ensuring their clients comply with their tax obligations in the crypto economy are substantial and do not always reflect the magnitude of tax burdens arising from crypto activities. Tax practitioners therefore face challenges in the feasibility of providing these services and of clients having access to appropriate services.

On this point, the BoT should consider whether a threshold be established to ensure any burden is appropriate and reflects appropriately the benefits flowing to the Government.[12] The $250,000 limited balance election for one or more digital wallets could be useful here, and with minor modifications could permit a threshold of token activity without need for tax calculations and in so doing ease the compliance burden.

Finally, it must be recognised the impact of focusing on web guidance as opposed to formal rulings. Formal guidance is limited to the set of determinations released in 2014. Whilst web guidance is increasing and the Government has flagged clarity over bitcoin and foreign currency, only the taxation determinations are binding on the Commissioner and only the binding section at that (which is limited).[13] Moreover, the changing, iterative nature of web guidance creates concern over the audit trail (version history) and transitoriness of ATO positioning over time. These factors have profound implications for both tax practitioners' and taxpayers' confidence in the tax system.

[11] Philip King, '180k July returns needed fixing, says ATO', *Accountants Daily* (Online, 22 August 2022) <https://www.accountantsdaily.com.au/tax-compliance/17443-180k-july-returns-needed-fixing-says-ato?utm_source=Accountants%20Daily&utm_campaign=22_08_22&utm_medium=email&utm_content=1&utm_emailID=9968c2e857ba1094968c49b803f4d49946bfd356077f48450708791bf05822d0>.

[12] In this regard, this is comparable to the issues raised and discussed in the Select Committee on Australia as a Technology and Financial Centre (n 5), including the submission by academics at the RMIT Blockchain Innovation Hub.

[13] TAA 1953, s257-60 Schedule 1.

An example of this is the recent changes to web guidance for airdrops made on 7 September 2022. This can have a fundamental impact on the tax obligations for taxpayers[14] and therefore create efficiencies similar to those described for recent prefilling events described above. Critically, these changes were not communicated via any standard ATO mechanisms and do not have a clear version history to refer back to. The QC number remains the same, with an updated date of last modification. This exemplifies the challenge in balancing the provision of necessary guidance in a timely manner whilst acknowledging the administrative practicalities.

Any reform / guidance should be practical to apply and consider issues such as:

- Practicality of complying.
- Deadlines for compliance.
- Record keeping and data capture capabilities.
- Retrospectivity and grandfathering.
- Safe harbour for reasonably arguable positions, noting the lack of case law precedent to develop a proper reasonably arguable position paper.
- The binding nature of guidance on the Commissioner.
- The changing blockchain landscape.
- Resourcing constraints.

2. Specific Responses to Consultation Questions

Current tax treatment of crypto assets

1. Is the current tax treatment of crypto assets clear and understood under the Australian tax law? If not, what are the areas of uncertainty that may require clarification?
2. Do crypto assets and associated transactions feature particular characteristics that are 'incompatible' with current tax laws? If yes, what are these and why are they incompatible?

Recent research indicates that tax practitioners are generally concerned with the current tax law, current tax guidance as well as pre-filling data. There are challenges with respect to balancing time and value; reliability and availability of information; capacity for clients to provide adequate information and substantiation requirements. Consequently, there are real risks with complying with the Code of Professional Conduct.[15]

There is currently a lack of clarity and understanding on how the law applies to crypto-economic activity. Importantly, there is a need to recognise that there are differing perspectives of how the law applies across numerous stakeholders within and/or connected with the tax profession. These include:

- Taxpayers and categories of taxpayers.
- Tax practitioners.
- Tax administrators (i.e., ATO).
- Other stakeholders.

[14] Harrison Dell, 'New airdrop tax guidance in Australia', *Crypto Tax Calculator* (Blog, September 2022) <https://cryptotaxcalculator.io/blog/new-guidance-airdrop-tax-australia/>.

[15] Elizabeth Morton, Gillian Vesty, Lan Nguyen and Ken Devos, 'The crypto-economy and tax practitioner competencies: An Australian exploratory study' (Working paper, 2022). Further details of this can be provided on request.

We raise the concern that current guidance being produced does not demonstrate sufficient contemporary understanding of the crypto economy. We are concerned that this results in positions that may be interpreted as too conservative, and too aggressively defended by the Commissioner, resulting in potentially onerous or inappropriate outcomes, or too broad lacking nuance of particular facts and circumstances, thus creating room for argument and therefore uncertainty.

It is not practical to list all areas of uncertainty arising from the different characteristics in the crypto economy in this submission, however, of note are issues such as:

i. Bitcoin as a foreign currency
ii. Revenue v. capital characterisation of activities
iii. Airdrops
iv. Characterisation of protocol activities (DeFi, staking, LPs etc.)
v. Wrapping and bridging
vi. Ethereum staking rewards and the tax implications of the merge
vii. Characterisation of Non-Fungible Tokens (NFTs) - Collectables and Personal Use Assets
viii. Crypto activities and GST
ix. Crypto used in gambling

We also refer to our initial reflection at item 1.1 in that token characterisation and decentralised entity characterisation will fundamentally impact the tax implications of crypto activities. In the following subsections we outline examples of problems with the current tax law, however this is not exhaustive, nor does it cover all the evolving crypto economy.

We urge the BoT to consider that often it is not the label (e.g., 'airdrop', 'staking') that is critical, but the underpinning asset or activity that may garner an understanding of the tax treatment which often goes back to the characterisation of the DAO referable to the token or token activity. Black and white interpretations based on labels may lead to distortions. This is true in other areas of tax law in relation to contentious issues such as employer v. contractor, debt v. equity etcetera.

Moreover, underpinning many of the issues that arise are concerns over valuation, particularly in combination with high volatility. Australian tax is only reported and paid in Australian dollars, although other jurisdictions are moving towards receiving digital tokens for payment for government services.[16]

i. Bitcoin and foreign currency

Whilst the Government has announced that clarification in the legislation will be made to ensure crypto assets are not regarded as foreign currency,[17] we raise the concern over whether the Government should be awaiting the BoT report before proceeding with the proposed amendment. We also refer back to our initial point of reflection at point 1.1 with respect to mapping tokens.

We do agree that there needs to be prompt action and clarity and this proposed change offers an iterative approach to clarifying the tax implications with respect to the reach of crypto activity and

[16] Turner Wright, 'CA lawmaker introduces legislation to accept crypto as payment for govt services', *Cointelegraph* (Online, 21 February 2022) <https://cointelegraph.com/news/ca-lawmaker-introduces-legislation-to-accept-crypto-as-payment-for-govt-services>.

[17] See for example, Hon Dr Jim Chalmers and Hon Stephen Jones, 'Crypto not taxed as foreign currency' (Media Release, 22 June 2022) <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/crypto-not-taxed-foreign-currency>.

the foreign currency regime given the events since the AAT decision *Seribu Pty Ltd and Commissioner of Taxation (Taxation) [2020]* AATA 1840.[18]

The Exposure Draft reflects the Government's acknowledgement that the events internationally, beginning with El Salvador, does raise the possibility that Bitcoin could be interpreted as meeting the definition of foreign currency in the ITAA97.[19]

The Exposure Draft does not clearly outline the policy goals it aims to achieve by this amendment. Whilst clarity is stated as a purpose of the Exposure Draft, the reasons for requiring clarity are not dealt with in the explanatory material. Further work and modelling should be presented to the public regarding the potential tax revenue gained or lost because of this Exposure Draft.

In addition, we raise attention to the Government approach to return to the status quo established in the 2014 tax determinations. The proposed amendment includes the power to prescribe regulations to exclude further currencies from the definition of foreign currency.

Whilst the use of regulations offers a mechanism to be flexible, agile and proactively in managing an ever-changing digital environment, such an approach comes with the risks or concerns of appropriate power and control, political bias and appropriate expertise driving changes.[20] The construction of this power is also a power only to be *exclusionary* rather than *inclusionary*, so may be limited in enabling positive changes in the crypto economy.

It also raises the question over whether every relevant section of the ITAA97/ITAA36 will be amended to include such an equivalent power? This is arguably inefficient and even be perceived as inappropriate. There is a real risk of, not only over complicating the tax system and creating a revolving door of prescribed treatment but creating a constant level of temporality in how the law operates. This may result in concerns over the administration and compliance burden.

This also leads to an overarching concern of the imbalance away from tax principles established by the judiciary v. the legislature. It is neither timely nor cheap to proceed to litigation or for a particular client or the industry to gather resources to lobby for the regulation-making power to be used.

If this approach is taken, we propose that an independent body or forum be established to ensure appropriate balance is maintained, including appropriate consultation and experts are brought together to achieve positive outcomes.

[18] See for example, Elizabeth Morton, 'Creating certainty: crypto will not be foreign currency' *RMIT Blockchain Innovation Hub* (Blog, 23 June 2022) <https://rmitbih.substack.com/p/creating-certainty-crypto-will-not>.
[19] *Treasury Laws Amendment (Measures for Consultation) Bill 2022: Taxation Treatment of Digital Currency* Exposure Draft Explanatory Materials.
[20] As has been found in relation to giving the relevant Minister legislative instrument power to supplement the TASA Code of Conduct pursuant to TPB Review recommendations examined in recent work by Ken Devos, Elizabeth Morton, Michael Curran and Chris Wallis, 'Tax Practitioner Perspectives on selected 2019 TPB Review Recommendations' (Working paper, 2022). Further details of this can be provided on request.

ii. Revenue v. capital characterisations

In recent times, the ATO has emphasised a purported dichotomous characterisation of crypto activities by taxpayers as falling within either the CGT regime or being characterised as part of carrying on of a business.

As has been raised by our peers in the profession previously, we raise our concern over this view.[21] As highlighted by the profession, crypto activity gains or losses can be on revenue account but not forming part of a business operation and may be best to be seen as an isolated profit-making transaction.[22]

We urge the BoT and the ATO in administering tax law and guidance that a more accurate position be portrayed of the range of possible characterisations reflective of unique taxpayer facts and circumstances. Whilst we recognise that such statements offer the perception of increased certainty, they lack the nuance of reality and thus lack resolution of more practical issues that arise from those activities, such as the *timing* of income derivation and valuation issues (particularly with respect to volatility and abstraction away from the Australian dollar).

We also raise the concern that this distinction focuses on the comparison to share trading activities. We urge the BoT to recognise the creative industries developing within the crypto economy, thus what constitutes a business in the arts and sporting setting is distinct from the threshold of activities required for share trading.[23] Such creative industries have previously been afforded exemptions under tax laws such as income averaging or more generous non-commercial loss criteria.

Moreover, consideration should be given to the consequential asymmetric treatment (e.g., revenue account for gains and capital account for losses in certain circumstances with no actual realisation back to fiat currency). This arises for activities relating to airdrops[24] and staking, for example. With the volatility that can occur within this space, this can lead to problematic outcomes for taxpayers.

iii. Airdrops

Clarification of the scope of airdrops that result in (1) assessable income on receipt and (2) CGT asset acquisition. We are concerned that the ATO focuses on specific instances of airdrops and makes broad statements as to the tax implications not reflective of the unique facts and circumstances of particular taxpayer activities.[25]

The current treatment creates asymmetries that can be detrimental to taxpayers in a volatile economy and furthermore create valuation issues (of which have been outlined in this submission already). We also highlight that these airdrops can be scams and forcing a compliance burden on taxpayers unnecessarily exposes them to further harm for example by clicking on malicious websites to understand the nature the token that has been airdropped.

We urge the BoT to consider the definition and scope of what constitutes an airdrop in this respect, therefore recognising that not all airdrops are equal. For example, judicial precedent would suggest

[21] See for example, John Jeffrey's, 'Profit motive puts crypto trades on revenue account', *AccountantsDaily* (Online, 2 July 2022) <https://www.accountantsdaily.com.au/tax-compliance/17228-profit-motive-puts-crypto-trades-on-revenue-account?utm_source=Accountants%20Daily&utm_campaign=02_07_22&utm_medium=email&utm_content=1&utm_emailID=9968c2e857ba1094968c49b803f4d49946bfd356077f484507>.
[22] Ibid. As highlighted in key precedent such as the *Myer Emporium* case as applied in *Greig*.
[23] See the discussion in Elizabeth Morton and Michael Curran (n 9).
[24] See for example, Elizabeth Morton, 'Is the receipt of an airdrop always ordinary income?' *RMIT Blockchain Innovation Hub* (Online, 14 July 2022) <https://rmitbih.substack.com/p/is-the-receipt-of-an-airdrop-always?s=r>.
[25] Ibid; Harrison Dell (n 14).

that some airdrops would not amount to ordinary income as are nor reward for services, instead be considered gifts.[26] The COALA DAO Model Law proposes that a person should only be considered a member of a DAO if they have actively engaged with any airdropped tokens referable to the DAO – if there is no engagement a person cannot be said to suffer any consequences from involuntary receipt of tokens especially when a person is unable to block or permission incoming tokens to their public address.

There are a number of ways in which airdrops could be treated for tax purposes as highlighted in other jurisdictions. Arizona for example is beginning to exclude airdrops from taxable income on receipt and treat the appreciation thereafter as taxable.[27] Similarly, in the UK there is a clear distinction in treatment based on whether the taxpayer has undertaken any activity. However, the issue with this approach is the clarity needed over the degree to which the taxpayer must do something for it to be taxable. Furthermore, NFTs that are airdropped cannot be 'part sold' in order to have an amount reserved on account of tax if the NFT airdrop is subject to tax.

Whilst the guidance update on 7 September goes some way towards improving (clarifying?) the tax treatment with the aim to provide more certainty, there is still concern over key definitions. For example, in the current guidance there appears to be overlap with initial coin offering (ICO).[28]

iv. Characterisation of protocol investing (DeFi, staking, LPs etc.)

Clarification and certainty are needed over characterising investments of crypto assets into blockchain protocols. Protocols are not homogenous, raising variations in determining whether the tokens invested are disposed of at the time of investment, as well as timing of revenue derivation arising from the investment and characterising the return of tokens once withdrawn from the protocols.

Consideration over the substance over form leads to comparisons with lending arrangements, with term deposit arrangements etc.

As Dell and Simon note,

> *There appears to be a misconception among many tax advisors, commentators, and the ATO that passive-yield bearing activities always operate as 'staking' mechanisms. In reality however, DeFi protocols are becoming more complex, and many protocols now offer a variety of different passive-yield functions that operate with fundamental different mechanisms.*[29]

[26] See for example, *Scott v FCT (1966)* 117 CLR 514 as compared to *Brown v FCT (2002)* 49 ATR 301 as discussed in Elizabeth Morton and Michael Curran, 'Crypto-donations and tax deductibility' (2021) 25(2) *The Tax Specialist* 54.
[27] See the following discussion: Re Roger M Brown in Elizabeth Morton (LinkedIn) <https://www.linkedin.com/posts/elizabeth-morton-aa713948_az2022-hb2204-activity-6952841037778231297-7yU5/?utm_source=linkedin_share&utm_medium=member_desktop_web>.
[28] 'Staking rewards and airdrops' *Australian Taxation Office* (Online, 7 September 2022) <https://www.ato.gov.au/Individuals/Investments-and-assets/Crypto-asset-investments/Transactions---acquiring-and-disposing-of-crypto-assets/Staking-rewards-and-airdrops/>.
[29] Harrison Dell and Patrick Simon, 'A clinic on Australian tax on staking rewards - A Post Mortem of Anchor Protocol' *LinkedIn* (Online, 17 August 2022) <https://www.linkedin.com/pulse/clinic-australian-tax-staking-rewards-post-mortem-anchor-/?trackingId=azYyb868S%2Bu3NxlZjcGB5A%3D%3D>.

Guidance needs to be more than just is it assessable, but also when is the point of derivation?

One recommendation could be that each DeFi protocol requires a class ruling to confirm the tax treatment. However, this is not a practical solution given the dynamic and global reach of activities, the speed at which the crypto economy operates as well as the multitude of potential classes of taxpayers participating. Simply put, there are too many classes, products, jurisdictions, and therefore hypothetical elements to apply existing processes of class ruling.

As such, we propose that a set of guiding principles be established to aid taxpayers and tax practitioners to interpret the most appropriate tax treatment. These principles ought to be underpinned by principles of a good tax system, in particular equity, simplicity and ultimately aimed at promoting compliance.

This would take into account the bundle of rights across the tokens invested, the DeFi protocol and outcomes. For example:

- If an ongoing connection with the original token can be demonstrated, a disposal or cancellation at the outset should not be recognised irrespective of for example when burning occurs and/or the taxpayer ultimately withdraws an equivalent asset rather than the exact token.[30]
- Clarify when and why a split, change or merging of an asset would occur and the consequential impact on cost base(s).
- Establishment of principal/return components, i.e., determination of derivation of income in respect of value and timing.
- Applicability of bare trustee entitlements, particularly with respect to characterisation of the decentralised application. Issuer characterisation is critical (clarification of whether a DAO would be considered a trustee / bare trustee).
- Applicability of withholding and/or other taxes.
- Consider options such as roll over or deferral of taxing points.

v. Wrapping and bridging

The ATO guidance indicates that wrapping/bridging crypto assets results in the disposal of the original (unwrapped) assets and an acquisition of the newly created assets (wrapped).

For example, ETH can be wrapped to create wETH. The purpose of this process is to enable the ETH to be compatible in the crypto-economy (ERC20 standard) and does not result in a change of value and can be unwrapped at any time.

We are concerned with the aggressiveness of the ATO position on these activities triggering CGT events. Whilst we agree that in many instances these activities will amount to a disposal, depending on the characteristics of the crypto asset pre and post transfer/wrapping and other factors such as holder, we argue that this is not a blanket proposition for all bridge/wrapping activities.

[30] I.e., beneficial interest is demonstrated. See in particular considerations of absolute entitlement in *TD 2004/D25 Income tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997*. See also for example, interpretations on parcel selection in PBR 5010050043171, PBR 1051545007826; TD 33 – Capital Gains: How do you identify individual shares within a holding of identical shares?; *TR 96/4 Income tax: valuing shares acquired as revenue assets*.

Such an interpretation would disadvantage the blockchain economy compared to the traditional internet businesses that integrate with payments platforms. An action such as wrapping or bridging to make the token software compatible with another blockchain should not give rise to a tax event.

vi. Ethereum staking rewards and "the Merge"

Proof of Stake (PoS) networks, for example Cosmos, mint additional coins in order to secure the network. These are distributed to those who stake with validators on the network. The ATO guidance suggests that staking rewards are on revenue account. This is distinct from their position of Proof of Work (PoW), in that it depends on the characterisation of a hobby miner v. business miner.

Putting aside the argument that the 'stakers' are being compensated due to losses as a result of the inflation rate (perhaps equivalent to share splits), one particular example of the dynamic nature of the crypto economy is the recent Ethereum "Merge" from PoW to PoS. This in itself creates numerous tax issues and uncertainty.

For example, the question arises as to whether staking rewards are treated as income pre-merge (the Beacon Chain responsible for the PoS consensus mechanism was running before the Merge), at merge, or when the withdrawal contract is enabled. In this respect, Beacon chain does not exist as a transaction layer until/unless the merge succeeds, and the rewards are on beacon chain.

This is anticipated to impact a high number of crypto economy participants.

It is also unclear whether ETH is the same property or a new type of property after the merge, where most taxpayers either wouldn't realise there has been a change of consensus mechanism (i.e., a change of a significant aspect of the 'business' carried on by validators) or would treat ETH as having the same cost base as the pre-merge ETH.

vii. Characterisation of Non-Fungible Tokens (NFTs) - Collectibles and Personal Use Assets

The ATO is yet to provide specific guidelines regarding the tax treatment of NFTs that have different characteristics and use cases. Whilst the majority of NFT activity today involves speculative trading and investing, NFTs can also be considered as collectables which share similar characteristics of traditional artwork, but in digital form. It is still unclear, however, whether the same tax exemptions that apply to physical collectables under s118.10 of the Income Tax Assessment Act 1997 can apply to digital collectables that are in the form of an NFT. It is recommended that the ATO consider their position on the tax treatment of owning physical collectibles to digital collectables.

NFTs can also represent in-game items, where ownership of a gamer's assets is recorded on a blockchain such as Ethereum. Due to the nature of gaming, it is possible that a gamer can accumulate thousands of micro transactions, potentially triggering multiple tax events under the current guidance of the ATO.

We propose there be a threshold which would exempt transfers of NFTs under a specific value from triggering a taxable event or alternatively consider these forms of NFTs as personal use in nature, given recreational gamers do not intend to make a profit from their activities. Indicia of being in business could be a certain dollar value of prize money or earnings from sale of assets earned / won in game.

NFTs are becoming increasingly popular as society shifts to a more digitally focused environment. It is not uncommon for NFTs to represent one's digital identity on social media platforms such as

Twitter and Instagram as holders of an NFT will use it as their profile picture (PFP). As such, these PFP NFTs that enhance one's digital identity should be distinguished from others that are purely used for trading and profit-making purposes and be tax exempt under the personal use asset exemption.

Without such a recognition, we argue that the collectable and personal use exemptions are being eroded and represent a clear misalignment between the on-chain and physical world counterparts. As we progress towards an increasingly digitised community, we see this as a major concern.[31]

viii. Crypto used in gambling

Digital assets are being used on gambling platforms and the tax treatment is not parallel to the real-world tax treatment. Gambling activities are inherently recreational in nature and are subject to a high degree of chance. Betting and gambling winnings are generally not assessable and considered a windfall gain unless the taxpayer is carrying on a business. Furthermore, a capital gain does not usually arise under the CGT provisions (*IT 2584*).

Taxpayers undertaking gambling activities online using digital assets as a betting stake are under ATO scrutiny. As an example, a taxpayer routinely purchased Litecoin on a registered digital exchange specifically to use for gambling on the online platform www.mbitcasino.io. The taxpayer did not make any disclosures in the tax return due to this activity. The ATO immediately reviewed the tax return based on data matching protocols. The matter was "dismissed" based on the ATO stating the matter was resolved and closed. Although a favourable outcome for the taxpayer akin to the real-world treatment, the uncertainty in this treatment impacts the efficiency and effectiveness of the self-lodgement system.

ix. Crypto activities and GST

All categories of taxpayers delving into the crypto economy face real challenges in tax compliance. For business entities, there is particular concern raised with respect to GST.

Whilst the Government has sought to clarify its position on digital currency and GST through amending the GST Act definition and withdrawing GSTR 2014/3 to essentially avoid sales and purchases of digital currency to be subject to GST, not all crypto assets are likely to be captured by the revised definition.

The definition of digital currency captures those that are:

a) Are designed to be fungible
b) Can be provided as consideration for a supply
c) Are generally available to members of the public without any substantial restrictions on their use as consideration
d) Are not denominated in any country's currency
e) Do not have a value that depends on, or is derived from, the value of anything else
f) Do not give an entitlement to receive, or to direct the supply of, a particular thing or things, unless the entitlement is incidental to:
    i. Holding the digital units of value; or
    ii. Using the digital units of value as consideration.[32]

[31] See for example, Elizabeth Morton and Michael Curran, 'Understanding Non-Fungible Tokens and the Income Tax Consequences' (n 9).
[32] GST Act, s 195-1.

Whilst recognising this definition is impacted by the proposed amendment to ensure Bitcoin is not captured by the foreign currency regime (as detailed above), the incidence of double taxation remains for several crypto asset categories. In particular, the definition is likely to exclude collateralised stable coins and utility tokens.[33] As such, these are likely to be characterised as a financial product and create additional burden to taxpayers to understand whether a stable coin supply could be an input taxed financial supply. Of particular concern is the exclusion of stable coins and law reform has already been recommended to include fully collateralised Australian dollar pegged stablecoins to be treated as money for legal and tax purposes.[34]

Secondly, the ATO guidance indicates that where the digital currency sales are to non-residents of Australia, rather than being treated as a financial supply (input taxed), the sale is GST-free.[35] However, the global reach of activities and the way in which transactions occur, the customer status is unlikely to be known/knowable.

Whilst the ATO in this respect has sought to offer guidance, the guidance is not practical and creates distorted outcomes.

These issues similarly extend to non-fungible tokens (NFTs). For example, where there is a sole trader registered to buy and sell NFTs, they should charge GST, however there are practical barriers preventing them from doing so.

Awareness of the tax treatment of crypto assets

3. Do entities which carry on a business in relation to crypto assets or accept crypto assets as a form of payment, have a comprehensive awareness of the current tax treatment of crypto assets and their tax obligations?
4. Are retail investors aware of the current tax treatment of crypto assets? To what extent are they receiving professional tax advice?

As noted earlier in our submission, due to the limited guidance provided and the complexity and ever-changing landscape of the crypto economy, there are undoubtedly retail investors that are not fully aware of their tax obligations. Whilst an imperfect solution, there are a limited number of professionals that seek to assist the Crypto community via various channels (such as Discord, TikTok and Twitter). The cost effectiveness of administering compliance with tax law is also a barrier and would be aided through reporting thresholds.

[33] Peter Murray and Joni Pirovich, 'The taxation of cryptocurrencies' (NSW Annual Tax Forum, 25 May 2018).
[34] See Convergence.Tech, 'To Excise and Beyond' (Online, May 2022) <https://uploads-ssl.webflow.com/60881ab60ee04f67ab0c597e/62a46e42ed9605fb9f11bcd6_Convergence.Tech%20-%20Beyond%20Excise%20-%20The%20National%20Blockchain%20Pilot%20Report.pdf>.
[35] 'GST and digital currency' *Australian Taxation Office* (Online, 16 March 2018) <https://www.ato.gov.au/business/gst/in-detail/your-industry/financial-services-and-insurance/gst-and-digital-currency>.

5. Do wholesale investors understand the current tax treatment of crypto assets? To what extent are they receiving professional tax advice?

Wholesale investors are finding channels for investment via custody providers. These service providers are doing their best to educate investors; however, this is a burden on the industry and further guidance from the BoT would aid the burgeoning industry.

6. How can taxpayer awareness of the tax treatment of crypto assets be improved?

The BoT should consider the demographic of taxpayers engaging in the Cryptocurrency transactions. Infomercials and social media releases may be beneficial in educating taxpayers and acknowledging the complexity of recordkeeping in the space.

International tax treatment of crypto assets and experience

7. What lessons can Australia draw from the taxation of crypto assets in other comparable jurisdictions, including novel ways of taxing these transactions?

There is global activity with respect to tax and the crypto economy. To name a few examples:

- The UK Law Commission's third categorisation of property, as detailed in section 1.1 of this submission.
- The UK's token mapping exercise (of sorts) carried out in 2019, as detailed in section 1.1 of this submission.
- Wyoming's introduction of DAO LLC entity type, along with Vermont's Blockchain Based LLC.
- Arizona's approach to taxing airdrops.[36]

More generally, there are reports such as the PwC 2021 Global Crypto Tax Report that outlines current guidance internationally.[37]

Administration of Australia's taxation laws for crypto assets

8. How can the existing tax treatment of crypto assets be improved to ensure better compliance and administration?
9. What data sources are available to assist taxpayers in completing their tax obligations and/or the ATO in implementing its compliance activities?
10. Are there intermediaries (such as exchanges) that are involved in particular crypto asset transactions that could play a role in the administration of the tax laws? If so, what would their involvement look like?

Consideration should be given to intermediaries such as digital currency platforms/exchanges to have higher quality data exports and higher quality data from application programming interface (API) connections.

Given the complexity of transacting in digital currency activities, higher quality data results in better administration of tax laws by lowering overall costs, inefficiencies and time spent for tax compliance. If taxpayers and/or tax practitioners are dealing with complete and reliable data obtained from platforms/exchanges, they are better placed to comply with tax laws. In turn, this reduces overall

[36] See LinkedIn discussion (n 27).

[37] PwC, *2021 Global Crypto Tax Report* (Online, 2021) <https://www.pwc.com/us/en/services/tax/library/releases-its-2021-global-crypto-tax-report.html>.

compliance costs for taxpayers and the follow up administrative tasks required of the tax authorities with respect to tax lodgements.

However, there are several practical issues faced in tax compliance such as the information from comma-separated values (CSV) file exports not being consistent with the data obtained via API, the quality of data received through CSV exports and API connections not being reliable, and the inability to access a complete history of transaction data belonging to a taxpayer.

Considering there are now over 455 Digital Currency Exchanges (DCE) registered with AUSTRAC,[38] importance should be given to increasing reporting requirements for digital currency platforms/exchanges to facilitate better administration of tax laws. General considerations include ensuring all user transaction data is collected and stored in a compliant and compatible manner; providing taxpayers with access to complete historical data spanning more than the usual 2-3 years; and transparency on all fees charged.

Specific regulatory guidelines are also required for new Web3 projects around availability of data for taxpayers, particularly in the crypto gaming space. Blockchain-based games that have the play-to-earn feature that allow players to earn rewards in the form of crypto tokens or NFT's, which can be transferred or traded between multiple platforms. Currently, platforms with play to earn games are rarely able to provide transactions to taxpayers for tax compliance purposes. This information in the form of data exports should be available for all transactions to taxpayers to ensure better tax compliance.

The current ATO guidance on loss or theft of crypto assets requires a list of evidence to prove ownership to claim a capital loss. However, in the event of platform/exchange shutdowns, crypto investment scams, loss of private keys or hardware wallets, taxpayers lose access to their crypto and their transaction data. Specific concern lies where records to prove ownership and substantiate losses cannot be attained from the relevant platform/exchanges however, the onus of proof of ownership remains with the taxpayer, and the imposition of potential penalties for claiming losses that cannot be sufficiently substantiated. We request better guidelines by the ATO, and protocols established for exchanges in such situations to help with administration of tax laws.

[38] Select Committee on Australia as a Technology and Financial Centre (n 5) 18.