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30 September 2022

C\- Anthony Klein & Ms Tanya Titman
Board of Taxation

Dear Mr Klein and Ms Titman,

Submission – Board of Tax Review of the Tax Treatment of Digital Assets and Transactions in Australia

1. We appreciate the opportunity to make submissions to the Board of Tax on digital asset taxation and the invitation to participate in consultation sessions.

2. We refer to:

    2.1. the published terms of reference and the consultation guide;

    2.2. the review of current guidance and principles set out specifically in the consultation guide; and

    2.3. the consultation questions.

3. Special thanks to Shane Brunette, Samara LeMerle, and the team at CTC Ledger Pty Ltd (CryptoTaxCalculator) for assisting with these submissions.

4. Our submissions are as follows.

Executive Summary

5. We have approached these submissions with the view to developing a framework of guiding principles for Government and the ATO to consider for the purpose of addressing the taxation of digital assets, as well as a set of recommended practical measures.

6. The principles of this framework have been developed based on an assessment of major sources of technical and practical uncertainty for taxpayers, the approach the ATO has taken to address those issues to date, and both taxpayer and Government interests that we believe should inform priorities and approaches to addressing taxation of digital assets.

Proposed framework principles

7. A summary of our proposed framework principles is as follows:

    7.1. (**Principle One – Economic substance over black-letter legal positivism**): Government should take a 'substance over form' approach to approach to adopting initial policy and interpretative positions in relation to digital asset taxation, which lead to tax outcomes that are realistic and fair for both taxpayers and the tax revenue;

    7.2. (**Principle Two – Priority-based and realistic increments**): priority should initially be given to addressing a core set of tax technical and systematic administrative issues that affect the taxpayers that experience the greatest

barriers to managing their tax risk (i.e. retail investors), as these taxpayers are typically less able to participate in traditional mechanisms for legal reform;

7.3. (**Principle Three – Proactive, facilitative, and future-minded**): Government and ATO should take a proactive approach to not only addressing immediate issues, by developing adaptable and scalable systems that facilitate fair and accessible engagement with taxpayers on issues with uncertainty, that will also drive ongoing legal development; and

7.4. (**Principle Four – Consultative and pragmatic**): Government and the ATO should commit to treating ongoing consultation with both industry and 'on-the-ground' technical specialists as a priority, in the interest of facilitating a collaborative approach to ensure that proposed policy measures are appropriate, fair, and fit for purpose.

Proposed practical measures

8. Based on the above principles, our recommendations for practical measures to address taxation of digital assets are as follows:

8.1. (**Transaction Mapping**) a series of transaction exercises leading to legislation and ATO guidance where appropriate. We propose that core transactions and pain points for retail investors would be prioritised initially, followed by issues more relevant to industry-level taxpayers and start-up and innovation concessions;

8.2. (**Regulator Channels**) we propose a specific ATO organised stewardship group, to facilitate ongoing collaboration between Government and industry in developing measures to address digital asset tax issues;

8.3. (**Internal Education and Knowledge**) we propose increased ATO resource allocation to specifically addressing taxation of digital assets, including increased education of ATO staff on crypto assets and issues relevant to their business lines, establishing a digital asset division of the ATO to educate internally and assist on audit and advice products, and developing a non-binding anonymous advice product to facilitate and encourage pre-lodgement taxpayer engagement with the ATO; and

8.4. (**Legal Development**) we propose an increase to test case funding and a proposed taxpayer amnesty program to promote development of jurisprudence in relation to taxation of digital assets and a stronger trust between government and the crypto asset industry.

9. Please refer to our more detailed submissions below.

Introduction

10. Assuming that our submissions are not the first the reader has reviewed during this consultation process, the reader has likely been reminded at least once or twice that cryptocurrencies have become an enormous international market of between USD$2 trillion and USD$3 trillion (depending on the day) in the mere 13 years since Bitcoin was first launched in 2009.

11. Developing a conceptual and practical solution to crypto asset tax is by no means a simple or straightforward task. While there are endless figures around total market capital and investor numbers that can be highlighted to drive this explosive and speedy growth home, we prefer to draw attention to a different measure of time –

more than a handful of draft ATO rulings that predate the 2009 release of Bitcoin have still not been finalised.

12. The discrete tax technical issues that arise in relation to distributed ledger technology (and particularly “decentralised finance” or DeFi) are expansive, and new and novel products and arrangements come to market on a daily basis. For reasons discussed in further detail below:

    12.1. our view is that it will not be realistic for Government to explicitly address all or even most of the current issues in the short term; and

    12.2. therefore, we have focused our recommendations around a proposed framework for addressing, developing, and reforming Australian taxation of digital assets that we consider will be realistic in scope and serve as a starting block to addressing interests of both taxpayers and Government.

13. On that basis, we have approached these submissions as follows:

    13.1. a discussion of our views as to the current ‘state of play’ of digital asset taxation, addressing:

        (a) the characteristics and features of cryptocurrency assets, transactions, and arrangements, that should be taken into account in determining fair and realistic policy principles for taxing digital assets; and

        (b) examples of specific tax technical issues that affect a range of different taxpayers in the cryptocurrency space, in terms of both academic legal interpretation (i.e. the tax law as it stands) and the ATO’s interpretation or public guidance on those issues (where applicable);

    13.2. a brief analysis of stakeholder interests and systematic considerations that need to be taken into account for developing a proposed framework for addressing the current tax technical issues with the goal of establishing a set of realistic and achievable goalposts that the proposed initial framework should aim to address;

    13.3. our proposed framework of guiding principles that Government and the ATO should adopt for the purpose of addressing taxation of digital assets; and

    13.4. finally, based on the above, our recommendations for practical measures that Government should consider adopting as part of an initial framework for adapting both the existing tax law and its administration in the context of digital assets – noting that legal development and reform is an incremental task that cannot be achieved overnight, and that ‘traditional’ tax law is a constantly evolving creature in and of itself.

Current State of Play – Technical Uncertainty and State of Existing Guidance

14. While we are not tax law historians by any means, we would respectfully suggest that the tax law in 2022 is built upon a ‘hodgepodge’ of different legislative approaches to drafting and designing law, and a similarly diverse set of judicial opinions on how the law should properly be interpreted. We think that this is clear from the fact that the income tax law is still split over two Acts, with wildly different drafting styles.

15. Certain components of the income tax law are drafted around very definitive and literal language that is designed to address particular situations or events, while

other provisions adopt more hands-off conceptual language to enable more general application. For a very basic example:

15.1. the CGT rules tend to be concerned with taxing particular events and arrangements, and CGT events tend to be very literal in application – just about any 'thing' can be a CGT asset[1], and the provisions of Division 104 of the *Income Tax Assessment Act 1997* (Cth) (**ITAA97**) set clear signposts for transactions and arrangements that will trigger CGT events and be brought to tax (although naturally the precise scope of those provisions is open to interpretation); and

15.2. other core revenue taxing provisions such as section 6-5 of the ITAA97 are designed around common law tax principles which are concerned with potentially highly abstract and indefinite concepts of 'ordinary income', and when that income is 'derived' for taxation purposes.

16. Similarly, individual members of the judiciary over the years have tended toward different principles of statutory interpretation, with the result that jurisprudence on any one particular point of tax law can often prescribe decidedly different interpretative approaches depending on whether the relevant judges of the day gravitated towards legal positivist (i.e. 'black letter') or purposive approaches. As another very basic example:

16.1. jurisprudence in relation to the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**) has firmly established the need to take a purposive approach to statutory interpretation; and

16.2. recent jurisprudence in relation to the CGT 'streaming' provisions under Subdivision 115-C of the ITAA97 have gravitated towards a more 'black letter approach', with the result that foreign sourced capital gains streamed through an Australia resident trust to a non-resident beneficiary are caught by the Australian tax net, despite having no real connection with Australia.[2]

17. At a high level, our view is that the main sources of uncertainty around the taxation of digital assets more or less stem from the following two broad issues, which are explained further by reference to specific examples later in these submissions.

18. Firstly, decentralised cryptocurrency transactions tend to be built upon complex and often opaque technology, and certain core features of some of these arrangements are not readily analogous to circumstances that either the Courts or the ATO are familiar with. For example, no singular entity can readily be identified as 'owning' or 'operating' a decentralised blockchains which introduces complexity around characterising certain functions of the network such as participating in network consensus mechanisms.

19. We expect that several other contributors to this consultation process will have embarked on a fulsome deep-dive of the technological and legal intricacies of this point, so we will not labour this point further (although it is naturally an essential piece of the puzzle). From a practical perspective, this leads to significant uncertainty about how the Courts or the ATO would characterise the factual elements of any particular blockchain transaction – i.e. the factual substance of what is actually occurring.

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[1] s 108-5, ITAA97.

[2] See *Peter Greensill Family Co Pty Ltd (Trustee) v Commissioner of Taxation* [2021] FCAFC 99.

20. Secondly, cryptocurrencies tend to be built around decentralisation. While there are plenty of examples of blockchain networks that operate with at least some level of centralisation,[3] or are completely centralised such as the proposed eAUD stablecoin, the nature of cryptocurrency markets is that these networks usually allow for participants to interact without a centralised body. In the absence of a centralised body to serve as a source of truth for any particular legal personality's assets and entitlements, the blockchain combined with Distributed Ledger Technology (**DLT**) are represented by the tokens that are associated with any particular cryptocurrency wallet. The result is that the economic substance of any particular cryptocurrency token could be as simple as a representation of a store of value (e.g. the earliest cryptocurrency tokens such as Bitcoin) or something more complex, such as a digital certificate representing interests in assets committed as collateral under a lending arrangement, or the token holder's rights to participate in the governance and profits of a legal entity or a purely on-chain organisation. Further, in some circumstances there may be no readily accessible record of certain rights associated with a particular wallet, such as where a future right or interest could be recorded as an entitlement under a smart contract to be exercised at a later date.

21. As discussed above, a significant portion of Australia's existing tax framework is designed around classifying 'things' as 'assets', determining the relative value of those assets, and then applying tax when certain economically significant events happen in relation to those assets. Various 'traditional' asset classes have evolved and become digitalised over time,[4] however, the fundamental legal characteristics of those assets have remained unchanged. In the context of cryptocurrency tokens, our concern is that the complexity and novelty of distributed ledger technologies will likely cause the Courts and regulators to 'miss the forest for the tree' by adopting a base line position that the token is a valuable asset in and of itself, rather than a substance-based approach of considering what the token actually represents.

22. This distinction is important for determining how the tax law currently treats digital assets from a technical perspective. This requires evaluation ofwhether the current tax treatment of digital assets accurately reflects the economic substance of the relevant transactions.

23. To our knowledge, this particular issue has not been considered in detail by either the Australian Courts or any Commonwealth or US Courts – and we note that there are naturally questions about the extent to which positions taken by foreign Courts on this point would be relevant for interpreting Australian law.

24. The result is that there is significant uncertainty as to how the tax law currently applies to most cryptocurrency transactions, perhaps with the exception of particularly simple sales of tokens that merely represent stores of value.

25. In the interest of trying to prevent this section of the submissions from becoming unwieldy, we have set out high-level comments around discrete technical issues that we encountered to date in the course of our practice as specialist crypto asset tax lawyers as a separate Schedule One to these submissions.

26. Schedule One addresses general categories of cryptocurrency transactions, along with a discussion around:

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[3] For example, "Maple Finance" is a widely-known cryptocurrency "lending" protocol that features a centralised (off-chain) KYC-AML due diligence process for prospective lenders and borrowers.
[4] For example, share certificates and property title certificates.

26.1. what we consider to be the major technical uncertainties associated with each category;

26.2. the position that the ATO has either explicitly or implicitly adopted in relation to each (where applicable), as well as the steps that the ATO has taken to guide taxpayers (again, where applicable);

26.3. where the tax law currently appears to create an unreasonable outcome, our views regarding the appropriate tax treatment to reflect the economic substance and reality of each category of transaction or issue; and

26.4. our views regarding the steps that should be taken to clarify or amend the application of the current tax provisions in relation to each issue.

27. While the list of issues set out in Schedule One is extensive, by no means do we represent this to be an exhaustive list of cryptocurrency transactions or technical issues in relation to which the tax positions are uncertain. No doubt there is a considerable list of other cryptocurrency related tax technical issues that other contributors will raise in their submissions, and we look forward to reviewing these once consultation submissions have been published by the Board of Taxation.

28. To summarise the key takeaways from Schedule One, our views are broadly that:

28.1. Where the tax law currently appears to create an unreasonable outcome this may require legislative amendment;

28.2. where the tax law currently appears to create a reasonable outcome it may be more appropriate for the ATO to simply commit to public binding guidance confirming that it will accept such an interpretation;

28.3. ATO public guidance has been minimal, and where guidance has been issued it is of a general nature that cannot be relied on by taxpayers and tends to provide little detailed technical analysis.

28.4. In addition, the current format of updating guidance on the ATO website does not include any formal announcements,, making it difficult for practitioners to keep up to date with ATO views without regularly reviewing existing webpages;

Stakeholder Interests

29. Our view is that the sheer volume of relevant issues will likely make it unrealistic for Government to be able to explicitly address all or even most of the issues in the immediate term, and that attempting to do so could significantly delay progress on the issues that require the most attention.

30. The tax law has always contained at least some degree of uncertainty and risk, and in our view tax advisory is as much a risk assessment exercise as it is a legal interpretation one.

31. For the purpose of formulating an appropriate initial framework for reducing uncertainty around the taxation of digital assets, we think that it is important to acknowledge that certain taxpayers are more equipped to address and manage tax uncertainty and risk than others.

32. In our experience, the relative complexity of the tax law and the rigidity of the administrative process creates a barrier for the majority of retail investors (excluding high net-wealth individuals and family groups) from accessing the resources and

processes that the tax advisory and administration system offers for protecting themselves from tax risk.

33. From our experience, this holds true for the majority of individual and small business taxpayers even outside of cryptocurrency taxation, however the problem is particularly exacerbated due to the novelty and acute legal and technological complexity of cryptocurrency transactions. As discussed below, the problem is multi-faceted and compounding.

Barriers to obtaining advice

34. As a generalisation, at the retail investor level cryptocurrency investment tends to be more heavily associated with younger demographics. For many of these individuals, cryptocurrency is the first 'high-turnover' investment activity they have engaged in (other than perhaps some simple share, bond, or ETF investments). These taxpayers are less likely to have owned other major income-producing assets (e.g. investment properties, substantial equity portfolios, private business interest, etc.) and until now their tax affairs have been simple enough that they may never have perceived a real need to engage an accountant to assist with tax compliance. Consequently, the majority of this category of taxpayers have very little tax literacy, as they have never had any real exposure to the tax system beyond simply inputting salary, deductions, and dividends into the ATO self-reporting website at tax time.

35. More experienced retail investors, or individuals that have experience in business ownership or management, are more likely to have an existing relationship with an accountant, however the reality is that most of these individuals will never have had to interact with any tax issues that involve a significant degree of uncertainty, or require detailed technical analysis. Further, many of the accountants are uncomfortable dealing with these crypto tax questions and refer common matters to specialists.

36. The result is that a substantial portion (if not a majority) of retail investors are unaware of the nuances in both the tax law itself and how the administrative system operates, and are unlikely to have any experience engaging tax advisors. Many of these taxpayers understandably depend on cryptocurrency tax software, and while these services are an invaluable practical tool for generating reports and assisting with tax compliance in this space, they cannot be relied upon as a sole basis for taxpayers to adopt any particular technical position.

37. The result is that a significant portion of retail investors have little to no awareness about the complexities of cryptocurrency tax, and are unlikely to become aware of those complexities because they will never have any exposure to a knowledgeable accountant to diagnose the issues.

38. For taxpayers that do take proactive steps to obtain advice, the issue is largely one of cost and a lack of accessible avenues for engaging with the ATO prior to lodging returns. This issue is exacerbated by the relatively limited number of tax advisors that are either familiar with cryptocurrency technology or otherwise comfortable advising on digital taxation issues.

39. While there has always been at least some level of uncertainty in 'traditional tax', the tax implications of the majority of arrangements and transactions that most taxpayers could enter into have been explored and addressed in reasonable detail by the Courts. Parliament, and the ATO. As a result, most accountants are comfortable advising on at least the core technical operation of the Australian tax law, and naturally technical specialist accountants will often be comfortable

advising on more complex technical issues as well. Traditionally, when novel or technical questions arise a taxpayer's accountant would have ready access to sufficient publicly available guidance to either diagnose and address the problem themselves, or make an informed decision on whether to suggest incurring the cost of engaging specialist tax lawyers for formal advice in particularly uncertain or complex circumstances.

40. As we highlighted above however, in the context of cryptocurrency:

    40.1. there is a significant degree of uncertainty around the tax implications of many types of transactions that both experienced and inexperienced retail investors will regularly engage in;

    40.2. the ATO has published limited guidance and there is a lack of public binding guidance that taxpayers can actually rely on; and

    40.3. the general positions that the ATO has offered do not always reflect the economic reality or substance of the relevant transactions, which can cause further confusion and uncertainty for taxpayers who could not be expected to appreciate the technical complexity and nuance of the taxation law. Further, while these positions may be 'black-letter law' correct in some instances,, we note that the ATO has previously adopted concessional tax positions for many 'traditional tax' transactions based in a purposive approach over black-letter interpretation.[5]

41. This places both generalist and technical tax advisors in a difficult position. It is difficult and risky for generalist advisors who do not have experience with complex legal and tax analysis to suggest technical positions for their clients, so they will often need to encourage the client towards obtaining technical legal advice. Given the lack of any legal precedent or detailed ATO analysis on cryptocurrency tax issues, it is difficult for tax technical specialists to provide cost-effective advice that actually assists the client in managing their risk profile.

42. More particularly, tax advice is first and foremost a risk management exercise. For circumstances or questions that have not been considered by the Courts, or otherwise 'grey' areas of the law, this typically involves a process of ascertaining the strengths and weaknesses of possible technical positions and the ATO's public views to provide a risk/benefit analysis. Sometimes there will only be a single position that has technical merit and sometimes there will be more than one position that could apply, at which point the questions become:

    42.1. which position is more acceptable for the client;

    42.2. which position is least likely to lead to the ATO conducting an audit or issuing amended assessments; and

    42.3. for clients that have an appetite and resources to potentially disagree with the ATO, which position would the Courts be likely to accept as being the most correct, or at least 'reasonably arguable' to protect against penalties.

43. In the absence of any detailed judicial or ATO commentary on how any particular provision or principle should be interpreted, it is very difficult to efficiently address the second or third question, for the following reasons:

    43.1. in our experience, the ATO is very unwilling to participate in meaningful early engagement with taxpayers on cryptocurrency issues. To our knowledge the

[5] See Taxation Ruling TR 94/30, which covers the CGT implications of varying share rights.

only available product for confirming whether the ATO would accept a position is to apply for a private binding ruling and officers have indicated that this complex advice product is almost always inappropriate for crypto asset tax issues. The costs of preparing these applications in the cryptocurrency space are substantial, as tax practitioners are required to engage not only in an extremely detailed 'first principles' analysis of the relevant law, but also provide a very detailed technical description of how the particular protocol or transaction operates, in an effort to assist the ATO to properly appreciate the nuances of the relevant factual matrix. Further, this requires the taxpayer to identify themselves to the ATO, which substantially increases audit risk – a substantial cost and stress even for completely compliant taxpayers. Between the cost and the lack of an opportunity to anonymously approach the ATO for non-binding guidance, this avenue is out of reach or undesirable for most retail investors, and also a majority of business clients (e.g. cryptocurrency start-ups); and

43.2. for clients that do not wish to risk identifying themselves, wish to reduce costs, or in circumstances where the ATO has published a public view on an issue that lacks technical merit, many clients are comfortable with adopting a position that is at least 'reasonably arguable' on the understanding that tax will still apply if the ATO disagrees with the position, however they should be protected from penalty tax. Importantly, establishing that a position is 'reasonably arguable' requires a very detailed analysis of the tax law, relevant authorities and the technical merits of alternate positions to conclude that what is argued is "about as likely to be correct as incorrect", and must be "cogent, well-grounded and considerable in its persuasiveness".[6] This requires very detailed technical analysis, with the result that the costs of preparing a 'reasonably arguable position paper' to provide protection from penalties are also prohibitive for most retail investors, and many business clients.

44. Where clients can manage the costs of engaging with the ATO to proactively manage their tax positions, additional work is often required to properly educate the ATO on the factual operation of cryptocurrency protocols and arrangements in order to reach agreement on the fact matrix of the application.

45. While we have not experienced this ourselves (as we generally do not recommend private rulings unless absolutely necessary) from discussions with other practitioners we understand that it is not uncommon for complex ruling applications to be pending for extended periods of time, and even for the ATO to decline to rule on certain issues. From our understanding, some of these applications have devolved into contentious litigation.

46. In our practice, we have noticed somewhat of a push from the ATO towards early engagement pre-ruling discussion, which at least one officer has suggested is intended to provide the ATO an opportunity to consider whether it would be willing to rule on the issues. Further, ATO officers have indicated that they would be unwilling to entertain an anonymous first meeting despite doing so with non-crypto tax issues in the past.

47. The result is that taxpayers of all sizes and circumstances struggle to access avenues to manage their relative tax risk. Retail investor clients struggle to afford advice, as there are insufficient resources available to accountants to provide first-touch tax

[6] s 284-15(1), *Taxation Administration Act 1953* (Cth); *Revised Explanatory Memorandum to the A New Tax System (Tax Administration) Bill (No. 2) 2000.*

advice on cryptocurrency issues, and larger business, wholesale investor, and fund clients that are potentially exposed to significant tax risk struggle to obtain clear and efficient engagement from the ATO. Our view is that this significantly limits the economic potential of crypto assets in Australia.

Barriers to accessing administrative review

48. Taxpayer inequality around access to administrative review is by no means a new phenomenon for the Australian taxation system, however our view is that the lack of jurisprudence or explicit taxation laws addressing taxation of digital assets significantly reinforces the existing barriers that smaller taxpayers face when challenging ATO audit decisions.

49. As a starting point, it is well-recognised among tax practitioners that the administrative review process for taxation decisions are heavily weighted against small business and individual taxpayers (other than high-net wealth individuals and family groups) from the outset. Most readers will likely be very familiar with the tax disputes process, however for the benefit of any unfamiliar readers the process for the majority of taxpayers (excluding ultra high-net wealth family groups, large private enterprise/investment funds, and listed entities) is broadly as follows:

    49.1. ATO notifies taxpayer that it will be commencing an audit, and typically provides an opportunity for taxpayer to 'come forward' by either disclosing any potential issues or amending prior year tax returns;

    49.2. ATO reviews taxpayer's affairs for the relevant period of review (usually either two or four years). The ATO may ask for clarification on certain positions or for further information;

    49.3. if the ATO considers that the taxpayer has adopted an incorrect position resulting in a tax shortfall, the ATO issues a position paper which sets out the technical basis for the ATO's position, including on any decision to impose administrative penalties. At this stage, the taxpayer has an opportunity to respond to the ATO's position if the taxpayer disagrees with any substantive points;

    49.4. if the taxpayer is unable to convince the ATO audit team that their decision is incorrect, either:

        (a) for small business taxpayers, the taxpayer may apply to have the audit decision reviewed by the small business independent review team. This process involves the taxpayer providing further submissions to the independent review team and one or more case conferences attended by the taxpayer, independent review team, and audit case officer (plus usually the case officer's director or manager), following which the independent review team makes a recommendation as to whether the audit team should reconsider their position. These recommendations may or may not be implemented by the audit team – in our experience audit teams will typically respect these recommendations, however the utility of the independent review process tends to be limited as the independent review teams are rarely willing to meaningfully engage with complex technical issues (which is a topic for an entirely different consultation process); or

(b) the ATO will issue a notice of amended assessment, as well as penalty notices where applicable. At this stage, the taxpayer has incurred a tax liability;

49.5. if the taxpayer wishes to continue to dispute the ATO's position, the taxpayer may formally object to the amended assessment and penalty notice. This involves preparing further detailed submissions rebutting the audit team's position, which are reviewed and considered by a fresh ATO team that is theoretically independent from the audit team;

49.6. if the objections team does not accept the taxpayer's position, the ATO has three main options:

(a) attempt to negotiate a settlement with the ATO (which can be occur at any stage, but is often initiated here);

(b) commence proceedings in the Administrative Appeals Tribunal (AAT); or

(c) commence proceedings in the Federal Court.

50. As should be clear from the above overview, each stage of the administrative review process involves substantial time, stress, and costs for taxpayers that seek professional assistance with this process. Without professional assistance, it is significantly less likely that a taxpayer will be able to identify and address the relevant technical issues with the level of detail required to properly advocate their position.

51. The reality for most taxpayers is that it is simply uneconomical to properly challenge the ATO's views on any particular technical issue. Without an experienced tax advocate, most taxpayers will have very little chance of convincing an audit team that their position is correct, and will therefore gain very little utility from the objection process. On the other hand, managing a tax dispute is specialist work and requires repeated detailed technical analysis and carefully prepared submissions, and tax advocates – meaning that costs of proceeding through the object process alone will inevitably be substantial and can very quickly exceed the balance of the tax shortfalls that many retail investors would face.

52. Taxpayers who wish to proceed beyond the objections stage without legal counsel are entitled to do so, and most so inclined taxpayers will try their chances with the AAT due to the more relaxed and accessible procedures. Without an experienced legal advocate to properly address the technical aspects of their case, these taxpayers typically stand little chance of establishing the legal positions required to convince a Tribunal that the ATO's decision was excess or otherwise incorrect.

53. This leads us to what we consider to be one of the most significant risks to fair and correct taxation of digital assets – while AAT decisions are not binding upon the Courts, our experience is that the ATO will often treat AAT decisions as binding legal precedent for the purpose of preparing audit and objection decisions. This creates a compounding cycle of inequality for both taxpayers that can and cannot afford to engage experienced legal advocates:

53.1. tax issues that disproportionately affect taxpayers that cannot afford advocacy are more likely to be taken to the AAT by taxpayers that are not legally represented. This leads to a body of AAT decisions that favour the ATO's internal policy position, where the technical merits of the ATO's position were never properly agitated;

53.2. the ATO relies on this body of AAT decisions for future audits on these issues, and both audit and objection teams are subsequently much less willing to give up ground when taxpayers dispute the technical merits of the ATO's internal policy position. Now the taxpayer (and their lawyer) has to not only displace the ATO's position as a whole, but also demonstrate the reasons for which these AAT decisions are technically incorrect or otherwise should not be determinative for their particular circumstances; and

53.3. because both the audit and objection teams hold up the AAT decisions as a basis on which to affirm the ATO view, the result is that taxpayers often do not receive a truly independent and objective review of audit decisions unless they issue proceedings in either the AAT or Federal Court.

54. Our view is that there is a real risk of this shortcoming in the administrative review process leading to development of 'bad law' for crypto asset tax, or otherwise a systematic barrier to a significant portion of affected taxpayers accessing impartial administrative review.

55. Further, both this and the access to advice issue demonstrate a further fundamental issue – unless Parliament and the ATO take a proactive and fairness based approach to clarifying digital asset taxation issues, taxpayers will continue to bear both the full risk of adopting uncertain tax positions and a substantial portion of the total costs of developing the ATO's positions.. As it stands, the ATO has the benefit of not being bound to any particular position, and the onus always falls on the taxpayer to develop a sensible and technically correct position, whether by engaging tax advisors to approach and educate the ATO through the private ruling application process, or by bearing the substantial costs of proceeding through to Courts (subject to possibly accessing test-case funding).

Policy maker considerations

Responsible policy and resourcing limitations

56. We appreciate that these submissions have been reasonably critical of the ATO so far, however we also wish to acknowledge the substantial challenges that both Parliament and the ATO face in addressing the taxation of digital assets.

57. Cryptocurrency markets have expanded and evolved at a rate that no national government has been able to keep up with, and if Government is actively aware of even half of the issues that will be raised in the course of this consultation process they will already have a full plate to contend with.

58. Despite our criticism around Government and the ATO's level of engagement with digital asset taxation to date, we also acknowledge that Government and revenue authorities have significant responsibilities to ensure that they are properly educated on emerging legal issues before implementing new administrative policy or legislative reform.

59. We also acknowledge that the sheer volume of cryptocurrency taxation issues is a major hurdle for both Government and the ATO to formulate carefully considered policy and interpretative positions, as it is unrealistic to expect either to be able to reallocate sufficient resources to the issue away from other areas when the public service is already stretched thin enough as it is.

60. In this regard, we appreciate that the ATO has made an attempt to provide web guidance that addresses the core tax issues, although we consider that greater effort needs to be made to bring changes in ATO views to industry attention (such as the recent update to the airdrop/staking rewards guidance), and more guidance needs to be provided in a form that taxpayers can confidently rely on.

Economic considerations

61. Recent research by Roy Morgan suggests that over a million Australians currently own cryptocurrency investments.[7] This is a significant portion of the population that will likely continue to increase substantially over the coming years, and will therefore represent a growing source of potential direct and indirect tax revenue if investment is promoted through clear and fair taxing positions that substantially reflect the economic reality of these transactions.

62. Although legal uncertainty presents substantial opportunities for advisors and commentators (i.e. us, on both fronts), reducing compliance costs and uncertainty for retail investors (i.e. the overwhelming majority) to accurately report their tax liabilities will remove a substantial barrier for Australians to participate in this global market as it comes further into the mainstream.

63. From a business perspective, Australia has very strong talent in the cryptocurrency space, and the decentralised and global nature of the cryptocurrency industry means that emerging Australian cryptocurrency businesses have a real opportunity to become world leaders in this space. Unfortunately, our experience has been that many of these taxpayers are unwilling to be exposed to the commercial risk associated with the current level of uncertainty around the likely tax outcomes for their particular business activities, and instead seek to establish operating entities in jurisdictions that have demonstrated a greater commitment to promoting cryptocurrency business.

64. Although cryptocurrency markets appear to be past the initial ‘early adoption’ phase, the international regulatory environment is constantly changing, and no single jurisdiction has emerged as the clear frontrunner for cryptocurrency business to plant roots. Low or no tax jurisdictions such as Dubai, Singapore, British Virgin Islands, and Cayman Islands have been popular for early decentralised projects (for obvious reasons), however as the cryptocurrency industry matures we are seeing a trend towards projects that specifically seek to bridge the gap between traditional, centralised, and decentralised markets, and actively seek association with high-regulatory oversight jurisdictions in order to appeal to conservative institutional customers.

65. Given the standard of local talent, our view is that Australia has a real opportunity to establish itself as a leading jurisdiction for the types of cryptocurrency projects that seek the branding of commercial legitimacy that comes from being based in a jurisdiction with an internationally recognised and respected regulatory framework. However, Australia is by no means the only competitor for this market, and the opportunity could easily be missed unless punctual steps are taken to ensure that tax uncertainty does not disincentivise development of Australian business.

66. This is especially relevant in today’s highly mobile global economy, as individuals increasingly seek digital nomad and similar lifestyles.

Proposed Framework Principles

67. Having regard to our above discussions regarding current uncertainties around the tax treatment of cryptocurrency transactions, the impact that these uncertainties have on taxpayers generally, and challenges that Government and the ATO face in effectively addressing the myriad of current uncertainties, we propose the following framework of guiding principles for addressing taxation of digital assets:

[7] https://www.roymorgan.com/findings/over-1-million-australians-now-own-cryptocurrencies-such-as-bitcoin-ethereum-ripple-cardano-dogecoin-and-shiba-inu

67.1. Principle One – Economic substance over black-letter legal positivism;

67.2. Principle Two – Priority-based and realistic increments;

67.3. Principle Three – Proactive, facilitative, and future-minded; and

67.4. Principle Four – Consultative and pragmatic.

68. These principles are explained in further detail below.

Principle One – Substance over form

69. We consider that one of the core overarching technical uncertainties is the question of whether the ATO and the Courts will adopt a substance-based purposive approach to applying the tax law to digital asset transactions, or a strict legal positivist approach that could lead to artificial and contrived outcomes that disincentivise investment and business development in Australia.

70. Our recommendation is that Government and the ATO commit to applying a 'substance over form' approach to adopting initial policy and interpretative positions in relation to digital asset taxation, which lead to tax outcomes that are realistic and fair for both taxpayers and the tax revenue.

71. Where a transaction is in substance effectively a 'traditional' financial or economic arrangement that merely utilises tokenisation as a means of effecting that type of arrangement in a blockchain environment, our view is that similar tax outcomes should occur. Naturally, if a digital asset transaction ostensibly represents a 'compound' transaction with multiple economic or commercial components bundled into a single smart contract, the tax outcomes should reflect the substance and reality of each component. For example, tokens leaving a taxpayer's wallet when committed as collateral under a DeFi borrowing protocol should not be treated as a disposal event in circumstances where the assets are expected to be returned, as the economic substance is that arguably no real change in beneficial ownership has occurred.

72. Where a transaction is truly novel, and does not simply utilise tokens as a mechanism for facilitating recognised financial or economic arrangements in a blockchain environment, our view is that the tax outcomes should focus on whether the transaction actually represents an economic realisation or utilisation of the underlying assets that would be an appropriate taxing point. For example, when a taxpayer bridges or wraps tokens they are not economically realising any fluctuation in the value of those tokens by trading to a materially different asset, but rather are simply transforming the tokens into a form that can be used on other blockchain that directly represents the value of the original tokens locked up on the original network. In our view, it would be unreasonable for transactions like this to trigger a tax event, as the taxpayer is effectively placing the original asset into a bailment-like arrangement then simply trading the digital certificate representing the entitlement at a later time.

Principle Two – Priority-based and realistic increments

73. While some level of uncertainty is unavoidable, wholesale investors, funds, and business taxpayers are typically better equipped to address and manage tax risk implications by obtaining advice and either proactively or reactively engaging with the ATO. Due to the level of technical complexity inherent in an emerging area of law, retail investors face significant barriers to accessing advice, as well as reduced access to truly independent administrative review.

74. We recommend that priority should initially be given to addressing tax technical and systematic administrative issues that affect the taxpayers that experience the greatest barriers to managing their tax risk (i.e. retail investors), as these taxpayers are typically less able to participate in traditional mechanisms and avenues for legal reform.

75. Our view is that:

    75.1. addressing a core set of issues that affect these taxpayers will be the most effective method of reducing systematic unfairness in the immediate term, and will ultimately allow more complex fringe issues to be addressed with the requisite level of detail in the medium to long term; and

    75.2. developing a priority-based strategy for addressing the most-pressing issues in an incremental manner will likely be essential for ensuring that cryptocurrency tax issues are not relegated to the political 'too hard basket', which could lead to the kind of substantial delays that have been associated with reform of other areas of the tax law such as Division 7A, individual and corporate residency, and bare trusts.

Principle Three – Proactive, facilitative, and future minded

76. Government and ATO should take a proactive approach to not only addressing immediate issues, but putting adaptable and scalable systems in place to facilitate fair and accessible engagement with taxpayers on issues with uncertainty, that will also drive ongoing legal development. Crypto space is showing no signs of slowing down, constantly evolving, and new uncertainties will continue to arise for taxpayers of all sizes.

77. Consistent with the substance over form principle, in most instances legislative reform and development should avoid falling into the trap of isolated stop-gap amendments to specific provisions, and rather should focus on developing a set of core digital asset taxation provisions that can be more readily built upon as the space advances. Ideally, the language of these provisions would be clear and concise, and supported by Explanatory Memoranda that communicate a clear policy intention of matching tax outcomes to economic substance to inform both Judicial and ATO interpretation.

78. Similarly, although there is a need for the ATO to allocate resources to developing substance-over-form interpretive positions and public guidance in relation to core technical uncertainties, we also consider that it will be essential for the ATO to take a proactive approach to developing new systems, programs, and advice products to facilitate pre-lodgement taxpayer engagement and greater access to fair and independent administrative review processes.

Principle Four – Consultative and pragmatic

79. Digital asset taxation reform will not occur overnight in a single leap, but rather by deliberate, achievable, and principle based incremental steps.

80. Our view is that both the Government and the ATO should commit to treating ongoing consultation with both industry and 'on-the-ground' technical specialists as a priority, in the interest of facilitating a collaborative approach to ensure that proposed policy measures are appropriate, fair, and fit for purpose.

Proposed Action Items

81. Based on our proposed framework principals, we have set out our recommendations for proposed initial action items that we consider to be necessary for Government and ATO to provide greater certainty around the taxation of digital assets.

82. We note that these recommendations are not intended to be a granular discussion about the precise scope or details of these action items, as Government and ATO will naturally be better placed to define the exact parameters.

Transaction mapping exercises leading to legislation / ATO guidance

83. We recommend that Treasury and the ATO conduct a series of transaction mapping exercises, aiming to identify a core set of transaction categories that affect different categories of taxpayers, as well as considering the economic substance of these types of transactions and corresponding fair tax outcomes. This should then inform Government on developing policy and legislation specifically in accordance with the framework principles set out above.

84. We propose that by breaking up this process into smaller focused measures, Treasury and the ATO will be better able to develop realistic and measured solutions for each group. In line with our proposed principle of prioritising taxpayers that typically have less opportunities to participate in the development of tax law, we suggest that the possible taxpayer groups and priority could be as follows:

    84.1. core transactions and pain points for retail investors, starting with as many of the ‘core issues’ set out in Schedule One as are appropriate. Our view is that addressing this set of fundamental core issues will increase certainty for all categories of taxpayers, and will be the lowest hanging fruit for reform. For core transactions that appear to have unfair or economically contrived tax outcomes under existing law, this stage should ideally drive the development of a set of core digital taxation provisions, which can be expanded upon through future processes. For core transactions that appear to produce a tax outcome that sufficiently reflects economic substance, this stage should lead to publication of ATO-binding public guidance confirming that the Commissioner will accept these positions;

    84.2. technical uncertainty and pain points for industry-level taxpayers, such as SME taxpayers, crypto-native businesses, large business and the financial services sectors. These taxpayers tend to be more equipped to proactively or reactively engage with the tax administration and legal system so we consider that retail investors should be prioritised first, however addressing pain points for these taxpayers will nevertheless be essential for incentivising large-scale investment and cryptocurrency business in Australia. We suspect that many of these pain points will be best addressed through relatively minor adjustments to existing legislative provisions (e.g. specifically clarifying whether certain cryptocurrencies could qualify as “tainted assets” for the purposes of the Controlled Foreign Company rules under Part X of the ITAA36); and

    84.3. technical uncertainties and pain points for start-ups and innovation activity, such as extending the application of concessional treatment under the Early Stage Innovation Company rules and the Employee Share Scheme rules to apply to tokens issued to employees of qualifying entities.

Proposed stewardship group

85. Regardless of the specific processes and procedures that Government and the ATO ultimately implement to address taxation of digital assets, our view is that industry and 'on-the-ground' private-client tax specialists should be consulted on an ongoing basis.

86. While formal consultation processes like the Board of Taxation review are welcomed as valuable opportunities to provide recommendations on 'big picture' issues, our view is that ongoing regular collaboration with industry in the process of developing programs and policy will ultimately be more efficient than a more rigid process of Government simply releasing proposals for public comment.

87. Thus, we recommend that a digital taxation stewardship be created, comprising of industry leaders and private client tax-specialists operating in this space, to participate in more regular consultation with Government and the ATO on nuanced cryptocurrency issues.

Increased allocation of resources to administration of digital asset taxation

88. Given that it will not be possible for Government to specifically address all of the potential tax issues that have and will arise in relation to digital assets, the ATO will necessarily stand as the first line of Government legal interpretation on fringe issues that are not captured in the proposed transaction mapping and policy development exercises.

89. Our understanding is that the current ATO organisational structure does not include a significant division dedicated to addressing taxation of digital assets.

90. Regardless of whether the proposed transaction mapping measures are ultimately implemented, we strongly recommend that additional funding be allocated to establishing a digital assets division of the ATO, which would be responsible for driving development of both detailed public guidance and new pre-lodgement engagement and advice products designed to assist taxpayers with managing their tax risk.

91. Once particular product that we would encourage the ATO to consider developing is an anonymous assurance program through which taxpayers can approach the ATO to obtain a non-binding assurance letter confirming the ATO's views regarding the technical merits of a proposed tax position on a no-names basis.

92. In our experience the ATO is often unwilling to provide advice without identifying the taxpayer because internal policies require particular categories of taxpayers to be managed by particular teams (e.g. private wealth, small business, etc), and the ATO is concerned that key details may be excluded that could impact the ultimate tax positions.

93. Our view is that these issues would be substantially mitigated if the ATO had a team dedicated to digital taxation issues, and by structuring the program so that the advice product does not bind the ATO the onus is passed on to the taxpayer to make sure that all key factual details are provided.

94. In addition, we consider that this advice product would present a valuable opportunity for the ATO to 'keep their finger on the pulse' of the kinds of transactions that Australian taxpayers are interacting with, as well as the associated technical uncertainties.

Increased test case funding and taxpayer amnesty program

95. As a matter of practicality, it is unrealistic to suggest that taxpayers and tax authorities will always agree on taxation issues, and disputes are an inevitable component of any fair taxation system.

96. While specific legislative amendment and ATO public guidance will assist with providing certainty for taxpayers in the short term, cryptocurrencies and distributed ledger technologies raise numerous legal questions that get at the 'bedrock' of fundamental common law concepts, and these answers to these questions may have widespread implications for multiple disciplines of law.

97. In the interest of reigning in the focus of our submissions to what we consider to be the most pressing taxation issues, and practical suggestions for addressing those issues, we have refrained from engaging in detailed discussion around what we have taken to calling 'bedrock' issues. No doubt other contributors have taken on the task of addressing these issues, and we would reinforce the importance of appreciating the significant level of technical legal nuance involved.

98. Regardless of how efficient, fair, and measured any legislative amendment may be, the issue remains that the fundamental guiding principles of Australian law are developed by the Courts, and future jurisprudence will inevitably set the parameters within which both existing common law and existing and future legislation interacts with digital assets.

99. This is a fundamental function of the Australian legal system, and our view is that Government and the ATO should take steps to proactively engage this function to reduce legal uncertainty around digital assets, by implementing systems that facilitate development of jurisprudence without punishing taxpayers who take reasonable steps to manage substantial uncertainty.

100. With this goal, we propose that the Government and the ATO commit to a digital asset taxation amnesty program, under which:

    100.1. taxpayers that either propose to, or have entered into digital asset transactions or arrangements that raise truly novel or complex legal questions that may have widespread or significant taxation implications can approach the ATO with detailed submissions setting out:

        (a) the substance of the legal question, and the significance of the implications for the taxation or legal characterisation of digital assets; and

        (b) the tax position that they would propose to adopt in relation to the transaction or arrangement, along with the detailed technical reasons why they consider that position to be reasonably arguable, noting that this generally requires the position to be 'more likely to be correct than incorrect';

    100.2. approved taxpayers are entitled to enter into the transaction and prepare their tax returns in accordance with the position set out in their application. Once returns have been lodged, the matter is fast tracked through to the Federal Court for consideration; and

    100.3. taxpayers that participate in this process are guaranteed test case funding, and amnesty from paying any tax shortfall or penalties in the event that the taxpayer's position is not accepted by the Court.

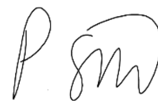
101. This measure would naturally represent a significant immediate cost given the lack of existing jurisprudence, however we expect that the costs would reduce over time as the body of case law grows. This is on the basis that it would be increasingly

difficult to establish the requisite level of legal significance of the applications as more fundamental questions are answered.

Closing Comments

102. We appreciate the opportunity to participate in this consultation process, and we look forward to the publication of the Board of Taxation's report.

Yours faithfully,
Cadena Legal



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Schedule One: Tax Technical issues

103. In the interest of attempting this schedule from getting too lengthy, we have broken up the categories of transactions and technical issues as follows:

    103.1. (**core issues**): categories of transactions and arrangements that we have observed are regularly entered into by retail investors, wholesale investors, and traders alike, and therefore impact a majority of taxpayers that participate in cryptocurrency markets. These are the issues that we believe require the most immediate attention by Government, and accordingly we have set out more detailed discussion;

    103.2. (**secondary issues**): these are categories of transactions, arrangements, and issues that we have observed are rarely (if ever) relevant for retail investors, but come up regularly in the context of blockchain businesses. Given that these issues affect a smaller overall portion of the population our view is that priority should first be given to addressing the core issues; and

    103.3. (**other issues**): these are issues that we simply wish to flag as existing, but do not consider require core legislative amendments or guidance as a priority. These are issues that may be better addressed by the Courts or the ATO as this space develops over time.

104. Accordingly, we do not propose to embark on a deep-dive of the applicable legislative provisions and common law. Instead, we simply intend for this discussion to guide the Board on understanding the issues, how they affect taxpayers, and our views regarding practical and fair approaches to reducing uncertainty.

Core issues

105. Our view is that the core transactions, arrangements, and issues that are likely to affect a significant portion of retail investor taxpayers are:

    105.1. purchase and disposals;

    105.2. general ownership principles;

    105.3. airdrops;

    105.4. “proof of stake” network validation;

    105.5. lending and borrowing protocols;

    105.6. liquidity pools;

    105.7. chain forks;

    105.8. personal use tokens;

    105.9. token minting; and

    105.10. token sacrifices

Purchase and disposals

106. Our view is that there is currently little technical uncertainty around the application of the income tax law to simple disposal events. This is still subject to academic questions around whether unspent transaction outputs in distributed ledger networks are captured under any of the currently recognised categories of property rights for the purpose of Australian law.

107. From an academic perspective this enquiry is a fascinating and complex example of a novel feature of distributed ledger technology that appears at its face not to "play nice" with fundamental legal principles. For example, in our view fascinating questions arise as to whether the powers of influence a wallet has over unspent transaction outputs associated with the wallet may represent a new category of property right that is not primarily sourced from the operation of a sovereign legal system, and by further extension whether those powers are vested in the mere wallet itself or the controller/owner of the wallet as a specifically identifiable legal identity. We understand there is pending legislation in the UK considering the property law implications of Bitcoin and unspent transaction outputs.

108. From a practical perspective however, our view is that it is uncontroversial that cryptocurrency assets should be treated as property for taxation purposes even if it is not so for property law purposes. This position reflects the substance and economic reality of cryptocurrency markets as having value and there is no justification for it to escape income tax or CGT due to the property law nature of the asset.

109. Assuming that cryptocurrencies are in fact property, it follows that disposals of cryptocurrencies follow basic income tax treatment:

    109.1. for disposals of tokens held on capital account, CGT event A1 occurs, and the taxpayer makes either a capital gain or loss;

    109.2. for disposals of tokens held as trading stock, the gross proceeds of the sale are assessable income, the taxpayer is entitled to claim a deduction equal to the outgoing incurred in acquiring the tokens, and the usual income/deduction adjustments occur at the end of each income year based on increases or decreases in total market value of the taxpayer's trading stock assets compared to the beginning of the year.

110. We consider that this treatment reflects the economic substance of transactions that involve an exchange of assets with different economic substances (e.g. BTC for ETH, ETH for $AUD). This treatment is consistent with well-established tax principles – for example, it is reasonable that exchanging real property for an equivalent value of gold bullion triggers a tax event, as one asset has been exchanged for another asset the market value of which is influenced by a different set of economic factors (I.e. the taxpayer has realised the relative value appreciation of the original asset).

111. In our experience the main source of uncertainty for taxpayers comes from keeping records as to AUD relative market values of tokens over often hundreds or thousands of transactions. Realistically, use of report generating software such as CryptoTaxCalculator is the only practical solution to this issue, although there is naturally a question of which 'source of truth' should apply for token prices especially as users delve into more obscure crypto assets.

112. The ATO has provided general guidance confirming that it will accept "exchange rates on a reputable exchange", however does not explicitly state which exchanges would be considered reputable.[8]

113. Our view is that the ATO should update this guidance to confirm that it will accept decentralised exchanges with reasonable liquidity volumes and price reporting

[8] https://www.ato.gov.au/individuals/investments-and-assets/crypto-asset-investments/transactions---acquiring-and-disposing-of-crypto-assets/crypto-asset-transactions/?anchor=ValuingcryptoassetsinAustraliandollars&anchor=ValuingcryptoassetsinAustraliandollars#ValuingcryptoassetsinAustraliandollars.

websites such as CoinMarketCap or CoinGecko as reasonable 'sources of truth' for exchange rates.

114. This is a minor issue, though easily managed by ATO website guidance.

115. This is in alignment with Principle Four.

Transfers and ownership

116. Similarly, our view is that there is little to no technical uncertainty that transferring tokens between wallets with identical beneficial ownership does not trigger CGT event A1, as there is no change in beneficial ownership. While this position may be clear to tax practitioners, our anecdotal experience is that there is still some 'rumour mill' confusion among retail investors on this point.

117. A cursory look over the ATO community engagement forums demonstrates that the ATO has answered this question on more than a few occasions, however our impression is generally that inexperienced taxpayers require more proactive engagement on even simple issues in this space.

118. Given that the ATO has publicly committed to cracking down on cryptocurrency, our recommendation is that the ATO consider publishing more targeted educational material in social media spaces that cryptocurrency investor demographics actually frequent.

119. As tax lawyers, we have regularly come across the ATO's 2021/22 educational advertising campaign, typically featuring Assistant Commissioner Tim Loh, on both TV news and professional social media platforms such as Twitter and LinkedIn, however we would suggest that the ATO is missing out on a substantial portion of the taxpayer base which, at least anecdotally, appear to spend more time on platforms such as Instagram, Reddit, Twitter and TikTok.

120. We note that Cadena Legal's principal, Harrison Dell, is active in these spaces and has found them to be a strong source of engagement with the cryptocurrency community. Tim Loh or any ATO official would be more than welcome on Harrison Dell's TikTok live sessions to discuss the nuances of crypto tax reforms and help educate the community.

Evidence of wallet ownership arrangements

121. In addition, there is a degree of complexity in keeping records to sufficiently demonstrate that certain cryptocurrency wallets are controlled by certain entity – particularly physical 'cold wallets' and wallets that are not associated with a centralised digital currency exchange account.

122. For example, a company or individual (even acting as trustee or a partner) may hold a wallet and resolve or state via deed poll that the wallet is owned and controlled by the company, while the private key is held by an individual director or related party. The current approach is to make resolutions, deed polls, or when required statutory declarations to record wallet ownership and there is continued uncertainty.

123. It is proposed that the ATO issue guidance confirming that it will accept contemporaneous or pre-audit company and trust resolutions documenting ownership of wallets as sufficient evidence of ownership – noting that many small trustees or company directors will only become aware of the need to document the arrangement sometime after the fact. In time, the ATO may even require reporting of entity held wallets across certain blockchains to aid its data matching efforts.

124. In addition, specific guidance should be issued confirming that a director holding the private key on behalf of the company does not jeopardise ownership nor trigger issues under Division 7A of the ITAA36.

125. This is in alignment with Principles One and Four.

Quasi-disposal events - 'staking', 'bridging', and 'wrapping

126. One major source of technical certainty is the tax law consequences of smart contracts that appear on their face to involve a disposal event due to tokens leaving the user's wallet, however in substance do not represent a user agreeing to give up the underlying economic substance of the assets.

127. Smart contracts are simply a program written on the blockchain which any user of the blockchain can interact with.

128. Three types of common smart contract activities that raise uncertainty around quasi-disposal events are explained in more detail below. All the below are in alignment with all Principles of the framework, though we note that Principle Four is the most relevant as consulting and being pragmatic in this situation is essential for reaching fairness.

Staking

129. Staking refers to a process in which a user's coins or tokens are voluntarily locked in a smart contract for a variety of purposes, typically with the expectation of a periodic yield, and are then returned to the user at a later stage – sometimes after a fixed period of time, and other times at the user's discretion.

130. Typically these smart contracts operate by connecting the user's wallet to the smart contract, which removes specified tokens to a different wallet (though some staking contracts leave tokens in the user's wallet that are untradeable). The 'recipient' wallet is typically the same for every user that interacts with that particular smart contract.

131. Importantly, the cryptocurrency industry has a tendency to use the word 'staking' to refer to a range of transactions that have fundamentally different legal characteristics, but generally tend to refer to arranements that involve tokens being committed to a purpose with an expectation of receiving a yield.

132. While investors will often refer to the participation in a DeFi liquidity pool as 'liquidity staking', our view is that this activity has a distinct set of legal characteristics from other staking activities. For this reason we have addressed 'liquidity pool staking' separately.

133. The most common staking contracts are 'proof of stake' consensus mechanisms. For the purpose of this initial consultation, we consider that the key feature of these arrangements is that users who do not have sufficient assets or infrastructure to operate their own network validator node are able to participate in arrangements that involve staking their tokens to a node operated by another user.

134. There is uncertainty around whether the ATO or the Courts would treat a tax event as having occurred - either CGT event A1 for capital assets, or a revenue asset disposal - in circumstances where the tokens have left the user's wallet and are stored in the wallet deployed by the relevant project. In some cases

135. Another example is 'governance staking' whereby a user can vote or influence the actions of a network by locking up governance tokens in a smart contract that indicates the user's intention. Networks that use this type of governance mechanism will often incentivise participation by returning a yield for staking tokens.

136. There is uncertainty around whether the ATO or the Courts would treat a tax event as having occurred - either CGT event A1 for capital assets, or a revenue asset disposal - in circumstances where the tokens have left the user's wallet and are stored in the wallet deployed by the relevant project. In some cases it is technically possible for the project to withdraw the funds in the wallet by disabling the smart contract – one of many forms of 'rugpulls' where investor funds are misappropriated. The phrase 'not your wallet, not your crypto' has become somewhat of a mantra of the industry, and there are questions of whether ownership interests in cryptocurrency tokens effectively vest in whichever wallet has practical control over the tokens.

137. On further analysis of the implied legal relationship, our view is that it may be akin to a form of implied or equitable lease or license arrangement, as the intention of the user is not to transfer economic ownership of the assets. There are also questions around whether a user who was 'rugged'[9] would have grounds to sue the entity that withdrew from the smart contract wallet. In our view, such grounds may exist despite the fact that the entity may be difficult to locate or identify as the core terms of the agreement may be inferred from the smart contract and related marketing materials.

138. At this stage the ATO has not published guidance specifically considering whether lock-up staking triggers a tax event.

139. Our view is that the transfer of tokens to a staking contract should not trigger a taxing point, as the user does not enter into the transaction with the intention of disposing of any assets.

Bridging Contracts

140. Bridging generally involves locking a coin or token from one blockchain into a smart contract, which then creates a derivative asset on another blockchain. For example, Bitcoin on the Bitcoin network cannot be used by DeFi protocols built on Ethereum to enable automated market makers (**AMM**) to allow for instantaneous swaps of Ether to Bitcoin, as Bitcoin does not exist on the Ethereum network. Instead, a contract is created to lock BTC on the Bitcoin network in exchange for a WBTC (Wrapped Bitcoin) token to be created on the Ethereum Network. WBTC can then be paired with another crypto asset such as Ether of USD Coin to enable AMM's to allow for free trading of BTC without centralised entities. WBTC does not allow for any operations on the Bitcoin network. Importantly, a fundamental feature of bridging contracts is that the total issued supply of 'bridged' tokens is always matched to the supply of the original token locked in the bridging contract.

141. There is uncertainty around whether locking crypto asset into the bridging contract may be considered to be a disposal event, for two main reasons:

    141.1. as with lock-up staking, practical control of the tokens changes, as the tokens move from a wallet the user controls to a smart contract or wallet that the user does not control. These bridging contracts can and have been rugged and are known to be relatively risky by blockchain developers; and

    141.2. at face value, these transactions technically do involve the user transferring one token (i.e. BTC) out of their wallet and receiving a token with a different denomination (i.e. WBTC).

[9] A colloquial verb of 'rugpull' meaning that crypto assets are stolen.

142. The ATO is yet to address the tax consequences of bridging contracts in any meaningful way. At this stage, the only public commentary released by the ATO appears to be a single post in the ATO's community forum in which an ATO officer appears to suggest that the bridging may involve the user disposing of the asset to the 'bridge owner', then reacquiring it from that entity.[10]

143. At risk of being unduly critical, our view is that it is inappropriate for the ATO to publish a view on an acute technical issue in this manner. This post currently represents the only form of guidance that a majority of retail investor taxpayers would be able to access, and many of these taxpayers would simply adopt this position out of caution regardless of the fact that the ATO has not demonstrated an attempt to consider whether the position is actually correct.

144. In our view, the economic substance of a bridging transaction is more akin to a bailment arrangement under which the token is bailed to the smart contract owner, who then issues a notional asset to represent the user's entitlement to the crypto asset locked in the smart contract. This notional asset does not provide the user with the same rights the original token had on the original network (i.e. WBTC cannot be used on the Bitcoin network), however it is effectively a one-to-one representation of an ownership interest in the original token.

145. Again, our view is that treating bridging contracts as a taxing point is inappropriate, as in substance the bridged token is intended to represent the original token, simply in a form that facilitates interaction with a different network.

Wrapping Contracts

146. A wrapping contract is similar to a bridging contract, however the 'wrapped' token that is created is usually issued on the same blockchain.[11]

147. The most common example is that the original Ether token was released before the development of the ERC-20 token standard, and therefore lacks certain features that are required for a token to be able to interact directly with certain DeFi applications. In order for users to use the value of their ETH for DeFi transactions, the ETH must be upgraded to the ERC-20 token standard by locking the original Ether in a smart contract, which then issues an equal number of ERC-20 'wrapped ETH' (WETH) tokens – less network transaction fees.[12]

148. The current ATO website guidance on this process is almost non-existent, with only ATO Community posts where the ATO officer suggests, almost unequivocally, that wrapping is a CGT event A1.[13] Unlike staking and bridging, there was no referral for early engagement in this case, which involved wrapping to ETH to WETH. This is as strong an indicator that the ATO considers all these smart contract functions as a disposal event.

149. We consider that the tax outcomes of 'wrapping' should be identical to the tax outcomes of 'bridging'.

Addressing quasi-disposal transactions

[10] https://community.ato.gov.au/s/question/a0J9s0000002oDg/p00172412.
[11] The term 'wrapping' is often used to describe bridged crypto assets. The industry has not standardised this terminology and even among submissions we expect some discrepancies.
[12] See www.weth.io
[13] https://community.ato.gov.au/s/question/a0J9s0000001IHj/p00046589.

150. Our view is that quasi-disposal issues should be addressed through both specific legislation and ATO guidance:

    150.1. the ATO should clarify in guidance that the additional rights from bridging and wrapping are not a CGT event, similar to Taxation Ruling TR 94/30 Income tax: capital gains tax implications of varying rights attaching to shares. TR 94/30 concludes that a change in share rights is not a CGT event, although on a black-letter interpretation of the CGT rules it would likely be CGT event D1. The approach in TR 94/30 would need to be expanded to the taxpayer not holding the original asset, only a derivative asset that represents the value of the original. This practical approach should extend to changes in crypto asset rights generally, and specifically to rights gained on entering into bridging contracts; and

    150.2. legislation should be introduced to specifically exempt certain smart contract interactions as described below. Ideally this would clarify parameters for a category of digital asset transactions that would not trigger a tax event under either the CGT rules or ordinary income taxing provisions, possibly in a similar manner to the small business restructure rollover provisions under Subdivision 328-G of the ITAA97.

151. This recommendation aligns with principle one of the framework.

Airdrops

152. The term 'airdrop' typically refers to an unsolicited deposit of crypto to a user for various reasons. These arrangements are commonly used to distribute a token to users who have interacted with a specific protocol in some way.

153. Our analysis of the state of airdrop tax guidance and the way forward is different than most other recommendations, as the ATO has very recently published a significant update to their website guidance in a significant way. Airdrops were previously seen as income if it was an 'established token' as specified in ATO guidance. That guidance changed on 7 September 2022 to distinguish between:

    153.1. initial allocation airdrops – which the ATO considers are not taxable and have a nil cost base; and

    153.2. established token airdrops – which the ATO considers are income and have a market value cost base.

154. Neither of these terms were defined in the updated ATO website guidance nor have any basis in case law that the authors are aware of.

155. There were dozens of significant airdrops in the 2022 income year, some worth well over $5,000 AUD. Some examples are $ENS, $LOOKS, $APE and more recently $SAFE and $OP.

156. The proposed changes align with Principles Three and Four.

<u>Initial allocation airdrops</u>

157. Our view is that zero cost base for an initial allocation airdrop tax treatment appears to have little basis in law. Specifically, subsection 112-20(1) of the ITAA97 states that where a taxpayer does not incur any expenditure to acquire an asset, the first element of the cost base is the market value. This clearly does not entirely align with the position taken by the ATO, except in circumstances where it may not be possible to identify an appropriate market value due to insufficient liquidity at the time of receipt.

158. Further, a bona fide gift is neither income nor a capital gain for the recipient in any situation known to the authors in Australia.

159. Our view is that a fair and technically correct reading of the tax law would result in the initial allocation airdrop triggering no assessable income, and having a market value cost base. In our view, airdrops that are received without the taxpayer having provided any consideration are effectively gifts, and should be taxed accordingly.

160. Our view is that further clarity is required on this point, including whether the ATO has based its position on an assumption that it is either not possible to determine a market value for initial allocation tokens due to insufficient market liquidity at the time of receipt, or otherwise that the market value of the tokens is specifically nil for some other reason.

Established token airdrops

161. Our view is that an airdrop of an 'established token' should not be treated as income in all cases. As above, if it is a bona fide gift, the recipient should derive no income or capital gains, and receive a market value cost base.

162. Where an airdrop is actual the receipt of income from property or provision of labour, it is likely to be taxable as ordinary income. This is dependent on the facts of each case.

163. As above, this term is not defined by the ATO and there is insufficient analysis of the term and the rules around gifts, and how these may apply to airdrops. Formal guidance and perhaps legislative clarification is required to distinguish between an initial allocation airdrop and an established token airdrop.

164. It is also important to note that the term 'airdrop' is an industry term which may also be used to describe income from property i.e. holding DAO governance tokens may occasionally entitle the holder to income generated from the DAO.[14] More detailed and more formal guidance is required to tackle this issue and assist taxpayers in categorizing their airdrops correctly.

165. We also note that the ATO website guidance was updated without any substantial announcement – many advisors, including the authors, only became aware of the change due to Dr Elizabeth Morton mentioning it during one of the Board of Tax consultation sessions. This has since become relatively high-profile news in crypto asset tax circles and the profession was not consulted on the change in any meaningful way. We also note that this change in position is very significant for taxpayers , who will be amending their returns to claim refunds, so it is concerning that the ATO has not taken more transparent steps to updating the public on this change in view.

Lending and borrowing protocols

166. Blockchain lending protocols are another source of technical uncertainty. The mechanical operation of these protocols can be complex, however the core substance of these arrangements is typically referrable to traditional lending arrangements where a lender advances value to a borrower, who is required to (eventually) pay some form of interest and often is required to commit valuable assets as collateral.

[14] Ignoring the breaches of securities law internationally.

167. The most common providers to date have been Celsius (now insolvent), Nexo and BlockFi.

168. The tax treatment of these types of transactions are uncertain in several main areas:

    168.1. does the transfer of crypto assets to a centralised platform trigger a disposal event;

    168.2. if a provider becomes insolvent and crypto assets are subject to claims from creditors, when is a CGT event triggered;

    168.3. does locking up tokens in a smart contract as collateral trigger a disposal event; and

    168.4. for more complex DeFi lending arrangements that involve ancillary tokens representing entitlements and other rights, what are the tax implications of receiving and dealing with these tokens.

169. The ATO has issued basic guidance on some of these issues through ATO Community posts, clarifying that even when deposited into a centralised platform like Celsius or Nexo, CGT event A1 does not occur.[15] While this is comforting for some taxpayers, the thread details various other responses where the ATO has claimed other positions.

170. Current ATO guidance on the Celsius insolvency is limited, though there are some ATO Community posts around the Celsius insolvency.[16] The ATO officer states that CGT event C2 should happen when the asset no longer exists, presumably meaning when the asset has been accessed to repay creditors as part of the insolvency process.

171. Our view is that a transfer to a centralised platform should not trigger CGT event A1, as it is merely granting of a security interest or occasionally a loan. The beneficial ownership remains with the transferor and only a legal interest has been granted at this stage. ATO guidance should clarify on this issue and legislation is not appropriate here.

172. When a provider becomes insolvent, which has happened to Celsius, it is extremely difficult for a taxpayer to determine when they lose their beneficial interest in the crypto asset. Many taxpayers consider this to be when the Celsius first notified that it was entering into an insolvency process, however many others are awaiting for the administration to be complete. The ATO Community post on the topic correctly states that there is no special CGT event for when a liquidator deems that a crypto asset entitlement will not be fulfilled unlike a return of capital on company shares.[17]

173. ATO guidance on this issue is inconsistent and difficult to locate. The ATO should issue clearer and binding guidance on this topic.

174. This is in alignment with Principles One and Four.

Liquidity Pools

175. DeFi has allowed for any user with crypto assets to provide to a smart contract, a liquidity pool or LP, which performs automated market maker (**AMM**) functions. This technological innovation is the foundation that DeFi was built on – as without it, centralised market makers would still be required to facilitate fast transactions.

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[15] https://community.ato.gov.au/s/question/a0J9s000000291g/p00169650
[16] https://community.ato.gov.au/s/question/a0J9s000000MwWq/p00186576
[17] Ibid.

176. LP's operate in a variety of ways, but the Uniswap v2 model is still the most common in our view. This method is to pair up two coins or tokens with equal value i.e. for example if 10 BTC = $100, and 5 ETH = $100, this means that depositing 10 BTC and 5 ETH would yield an evenly weighted LP token. If the price of BTC increased, the pool will automatically rebalance to sell BTC and buy ETH to ensure $100 of each asset are in the pool. It is possible to lose value in a pool where both tokens decrease, or one token increases or decreases relative to the other – this is called impermanent loss. The exact operation of LPs and impermanent loss is well beyond the scope of this paper.

177. For the purpose of these submissions, the key information for the Board is that two tokens are deposited, to receive an LP token which represents an entitlement to the underlying liquidity pool of crypto assets.

178. There is uncertainty as to how a deposit into a liquidity pool should be characterised. For example, one possible view is that:

    178.1. the taxpayer is opening up a speculative position, and receipt of the LP token is recognition of this current position; and

    178.2. when the taxpayer returns the LP token and withdraws assets, the taxpayer is closing the speculative position, and the difference in the deposit and withdrawal values should be taxed as realised profit or loss.

179. The speculative nature of these assets may suggest that a flat 'always income' treatment should apply if an LP operates similar to a CFD. Unlike CFDs however, LPs commonly incentivise user participation by paying a periodic yield to holders of LP tokens – which at face value suggests that it may possible for LP tokens to have capital characteristics for taxpayers that are not carrying on a cryptocurrency trading business.

180. We also note that LPs are incredibly complex and evolving. For example, Uniswap v3 LPs are designed to pair NFTs rather than ERC-20 tokens. This further complicates the capital vs revenue issue, as the LP token may represent a speculative asset with enhanced risks and reward, which only taxpayers with substantial knowledge of the space would generally interact with..

181. An 'always income' treatment of LP's may be appropriate on an opt-in basis to simplify reporting of these assets, though further analysis is required before making legislative amendments or recommending work on ATO guidance products. This is in alignment with all the Principles.

Forks

182. A 'hard fork' refers to a point in time where a blockchain programming is changed so there are two versions and the user now has two assets – the original asset and the forked asset. An example was when Bitcoin holders received Bitcoin Cash in August 2017, which was created to accommodate more data in the blocks by a larger block size – this required a fundamental change to the Bitcoin source code which could not be integrated into the existing Bitcoin ledger.

183. The ATO website guidance is that the new asset is not income and acquires a zero cost base.[18] This guidance is too scant, as some issues that arise include:

[18] https://community.ato.gov.au/s/question/a0J9s0000001IE8/p00046366

183.1. acquisition timing for CGT purposes. As it was received without a CGT event, it is presumed that the ordinary rule applies and the 12 month period is reset for the forked asset;

183.2. whether any cost base can be allocated between the assets. In some cases, forking occurs due to a dispute among the nodes which then agree to maintain two different ledgers. This occurred with Ethereum and Ethereum Classic, both could have become the more valuable but the Ethereum Classic tokens received zero cost base; and

183.3. the assurance that the forked asset is not income is not clear on the law. It may be better addressed as an 'airdrop' noting our raised issues with the current ATO approach on airdrops.

184. The ATO should release formal guidance on the tax treatment of hard forks after consultation on the issues. Soft forks, being a less significant change of the programming code that the original blockchain is usually maintained, appears to raise fewer tax issues though should also be consulted on.

185. This is in alignment with Principle One and Four

Secondary issues

186. These are transactions, arrangements, and issues that will need to be addressed, but are less likely to affect retail investor taxpayers:

186.1. "proof of work" rewards;

186.2. minting tokens and NFTs

186.3. crypto asset derivatives, contracts for difference, margin and future trading;

186.4. TOFA;

186.5. transferor trust rules;

186.6. public trading trust rules; and

186.7. controlled foreign company rules.

187. Many of the below issues are addressed in less detail than the core issues. We are available for further clarification and consultation on these issues if required by the Board.

Proof of work rewards

188. In our view, there is significant uncertainty as to the tax implications of participating in 'proof of work' network consensus mechanisms, such as 'mining' Bitcoin.

189. As a starting point, there is significant uncertainty as to whether proof of work validation activities should be characterised as the provision of services in exchange of the mining rewards, either to the network as a whole or the parties to the transaction that is being validated, or as the miner creating the rewards through their own efforts (I.e. akin to a baker baking a loaf of bread). This legal characterisation is essential to determining whether 'received' mining rewards are income of the miner – rewards for services are clearly income, while the manufacture of an asset does not typically result in the market value of the manufactured asset being included as assessable income.

190. To date, the ATO has only addressed this issue in community forum engagements confirming that expenses incurred in carrying on Bitcoin mining as a hobby are not deductible.

191. If the ATO or the Courts adopt a 'services' approach, further uncertainties arise for taxpayers that hold the mining rewards as trading stock assets, including whether subsection 23A(3) of the ITAA36 would operate to reduce the amount of income brought to account in respect of the mining rewards to nil (I.e. as non-cash benefits in respect of which the miner could have claimed a deduction if the miner had simply purchased the BTC).

Minting tokens and NFTs

192. Projects often use token sales (including NFT's) to fund their project and the main value of the project accrues to those tokens. This is despite those tokens not being a security or quasi-equity in the issuing entity (often an offshore company).

193. There is currently no ATO guidance on minting tokens or NFT's as a capital raising activity. Treasury did consult on ICO taxation issues and the Hall & Wilcox submission on the topic we find to be broadly accurate in the current environment.[19]

194. The general position is that mint fees are ordinary income to the issuing project entity in most cases, or otherwise the proceeds of an isolated profit-making undertaking or scheme. This is because the sale is not an equity issue, which is normally not income or a capital gain due to the exemption in CGT event D1. The ATO is yet to publicly comment on this issue at the time of writing, although we note that it may be difficult to argue that mint fees are not ordinary income (likely as a non-cash business benefit) unless a full analysis is undertaken of the tokens or coins themselves and the rights that attach.

195. The most appropriate outcome is for these activities to be deemed non-assessable non-exempt income and included in the exemption in CGT event D1, but only if the minting is for the purposes of raising capital or other exemptions. How this would be executed we leave to Treasury to draft, though we suggest specific consultation is done with experienced crypto asset tax advisors to create the more equitable outcomes.

196. This is in accordance with Principles One and Four.

Crypto asset derivatives, CFD, margin and futures trading

197. Complex financial instruments generally tend to be treated on revenue account, as the only purpose of buying such an asset is to generate a profit or the taxpayer is presumed to be in business. Our view is that asimilar treatment may be appropriate for complex crypto derivatives, CFD's, margins, some synthetic assets and futures.

198. Taxation Ruling TR 2005/15 *Income tax: tax consequences of financial contracts for difference* should be amended to specifically include crypto asset CFD's. Other rulings may need to be created to cover derivatives and margin trading. We recommend the ATO collaborate with ASIC and significant platforms that offer these services, such as Binance Derivatives.

Issues for large businesses and institutional investors

199. We do not intend to allocate significant time to addressing large business and institutional issues at this stage, as most issues relate to fundamental crypto asset

[19] https://treasury.gov.au/sites/default/files/2019-07/attachment_-_hw_submission_-_treasu.pdf.

tax ambiguity. However, we note the below significant issues that are hindering wide scale adoption by institutions (in addition to regulatory uncertainty which is also undergoing various stages of policy consultation).

200. The definition of 'eligible investment business' in section 102M of the ITAA36 does not clearly allow for passive crypto investments to be run via trusts and not be taxed as a public trading trust. The only relevant category in general is whether crypto assets are a 'similar financial instrument' where that term is undefined. A review of the term 'financial instrument' is best found in AASB 9, which generally defines a financial instrument as an asset for one entity and a liability for another. Many crypto assets are utility based, and therefore have no liability on the issuer side. It is a serious question of whether these utility tokens are financial instruments, as many strive to not be financial product or securities by design.

Issues for international groups

201. As with large business, we consider it premature to consider international tax issues in detail until the fundamental issues are resolved. However there are two main areas where domestic law affects international structures in our client base.

202. First, the Controlled Foreign Company Rules in Part X of the ITAA97 are likely to apply to foreign companies used by projects to issue tokens. As with the public trading trust rules, it is not clear whether crypto assets can be 'similar financial instruments' and hence caught as a tainted asset. This directly affects the outcome of whether a foreign company can satisfy the active income test to prevent income attribution.

203. Second, many Decentralised Autonomous Organisations (**DAO's**) use foundation structures in the Cayman Islands and Panama to become an 'orphan structure', these entities are technically companies created under local law with no shareholders. It is not clear whether the ATO would attack these under the transferor trust provisions based on previous private rulings on anstalts.[20] Our view is that these entities would be unlikely to apply for a private ruling from the ATO given the increased risk of audit.

204. Many DAO's use trust structures which are clearly subject to the transferor trust rules. The most common example is the Guernsey Purpose Trust and other common law jurisdictions are starting to allow trusts as vehicles for DAO's - perhaps even Australia if the DAO legal entity consultation progresses down that path.

205. Our view is that core international tax provisions that are designed to protect Australian tax revenue interests in offshore companies should be reviewed to ensure that these rules do not unfairly or arbitrarily attribute income to Australian residents in inappropriate circumstances.

Other issues

206. These are issues that we simply wish to flag as existing, but do not consider require core legislative amendments or guidance as a priority. These may be better addressed by the Courts as this space develops over time.

Scam and dead crypto assets

207. Many tokens are either intentional scams, have zero value or once had value but now have no value.

[20] See PBR 1051209890341.

208. The ATO should set out guidance for how these tokens can be dealt with to ensure they do not cause tax complications. We recommend the ATO consult with software providers on principles of identifying these kinds of tokens.

209. A 'rugpull' should be clarified to be a CGT event C2 and no proceeds received. This should be done via ATO guidance as the current law around CGT event C2 is appropriate, though taxpayers are not usually aware of this or what conditions would need to be satisfied to claim the likely capital loss.

Stolen crypto assets

210. Crypto assets can be stolen by either:

    210.1. Taking the assets from a users wallet, often due to the user executing a malicious smart contract; or

    210.2. A bad actor obtains control of the private key or seed phrase and can then drain the wallet.

211. The first category is relatively simple to identify, as a smart contract will execute transfers and the wallet effectively drained.

212. The second category is more difficult to prove. Many users would not make a police report, though some may engage forensic accountants to track the bad actors. We propose that the ATO provide guidance, likely via website content, on acceptable ways to show that a wallet is no longer controlled and the assets were transferred gains the legal owners will. A statutory declaration would be appropriate in this case and the statutory declaration should be made prior to lodging a tax return showing a capital loss on stolen crypto assets.

Crypto card issues

213. While a minor issue, rewards for owning these cards are often paid in crypto and, a user is often required to stake a specific token in order to qualify for a card. The most notable and well-known card is the crypto.com card.[21]

214. The first issue is whether the rewards and cashback are income - likely not for individuals using the cards for personal use.

215. The second issues is whether the staked crypto is a personal use asset, noting that significant stakes are required to participate in high-end crypto.com cards. The maximum card level requires $500,000 USD worth of CRO token staked to access the rewards.

216. It is not clear whether the personal use asset exemption applies to each individual token. If so, as each CRO token is worth much less than $10,000 and it is kept mainly for personal use, it is arguable a personal use asset and a taxpayer would have an exempt capital gain if they liquidated the CRO.

217. This issue is worth ATO guidance in our opinion.

Salary and wages paid in crypto

218. Ordinary principles suggest that salary and wages paid in crypto assets are taxable when derived and booked at the AUD value at that point. Many service providers allow for payments to be made in crypto assets, a native project currency or may

[21] https://crypto.com/cards

receive fees (such as for providing liquidity to a decentralised exchange) paid in more tokens.

219. The current rules around ordinary income and derivation are largely appropriate and do not require changes. However, once earned the crypto asset may be held on capital account and the 12-month period for determining the CGT discount commences when received.

220. Clarification from the ATO on these transactions would be helpful to many taxpayers.

221. Similarly, there are various programs that provide a referral reward for introducing new users for a platform. An example is the Binance Referral Program[22] which provides 100 USDT (Tether) in trading fee bonuses.

222. Clarification from the ATO that these bonuses are not income would be appreciated, as such referrals would normally be considered a hobby. Of course, if the conduct amounted to carrying on a business it should be taxed appropriately.

Rebasing tokens

223. Rebasing protocols were extremely popular in 2021 and have somewhat dropped since, but the mechanics are still used today in viable ways.

224. A rebasing protocol will allocate new tokens, often on an epoch cycle, to holders who stake the token within the specified smart contracts. This was popular as the protocol could then own all the liquidity and benefits from fees from swaps.

225. The new tokens generated appear to be a staking reward where a token holder gains in value, however the practical reality is that after each epoch, the underlying value of the protocol is split among the participating token holders. This is akin to a share split and not staking rewards. These epochs are commonly 8 hours, though some are much shorter or longer.

226. The ATO has released no guidance on rebasing protocols. The starting point is that they are ordinary income though issues arise as:

    226.1. It is more akin to a token split – no new value is created generally;

    226.2. There is no blockchain transaction to record when rewards are accumulated for each user. Tax software providers cannot extract any data for each taxpayer.

227. On this basis we recommend making rebasing protocols, or elastic supplies, exempt income and exempt from CGT under the split, merged or changed assets CGT rules. This gives certainty to taxpayers who have no data to comply if the receipts were income anyway, and aligns the economic gains on sale appropriately under the CGT rules by spreading the cost base to the new assets.

GameFi

228. GameFi refers to computer gaming software that integrates blockchain elements. , This integration can take a range of forms, however typically involves key game pieces or assets being issued as NFTs, and a fungible native token is often required to participate in the game.

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[22] https://www.binance.com/en/activity/referral

229. The current personal use asset rules apply to many GameFi assets for players who participate mostly for enjoyment. The receipt of GameFi assets for hobbyists would also be not assessable income.

230. These rules have applied to other games pre-blockchain technology. Games such as CounterStrike, RuneScape and World of Warcraft saw some power users generate value from simply playing the game – these receipts are tax exempt for the most part under both hobby income and personal use asset exemption.

231. Businesses of 'farming' and then non-blockchain digital assets have existed for some time. During the financial crisis in Venezuela for example, many individuals turned to the MMORP game RuneScape to survive, as rare in-game assets could be sold to foreign residents for US dollars.[23] In addition, many business' sell CounterStrike skins on a commercial basis and are clearly a business.[24]

232. All these activities were possible prior to blockchain, and our view is that GameFi does not increase the tax complexity of using games on a commercial basis. It has always been possible for a taxpayer to carry on a business dealing in video game assets – GameFi merely makes it more frequent and easily accessible. Gaming guilds now exist, which can rent out NFT's used in specific games in exchange for a share of revenue generated. The industry is maturing.

233. The ATO should set gaming business guidelines on scale, turnover and sophistication as factors to determine if you are carrying on a business of dealing in gaming assets.

[23] https://www.polygon.com/features/2020/5/27/21265613/runescape-is-helping-venezuelans-survive
[24] See DMarket, CSGO-Skins, Skinbaron.de.