

20 October 2022

Board of Taxation Secretariat
The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600

By email: TaxDigitalAssets@taxboard.gov.au

Dear Secretariat,

Review of the Tax Treatment of Digital Assets and Transactions in Australia

The Law Institute of Victoria (**LIV**) is appreciative of the opportunity to have attended the Roundtable consultation held by the Board of Taxation (**Board**) and to prepare this follow up submission on the appropriate policy framework for the taxation of digital assets and transactions in Australia.

Introduction

The LIV is Victoria's peak body for lawyers and represents more than 18,000 people working and studying in the legal sector in Victoria, interstate and overseas.

The LIV's purpose is to promote the highest standards of ethical and legal practice and service excellence in the practice and administration of law to ensure the community benefits from strong legal representation, effective advocacy, and a fair and equitable legal and justice system. To achieve this purpose, it is necessary that laws and the published guidance issued by Government and regulatory bodies are clear and capable of efficient application.

In line with this purpose, the LIV sets out further detail to those high-level comments provided at the Roundtable for the Board to consider in preparing the policy framework for the taxation of digital assets and transactions in Australia.

Further Detail to General Comments raised at the Roundtable

Digital Concepts and Terms

The LIV notes that those in the digital asset industry (referred to generically as the '**Crypto Industry**' in this submission) traditionally make use of certain concepts and terms. The LIV submits that in many instances such Crypto Industry terms and phrases are broad and may result in some confusion rather than assistance. The LIV considers that in drafting any provisions for the taxation of digital assets, it should be taken into account that such terms are often fluid. For example, terms such as 'NFT', 'staking', and many others might connote a broad spectrum of assets and/ or transactions.

Also, when considering the term 'staking', there are a number of different common law legal outcomes which may arise. For example, some staking transactions might:

- be akin to (or in fact) bailment; or
- resemble leasing transactions; or
- be akin to margin lending; or
- result in a buy-sell with a subsequent repurchase.

In addition, when considering another term broadly used in the Crypto Industry, 'smart contracts', use of the term 'contract' implies a legal contract, however this may not be the case in all circumstances. Further, the LIV notes that smart contracts often reference coding rather than a written document; the coding dictates certain events taking place or constrains certain events from taking place with it being unclear whether the 'contract' actually binds the parties.

Common Law

In addition to the difficulties faced with digital concepts and terms, the LIV notes that the tax treatment of digital assets and transactions in the Crypto Industry generally raises a number of difficulties at common law, both as to the nature of particular transactions and as to the nature of digital 'assets'. In this sense, it is important to consider what rights does a holder have in a digital asset, and what obligations are owed in respect of it? In certain instances, use of the term 'asset' might be extending the legal meaning of that term. Further, it might be that in certain situations it is possible to have legally recognised property rights in a non-fungible token (**NFT**); whilst in other circumstances rights in respect of the NFT might not be property rights, but a non-proprietary legal right only.

The LIV submits that a simple example of the difficulties faced at common law can be seen in exchange wallets. Exchange wallets operate differently to cash in banking institutions in terms of regulation and the Government guarantee. On certain exchanges, the cryptocurrency 'held' in the wallet is not, in fact, owned by the holder of the wallet. Rather, the wallet owner has an unsecured claim to that coin or token should they wish to withdraw it from the exchange or send it to another wallet (whether it be a third-party wallet or another exchange held wallet or an offline 'hard' wallet). This has been highlighted in recent exchange collapses. If the wallet holder sends the cryptocurrency received from one exchange to another exchange, the wallet holder might then own that cryptocurrency, or rather, have a right to be provided with such cryptocurrency.

The LIV considers that it is therefore difficult to reconcile Crypto Industry understandings of ownership with those at common law, and therefore also difficult to speculate as to how a Crypto Industry termed transaction or digital asset might be dealt with at common law. Unfortunately, at this time, there is insufficient court precedent providing guidance as to the likely common law treatment of many Crypto Industry transactions. If too prescriptive, the application of taxation legislation may result in numerous unforeseen situations and incorrect and/or inequitable taxation treatment. Therefore, the LIV considers that any taxation legislation which is prepared to address Crypto Industry transactions should be flexible enough to develop alongside the common law, rather than being fixed and possibly inconsistent with common law development in this area. The LIV also considers that any taxation legislation should be drafted to interact effectively with key questions in other areas of law, for example, whether certain digital assets are securities.

Crypto Industry – Evidentiary Issues

The LIV considers another key area of importance when examining the tax treatment of digital assets and transactions in the Crypto Industry is that of evidence. This is particularly difficult as platforms for the exchange of digital assets may be developed that do not recognise the legal nature of transactions and the need to understand and document the nature of the transactions and 'assets'.

This is due to the fact that the traditional written documentation of transactions involving assets (i.e. non-coded) is often at odds with the core reason for and purpose of the creation of new technologies.. Given the existing legal framework, there is often a greater burden on the taxpayer to evidence transactions involving digital 'assets'. However, as technology is embraced further and becomes more intertwined with the mainstream economy (such as, for example, mainstream financial systems) it is considered likely that an increasing number of legal relationships will be governed by contracts coded into the technology rather than traditionally drafted written legal agreements.

When considering the evidentiary difficulties faced in the taxation of digital assets, the LIV believes that one key issue is determining where the counterparty is located in a transaction (or in fact who the counterparty is). In the case of an exchange, this might be the exchange itself (refer to the above discussion on exchange wallets – again the LIV cautions this as not all exchanges and exchange wallets are the same). However, the LIV notes that this is not always the situation. Further, many larger transactions take place via platforms such as fireblocks or alternative platforms which facilitate transactions (acting, for example, as a form of escrow). As highlighted above, the transactions are often coded rather than via written documents and neither the platform nor the parties transacting know each other. In many instances, the platform will know the account holder, the account holder having gone through strict know your client (**KYC**) compliance. However, as many such platforms are non-Australian, it might pose difficulty for taxpayers to obtain any evidence as to the counterparty.

The LIV considers that when viewing the difficulties noted above, a mechanism that might reverse the current tax position and require the Commissioner, in the first instance, to demonstrate evidence as to why a particular tax treatment should apply (with an opportunity for the taxpayer to demonstrate otherwise), may be more reasonable.

Drafting

The final general aspect the LIV considers of importance when examining the tax treatment of digital assets and transactions is that those drafting the legislation have an in-depth knowledge of the Crypto Industry and the nature of transactions and assets within the Crypto Industry. In this sense, the LIV understands that Intellectual Property Australia, has a number of individuals that are highly knowledgeable of the Crypto Industry and the technologies being developed. This is due to the fact that IP Australia has an interest in NFT technology and its potential application in future registration and ownership of intellectual property, such as for example, trademarks. IP Australia may therefore be one avenue available to Treasury to draw upon suitable technological expertise.

Conclusion

For the reasons set out in this submission, the LIV strongly recommends a principle-based approach to the tax treatment of digital assets, rather than one which is too prescriptive. The LIV appreciates that in the short-term, this might give rise to administrative difficulties (for both industry and the Commissioner), however the LIV believes that in the longer term this will provide a more robust and flexible basis for the taxation treatment of digital assets and transactions in a rapidly changing technological space in the future.

Further consultation and contact

The LIV welcomes the opportunity to discuss this submission with you in greater detail and to expand upon the points outlined above.

If you have any further queries, or if your or your office would like to discuss this matter further please contact Angela Gidley-Curtin, LIV Section Lead and Senior Commercial Lawyer, on (03) 9607 9409 or at agidleycurtin@liv.asn.au.

Yours sincerely,



**President
Law Institute of Victoria**