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The tax treatment of cryptocurrency

Cryptocurrencies, once again surging in popularity, have a unique tax treatment that every taxpayer dealing with cryptocurrency should be aware of.

It's been more than 10-years since the advent of bitcoin and the term "cryptocurrency" entered the public consciousness.

However, neither bitcoin nor the many thousands of cryptocurrencies that have followed have become widely used for payments by the general public. Instead, people are more likely to use cryptocurrencies as a speculative high-risk investment class.

However, the pandemic has prompted a marked increase in consumer investment, the ATO has followed this development with warnings of a "crypto compliance" crackdown this tax time — so it will pay to be careful.

Cryptocurrency is essentially a digital representation of value that is neither issued by a central bank or a public authority, and usually not attached to a national currency.

Cryptocurrency can be transferred, stored or traded electronically.

Essentially, there are three ways to acquire cryptocurrency:

- Buying it through an online exchange system that put sellers in touch with buyers. Purchases are then made by transferring money via online banking. Typically, cryptocurrency is stored in an online "wallet".
- Providing goods and services in return for cryptocurrency.
- Mining — as in the process by which cryptocurrency is created, whereby a computer crunches through a set of complex mathematical exercises and the end result is a "piece" of cryptocurrency.

But broadly, what is the tax treatment of this form of currency?

Capital gains

Cryptocurrency is generally regarded as a CGT asset, and the disposal of cryptocurrency to a third-party may constitute what the ATO calls a "CGT event". Disposals can take several forms: selling or gifting the cryptocurrency; trading or exchanging it; converting it to Australian dollars; or using it to acquire goods or services.

A capital gain is made when the proceeds from the disposal of the cryptocurrency exceed the original cost base. The capital proceeds from the disposal of the cryptocurrency is the money or the market value of any other property received in respect of the disposal. The main element of the cost base is the money paid or the market value of any other property a buyer gave in acquiring that cryptocurrency. The general 50% CGT discount may also apply where the currency is held for 12 months or more, as detailed in the following example.

> ***Cryptocurrency as an investment***
> *In September 2019, Edward buys 300 coins of cryptocurrency for $12,500. In October 2000, via a digital currency exchange, Edward then exchanged 150 of these coins for 200 coins of another type of cryptocurrency. The exchange rates at the time of the transaction put the market value of the 200 coins at $10,000. The gross capital gain will be $3,750 ($10,000 minus half of $12,500). As the currency disposed of was held for 12 months or more, the gross capital gain can be reduced by 50%, down to $1,875.*

In the event that the cryptocurrency received cannot be valued, the capital proceeds from the disposal are worked out using the market value of the cryptocurrency disposed of at the time of the transaction.

Note that, as with shares, if a cryptocurrency increases or decreases in value while held by a taxpayer, this does not result in a capital gain or loss. This is because there is no "disposal".

Personal use asset

According to the tax rules operating in the area of CGT, a capital gain made from a “personal use asset” is disregarded if the first element of the cost base is $10,000 or less. In addition, any capital loss made from a personal use asset is disregarded. These provisions apply equally to cryptocurrency. The relevant time for determining whether the cryptocurrency is a personal use asset is at the time of its disposal.

Examples where cryptocurrency is held for personal use may include where it is kept or used mainly to make purchases of items for personal use or consumption, for example, clothing or music.

This personal use carve-out, however, would not apply where the cryptocurrency is kept or used mainly for the purpose of profit-making as an investment (to be sold or exchanged at a later time when the value has increased) or to facilitate purchases or sales in the course of carrying on business.

Assessable income?

It may be the case that a gain on the disposal of cryptocurrency (that is not a personal use asset) is assessable as ordinary income rather than a capital gain. Where this is the case, the CGT discount will not be available.

In the case of an isolated transaction that is not carried out as part of a business operation, the ATO is of the view that a gain will generally be ordinary income where the taxpayer’s intention or purpose in entering into the transaction was to make a profit or gain.

In determining whether an isolated transaction amounts to a commercial transaction, factors to consider include:

- the nature of the entity making the transaction
- the scale of the activities
- the amount of money involved
- the nature, scale and complexity of the transaction
- the manner in which the operation or transaction was entered into or carried out, including the use of agents or professional advisers, and
- the timing of the transaction or the various steps in the transaction.

Trading stock?

In some circumstances, cryptocurrency can constitute “trading stock”, and will be treated as such where:

- it is held by a taxpayer carrying on a business of mining and selling bitcoin, or
- a taxpayer is carrying on a cryptocurrency exchange business, or
- it is received as a method of payment by any business that sells goods where the cryptocurrency is held for the purposes of sale or exchange in the ordinary course of the business.

Proceeds from the sale of cryptocurrency held as trading stock in a business are ordinary income, and the cost of acquiring cryptocurrency held as trading stock is deductible.

The CGT rules do not apply.

Foreign currency gains or losses

The tax law provides rules for recognising foreign currency gains and losses for income tax purposes. The ATO’s longstanding position is that gains or losses made from cryptocurrencies, such as bitcoin, cannot give rise to foreign currency gains or losses because such currencies do not constitute “foreign currencies” under the existing tax legislation. High level court cases have also ruled that bitcoin and other cryptocurrencies are not a currency or foreign currency for income tax purposes.

Record keeping

Taxpayers dealing with cryptocurrency need to keep the records laid out in the table on the next page.

RECORDS REQUIRED TO BE KEPT

INFORMATION THAT YOUR RECORDS MUST SHOW	EXAMPLES OF TYPES OF RECORDS
• date of the transactions • what the transaction was for and the identity of the other party to the transaction • the value of the cryptocurrency in Australian dollars at the time of the transaction (from reputable online exchanges)	• receipts of purchase or transfer of cryptocurrency • exchange records • records of accountant, agent or legal costs • digital wallet records and keys

Finally, for those using cryptocurrency for both personal use and for investment or business purposes, it is particularly important to keep clear records. This is because it will fall to them to show the intention behind each transaction.