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Dear Ms Purvis-Smith

GST Treatment of Digital Currency – discussion paper

Thank you for the opportunity to comment on the Treasury's discussion paper 'GST treatment of digital currency', published on 3 May 2016. As the lead policy agency responsible for Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime, the use and ongoing expansion of digital currencies is an area of continuing interest to the Attorney-General's Department (AGD).

Noting that the Australian Government has now assumed a caretaker role pending the outcome of the election on 2 July, AGD offers the following comments on an information-only basis. AGD has consulted the Australian Transaction Reports and Analysis Centre (AUSTRAC) on the contents of this letter.

Statutory review of Australia's AML/CTF regime

The recently tabled report and recommendations of the statutory review of Australia's AML/CTF regime considered the opportunities and challenges associated with the continued proliferation of digital currencies.¹ While digital currencies offer the potential for cheaper, more efficient and faster payments, the associated money laundering and terrorism financing risks are well-documented. Digital currencies allow for greater anonymity than traditional non-cash payment methods and the peer-to-peer nature of transactions ensure that users can often avoid interacting with the regulated financial system.²

In particular, the statutory review report noted that many digital currencies are not clearly captured by Australia's AML/CTF regime. The current definition in the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) defines 'e-currency' to be an internet-based, electronic means of exchange that is backed either directly or indirectly by precious

¹ Report on the Statutory Review of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* and Associated Rules and Regulations, available online at: <https://www.ag.gov.au/consultations/pages/StatReviewAntiMoneyLaunderingCounterTerrorismFinActCth2006.aspx>.

² *Ibid*, p 47.

metal, bullion or a thing prescribed by the AML/CTF Rules and is not issued by or under the authority of a government body. This definition excludes de-centralised digital currencies such as Bitcoin which are backed by a cryptographic algorithm, rather than a ‘physical thing’.³

The statutory review report recommended that:

- the definition of e-currency be expanded to include digital currencies not backed by a physical thing, and
- AML/CTF regulation be extended to digital currency exchange businesses.⁴

The review also proposed that regulation only extend to digital currencies that are ‘convertible’, that is, digital currencies that have an equivalent value in ‘fiat’ currency (national currency) and can be exchanged for other currencies. The review does not support extending regulation to include non-convertible digital currencies and exchange mechanisms (e.g. frequent flyer and loyalty programs), due to their limited intersection with the financial system and because they are limited in their functionality to transfer value.⁵

Proposed definition of ‘digital currency’

The Treasury’s proposed definition has six components:

- a digital or non-tangible unit of account
- not being denominated in units of other currencies, making it a unique currency
- a commonly used medium of exchange
- two-way convertibility to real-world goods, services and fiat currency, outside of a centralised exchange
- reliance on cryptographic techniques to validate transactions, and
- a lack of centralised control or centralised validation of the currency, such as through the ‘distributed ledger’.

This definition is comprehensive and clearly there are benefits associated with establishing specific boundaries to promote clarity and consistency in the interpretation of Australia’s taxation laws. However, AGD notes that this definition is narrower than some widely-accepted definitions of digital currency. In particular, it appears to focus on convertible, de-centralised digital currencies such as Bitcoin.

The Financial Action Task Force (FATF), which is the body responsible for setting international standards on AML/CTF, has defined digital currency more broadly to include centralised and non-convertible digital currencies:

[A] digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal

³ Bitcoin is ‘de-centralised’ as it is not issued by a central administering authority.

⁴ Statutory Review Report, p. 50.

⁵ *Ibid*, p. 47.

tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor [sic] guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the digital currency.⁶

Based on the proposed definition in the paper, the beneficiaries from the proposed change to the taxation treatment of digital currency would be users of de-centralised, cryptographic, convertible digital currencies like Bitcoin. Such a definition may exclude other digital currencies which do not meet each of the definition's requirements.

While Bitcoin is the most prominent example of digital currency currently, other convertible digital currencies, such as (the now defunct) e-gold, have not relied on cryptography to validate transactions and were not de-centralised. This is true also for future digital currencies, which may be centralised or may rely on non-cryptographic techniques to validate transactions. By adopting a narrow definition, the Treasury may risk excluding users of other convertible digital currencies from the benefits of the proposed reform.

AGD notes the advantages of adopting a technology-neutral approach to new regulation as discussed in the 2014 Financial System Inquiry report.⁷ When the AML/CTF Act was drafted in 2006, Bitcoin had not yet been invented and e-gold was the main digital currency of concern to policy-makers. The definition of 'e-currency' in the Act therefore is focused on capturing e-gold, rather than broadly capturing digital currencies. It was a general recommendation of the statutory review of Australia's AML/CTF regime that future regulation should not favour one technology at the expense of another and should anticipate the future use of technology as much as possible.⁸

Following the election, AGD is keen to engage with the Treasury in the development of a definition of digital currency in the GST law. If the recommendations of the statutory review report are implemented, a new definition of digital currency will be needed to replace the current e-currency definition in the AML/CTF Act. Similarity in definitions between the GST law and the AML/CTF Act should help promote regulatory consistency and clarity for digital currency businesses in the future.

If you have any further questions in relation to the above, please contact Simon Ward on (02) 6141 2760 or simon.ward@ag.gov.au.

Yours sincerely



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⁶ FATF, *Virtual Currencies: Key Definitions and Potential AML/CFT Risks*, June 2014, <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>. NB: The FATF's use of the term 'virtual currencies' is synonymous with the use of digital currencies in Australia.

⁷ Recommendation 39, Financial System Inquiry, *Final Report*, 7 December 2014, <http://fsi.gov.au/publications/final-report/>.

⁸ Statutory Review Report, p. 5.