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Taxation Law Committee

GST treatment of digital currency

29 June 2016

Submission of the NSW Young Lawyers Taxation Law Committee

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The NSW Young Lawyers Taxation Law Committee (**Committee**) makes the following submission in response to the GST Treatment of Digital Currency Discussion Paper released by Treasury on 3 May 2016 (**Discussion Paper**).

NSW Young Lawyers

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The NSW Young Lawyers Taxation Law Committee (Committee) consists of young practitioners from NSW who share an interest in and passion for taxation law. The Committee represents a group of emerging legal practitioners who will be at the forefront of tax planning advice and tax disputes over the coming years.

Summary of Recommendations

The Committee recommends that digital currency should be treated as money under the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**) and that:

1. the definition of 'money' in section 195-1 of the GST Act be amended to insert a defined term 'digital currency' as paragraph (e1) of that definition;
2. a definition of digital currency be inserted into section 195-1 of the GST Act; and
3. a definition of 'public-key cryptography' be inserted into section 195-1 of the GST Act.

In the alternative, if Treasury is of the view that digital currency should be treated as a financial supply, then the Committee recommends that the definition of 'digital currency' and 'public-key cryptography' be

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inserted into Division 40-A of the *A New Tax System (Goods and Services Tax) Regulations 1999* (Cth) (**GST Regulations**) instead.

Overview

The Committee's submission is predicated on the treatment of digital currencies as 'money' and therefore in answering the question of drafting a definition for digital currencies, proposes to insert that definition into the definition of 'money' in section 195-1 of the GST Act. Although the Committee enters into a discussion on the preferable GST treatment of digital currencies, the Committee refers to paragraphs 43 to 49 of the Discussion Paper and records its general agreement with the advantages of treating digital currencies as money, notwithstanding the difficulty of this approach set out in paragraph 48 of the Discussion Paper.

Background

Paragraph 28 of the Discussion Paper identifies that changing the treatment of digital currency within GST law requires identifying the scope of 'digital currency' for the purpose of GST law.

The Discussion Paper sets out the following four discussion questions on that topic:

1. Should digital currencies be identified for GST purposes by defining them or listing them? If a combination or alternate approach should be used, please describe how it would work.
2. Assuming digital currencies are to be defined for GST purposes, what criteria should be included? Should specific types of other currencies be explicitly excluded in the definition? Would all criteria be given equal weight?
3. Regardless of how digital currencies are identified for GST purposes, should a decision-maker have the capacity to exclude one or more of them under certain circumstances,

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such as if a currency was being used predominantly for illegal purposes?

4. Regardless of how digital currencies are identified for GST purposes, what can be done to ensure the provisions remain relevant as technology advances?

This submission considers each of the four questions in turn.

Drafting a definition of digital currency

The Committee's view is that digital currencies should be identified for GST purposes by defining them. A definitional approach gives the greatest flexibility and is consistent with the general manner in which the GST law taxes by categorising types of 'supplies' by definition. A listing approach suffers from inflexibility and early obsolescence if a particular digital currency changes name.

The Committee's view is that where certainty is required, the Commissioner has the power to issue a GST ruling to provide a safe harbour for clearly recognised digital currencies.

Therefore the Committee's view is that:

1. a new paragraph '(e1) digital currency' be inserted after paragraph (e) in the definition of money in s 195-1 of the GST Act;
2. a new definition 'digital currency' be inserted into s 195-1 of the GST Act; and
3. a new definition of 'public-key cryptography' be inserted into s 195-1 of the GST Act.

The Committee notes that if Treasury comes to the view that digital currencies should not be treated as 'money' in the GST Act, then it is not necessary to insert a new paragraph (e1) into the definition of

'money' in the GST Act and it is sufficient to only have a definition of 'digital currency' and 'public-key cryptography' as appropriate. In the event that the preferred policy option is to treat digital currencies as financial supplies, then the corresponding definitions may be inserted into Division 40-A of the GST Regulations.

The Committee's proposed definition of 'digital currency' and 'public-key cryptography' is considered in the next section of this submission.

Criterion for digital currency

The Committee proposes the following definition of digital currency:

> ***digital currency*** means any property that
>
> (a) is acquired as a medium of exchange;
>
> (b) relies for its existence on a decentralised peer-to-peer payment network; and
>
> (c) relies on the use of public-key cryptography to transfer the economic value of that property.

The Committee also proposes the following definition of public-key cryptography:

> ***public-key cryptography*** includes any cryptographic technology relying on a publicly readable and writeable blockchain.

This definition is derived in part from the Australian Taxation Office's Goods and Services Tax Ruling 2014/3, which observes Bitcoins, being one type of digital currency, as operating on "a decentralized peer-to-peer payment network whose implementation relies on the use of public-key cryptography to validate transactions involving existing bitcoin" (at paragraph [41]).

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The proposed definition of ‘digital currency’ contains four requirements. The ‘digital currency’ must be ‘property’, ‘acquired as a medium of exchange’, and possess two of the essential characteristics of digital currency.

Digital currency is defined in terms of property so as to avoid the circular definition of defining digital currency as a type of currency. As the Australian Taxation Office Taxation Determination 2014/26 observes, digital currencies already satisfy the common law criterion that recognises novel types of property (at paragraphs [6] – [11]).

The sub-paragraphs of the definition set out the essential identifying characteristics of digital currencies. The Committee notes that:

1. the concept of ‘medium of exchange’ intends to limit the scope of the definition to only those kinds of property acquired as a medium of exchange and not acquired *per se* (such as other types of contractual or economic rights);
2. the requirement that the property relies for its existence on a decentralised peer-to-peer payment network and relies on the use of public-key cryptography for its operation is characteristic of digital currencies;
3. the expression that the property ‘relies for its existence’ on a decentralised peer-to-peer payment network is used in preference to ‘exists on’ a decentralised peer-to-peer payment network is intended to address any ambiguity regarding the location of the property rights; and
4. the expression ‘transfer the economic value’ is used in the definition in recognition that an argument may be raised that the property itself is not being transferred in a transaction involving the digital currency.

This definition of digital currency strikes the balance between simplicity, discreetness and flexibility.

A definition of public-key cryptography is required because there is an argument that the public-keys used by various digital currencies are

not in fact public. Taking Bitcoin as an example, the owner of Bitcoin must keep his or her key to that Bitcoin private to prevent unauthorised transactions using his or her Bitcoin.

As the foundation of current digital currencies such as Bitcoin and Ethereum is the existence of the publicly readable and writeable blockchain technology, the Committee is of the view that defining public-key cryptography in those terms would provide sufficient clarity.

The term 'blockchain' is not further defined, as it is intended to be a question of fact whether a certain technology constitutes 'blockchain' within the ordinary technical meaning of the term.

As the sub-paragraphs in this definition set out defining characteristics of digital currencies, the Committee's view is that they should not be subject to an evaluative exercise as to weight. It is sufficient for characterisation as digital currency if each of the defining characteristics are satisfied. Therefore:

1. it is sufficient that the property acquired as a medium of exchange exists on a decentralised peer-to-peer payment network (even if it is also capable of expression in physical form such as a gift certificate or voucher); and
2. the definition is not met if the property is subject to control by a central authority, such as in the case of loyalty points or online wagering credits where the issuer of those points or credits administers the system.

Accordingly, if any medium of exchange satisfies the definition of 'digital currency' it should be treated as digital currency for the purposes of the GST law.

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Administrative exclusion from definition

The Committee disagrees with any suggestion that a decision-maker should be allowed to exclude certain digital currencies from the definition of 'digital currency' in the GST law. In this section, the Committee has taken 'decision-maker' to include the Commissioner, the Commissioner's delegate or any other member of the executive arm of government.

The Committee has identified four problems with this proposal.

The first is that it is unprecedented for Parliament to give powers to the Commissioner to make delegated legislation. To give the executive power to change the taxation law and to raise revenue outside Parliamentary approval is simply contrary to fundamental democratic values. That value should not be so readily discarded, especially not in the present circumstance.

The second is that such a law would put an intolerable burden on taxpayers. Generally speaking, it is not appropriate for the Commissioner to make a determination based on circumstances other than the taxation law and the circumstances particular to the taxpayer (such as the Commissioner's powers to make a determination under s 177F of the *Income Tax Assessment Act 1936* or s 815-30 of the *Income Tax Assessment Act 1997*). By way of example, if the Commissioner were entitled to make a determination that a particular class of digital currency no longer qualified as 'digital currency' under the GST law by reason of its predominant use in illegal activities, an affected taxpayer must lead evidence that the digital currency concerned was not being used predominantly for illegal purposes. The increased cost of compliance on objection and the cost of bringing the matter on appeal pursuant to Part IVC of the *Taxation Administration Act* 1953 would not be insignificant.

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The third is that such a power serves no public policy to deter illegal conduct. To suggest that those engaged in illicit enterprises would be deterred from using bitcoins simply because future supply of those bitcoins may be subject to GST is, in the Committee's view, highly doubtable. Rather, a likely outcome would be that those who are in the trade of the relevant digital currency will suffer for activities beyond their control. The Committee considers that those who trade in a digital currency are not in a position to foresee whether the counterparty is engaging in illegal conduct and therefore it is not clear what public policy such a power is designed to serve.

Lastly, the Committee considers that such a power will create a serious uncertainty for users of digital currencies and thereby defeat the purpose of amending the law to provide for greater certainty.

Changes in technology

The Committee's view is that it would be unwise to legislate for unforeseen technologies.

A definitional approach to 'digital currencies' based on their identifying characteristics is sufficient to meet the policy objectives of removing economic double taxation on digital currencies as a medium of exchange.

The Committee's view is that where developments in technology result in new economic products, it is appropriate to consider the fiscal policy appropriate to that product at that time.

Concluding Comments

NSW Young Lawyers and the Committee thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

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