

KPMG supplementary submission

Treasury Issues Paper

Initial coin offerings

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Submission comments

1. General

- 1.1 Reference is made to our submission on 4 March 2019 in respect of Initial Coin Offerings. We would like to expand on that submission.
- 1.2 In the conclusion we say “a pragmatic approach would allow the same treatment for all types of blockchain token.” While it is acknowledged that “current income tax rules should be adequate to deal with transactions involving cryptocurrency and tokens,” if an interpretation of the law is adopted that does not reflect the pragmatic approach we suggest, then the consequences may be that “Australia’s regime does not provide [sufficient] clarity, and ... these businesses are likely to choose to base themselves and operate in other markets where regulatory clarity does exist”.
- 1.3 This supplementary submission expands on those themes.

2. What is special about crypto-assets

- 2.1 It is accepted that if general principles produce sound economic results with clarity, then there is little reason to produce a specific code for any new products or arrangements. Thus if a specific code has justification it must be grounded in the fact that crypto-assets are in some manner different from other assets or the nature of crypto-assets is such that greater uniformity of treatment is desirable between categories of crypto-assets.
- 2.2 Thus why might crypto-assets deserve special treatment?
 1. In a new market clarity becomes disproportionately important for the market to evolve in comparison to established markets.
 2. Australia currently has a competitive advantage in the ICO market based on trust in our institutions and general culture. The window within which advantage exists may be short and the advantage may be lost if there are perceived impediments to the market such as taxation uncertainty.
 3. A significant crypto-asset market is likely to have substantial benefits for the Australian economy over the long term, in comparison to established old economy markets.

4. Guidance to date from the ATO has not been clear and arguably very incomplete, meaning that the starting point simply does not provide clarity. Moreover, current guidance gives rise to potentially uneconomic results as discussed below.
5. Participants in the crypto-market are likely to be very varied, but will include a disproportionate number of younger people who are not necessarily sophisticated from a tax perspective. This is different from those dealing in equities, debt and derivatives.
6. The crypto-market produces a great diversity of products which often contain nuanced differences. To the extent that those differences give rise to a difference in taxation treatment, it becomes disproportionately costly to explore and determine the impact of those differences, both from the perspective of the taxpayer and a revenue authority. Moreover, it might be said that the distinction between different categories of taxation treatment might be said to be “greyer” than many conventional assets.
7. Most, but not all, crypto-assets are “all tree and no fruit” to use the metaphor of trust law which has become a point of distinction between revenue and capital. This means parallels with conventional assets such as shares and bonds are less relevant.
8. The manner in which crypto-assets can be swapped or traded for another crypto-asset, means that there may be a disproportionately high level of taxation realisation events compared to ordinary assets (equities and physical assets). This can create significant mismatches between the economic and taxation result.
9. The taxation treatment of the issuer is relatively well settled for most conventional assets such as shares and debt instruments and that treatment is not damaging to the market as the issuer is not construed to be assessable on the issuance. For some crypto-assets on some constructions (where the asset could be construed to be a prepayment of a service), that safety does not exist under current rules. That is not to deny that if the crypto-asset was considered to be the provision of a service, that spreading a deduction by the holder should be matched by an *Arthur Murray* style spreading of the receipt by the issuer.

10. Possibly another distinction between crypto-markets and other markets is the potential level of volatility. To the extent this is correct, and it will not always be so, it means that the crypto-market has more at stake from a taxation perspective.
 11. There is a reasonable to high probability that there will be litigation – indeed multiple litigation – on the taxation of crypto-assets. That litigation may give rise to very specific tax outcomes based on narrow circumstances creating great uncertainty in the market and indeed the potential for law change. This is generally not true of any other asset.
- 2.3 Crypto-assets could potentially fall within 6 categories for tax purposes, described below from the perspective of the holder, with varying (and sometimes capricious) tax consequences. Another delineation – whether they constitute currency or not – sits on top of some of these categories. They are:
1. A revenue asset which is trading stock;
 2. A revenue asset which is not trading stock;
 3. The pre-payment of a service;
 4. A capital asset which is a personal use asset;
 5. A capital asset akin to an equity investment; and
 6. A gambling outlay (arguable although unlikely to succeed).
- 2.4 It should also be acknowledged that a crypto-asset could move from one category to another with a change of purpose or a change in the phase of rights associated with the holding of the asset. For example, it may move from a revenue asset which is not trading stock to the pre-payment of a service.
- 2.5 Given these circumstances, the question arises as to how best to achieve the “pragmatic approach would allow the same treatment for all types of blockchain token”.

3. Principles for crypto-assets

3.1 It is suggested that – at least with a blank piece of paper – the following principles should apply for taxation purposes:

Principle 1: The outlay for a crypto-asset should not be *effectively* deductible to the holder or *effectively* assessable to the issuer, upfront. Note the trading stock provisions convert a deductible outlay into something which is not *effectively* deductible upfront. Also this principle would contradict a crypto-asset which was a pre-payment of a service.

Principle 2: Gains and losses should be on revenue account for both the holder and the issuer.

Principle 3: Traditional realisation rules should apply such that a tax event occurs where one crypto-asset is exchanged for another even though there is no conversion into cash. There should not be a rollover.

Principle 4: Losses should be able to be offset against other business and investment income at least, and possibly all other income.

3.2 If these are the right rules the question arises as to whether they can be achieved under current law through the issue of clear and binding guidance, or whether a code needs to be put into place.

3.3 Ultimately what is needed is:

- clarity of principles;
- a sound economic outcome;
- a simple document that articulates Australia's tax position for the world; and
- timeliness in formulating and presenting such a document.