Bitcoin Association of Australia

Position Paper

Tax treatment of Bitcoin in Australia

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Position Paper

Tax treatment of Bitcoin in Australia

1 Adoption of Bitcoin

1.1 As Bitcoin becomes more widely adopted around the world, revenue authorities in all jurisdictions are grappling with the tax outcomes for businesses and consumers who use Bitcoin.

1.2 This paper examines the recent increase in adoption rates by businesses and consumers globally and in Australia, and explores in detail the tax outcomes which are most appropriate and should be applied for Bitcoin users.

1.3 Adoption rates for bitcoins can be analysed by looking at the following indicators:

(a) Blockchain.info wallets and exchanges.

(b) Transactions per day.

(c) Merchant adoption and Bitcoin businesses.

(d) Accessibility.

(e) Industry investment.

1.4 Blockchain.info wallets

(a) From Jan 2013 to May 2014 blockchain.info wallets increased from 78,000 to 1.5 million representing growth of 1920%.[1] Coinbase alone averaged ten thousand signups per day at the end of 2013.[2]

(b) The two major Australian exchanges, CoinJar and BitTrade Australia, estimate that combined they have in the region of 40,000 Australian users.

1.5 Merchant adoption and Bitcoin businesses

(a) Bitpay reported an annual turnover of USD$100m through its 15,000 merchants for the calendar year 2013.[3]

(b) Overstock.com sees 4,300 customers spend the equivalent of USD$100m in sales in two months with approximately 60% of those new customers.[4] Bitcoin sales past the initial two months are between USD$20-$30 thousand per month.[5]

(c) Coinbase, a bitcoin merchant services provider has currently 30,000 merchants including Bloomberg, OkCupid and the Chicago Times.[6]

(d) Coinmap is considered by the Bitcoin community to be a reasonably reliable source of information reflecting the number of brick and mortar shops accepting bitcoins. The below graph depicts adoption rates beginning July 2013 of below 1,000 merchants to May 2014 of over 4,000 merchants.[7]

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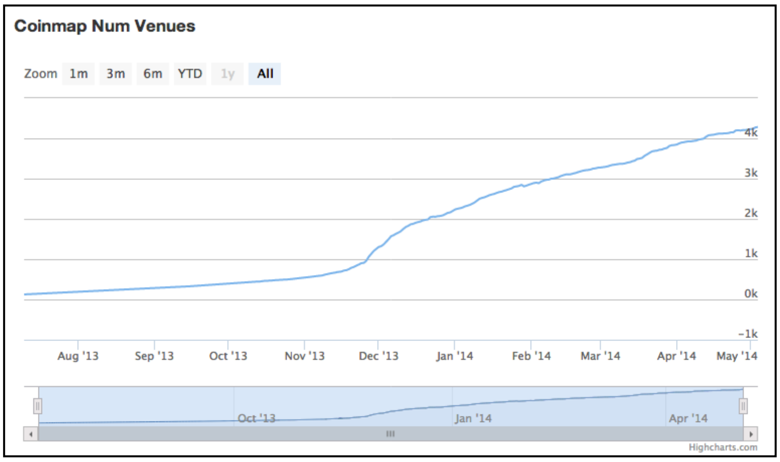
[1] http://blockchain.info/charts
[2] http://www.businessinsider.com.au/coinbase-gets-25-million-in-funding-2013-12
[3] http://www.coindesk.com/merchants-love-bitcoin-bitpay-100-million-reasons-prove/
[4] http://techcrunch.com/2014/03/04/overstock-com-exceeds-1m-in-bitcoin-transactions-in-two-months/
[5] http://www.businessinsider.com.au/bitcoin-and-overstock-2014-3
[6] https://coinbase.com/clients
[7] http://www.bitcoinpulse.com/chart/coinmap/num_venues/total

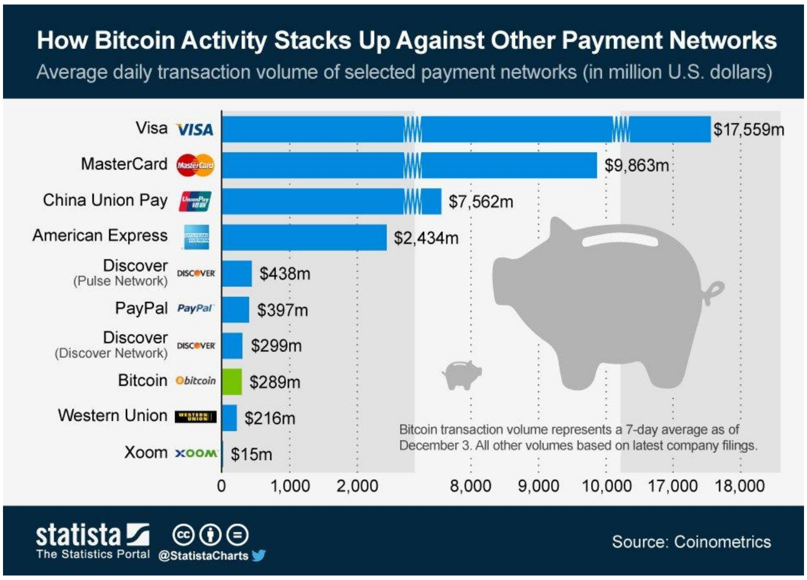


(e) The Australian Bitcoin business directory, BitScan, reported a 480% growth in Bitcoin businesses in the first 4 months of 2014. Australia now has an estimated 192 businesses. While these numbers are low compared to the traditional banking network, they indicate high growth rates created by rapidly increasing user and merchant adoption.

1.6 Transactions per day

(a) Total global Bitcoin transactions per day, linear scale shows a total increase of 92% between Jan 2013 and May 2014.[8]

(b) In December 2013 the value of all daily Bitcoin transactions surpassed the value of daily transactions made by Western Union.[9]



1.7 Accessibility

(a) Initially Bitcoin was only available via online exchanges such as (the now defunct) Mt Gox, bitstamp and Coinjar. During calendar year 2013 two companies (Lamassu and Robocoin) started producing what are nominally known as ATMs.

[8] http://blockchain.info/charts/n-transactions
[9] http://www.moneyandmarkets.com/news/bitcoins-dollar-value-transactions-surpass-western-unions-56745

(b) In the first month of a Robocoin ATM being installed in Canada it had turned over CAD$1,000,000. Lamassu has orders (fulfilled and pending) of 220 machines that are destined to over 25 different countries and has exhibited at the largest electronics show in the United States, CES.

(c) In Australia, two separate businesses have launched Bitcoin ATMs, with ABA Technology installing machines in high traffic retail areas like Westfield Shopping Centres.

1.8 Investment Funds

(a) Bitcoin businesses are not geographically restricted. Investment in Bitcoin businesses in other jurisdictions has a direct effect on the local adoption of Bitcoin.

(b) There are strong signals of growth in the Bitcoin economy with hundreds of millions of dollars worth of venture capital investment being earmarked as Bitcoin investment funds. These earmarked funds are in addition to the tens of millions that have been invested in just two US based companies, Coinbase and Bitpay.

(c) In the United States, Coinbase recently received USD$25 million in funding to bring total funding to $31m.[10] Bitpay raised USD$30m in series A funding,[11] and Marc Andreessen via his investment firm Andreessen-Horowitz has already invested $50m and is investing further, "hundreds of millions", into Bitcoin ventures.[12]

(d) Australia holds approximately 7% of the world's investment in Bitcoin ventures. Coinjar have secured AUD$500,000 from Blackbird ventures and digitalBTC raised $9.1 million.

(e) A new $30 million investment fund has also been launched to invest in companies that are leveraging Bitcoin and crypto-currency services.[13] The investors in this fund have stated that:

"*We view the emerging Bitcoin ecosystem as an investment opportunity that has transformative potential across a raft of social, technology- based and cultural applications and we see great scope for the broader adoption of Bitcoin and its related applications to redefine the global payment status quo*".

(f) A $30 million dollar local investment in innovation will result in a meteoric rise in the adoption of Bitcoin in the Australian community and it has the potential to deliver significant returns for local investors, the local community and the local government.

1.9 If the approach taken by Australian Taxation Office ("ATO") were to counteract the efficiency and simplicity of the Bitcoin process, these innovative businesses would not be viable. This will push both the innovators and the investors offshore and it will see alternative jurisdictions benefiting from Australian innovation and capital.

2 Bitcoin and the 'ordinary meaning' of money

2.1 Money can be broadly defined as "*any generally accepted medium of exchange for goods and services and for the payment of debts*".[14] The concept of money is distinct from the concept of 'currency' or 'legal tender'.

2.2 When determining whether Bitcoin is money, the focus is not on defining a bitcoin itself; the focus is on accurately characterising its use and purpose in the wider community. Applying

[10] http://www.businessinsider.com.au/coinbase-gets-25-million-in-funding-2013-12
[11] http://www.bizjournals.com/atlanta/blog/atlantech/2014/04/bitcoin-services-startup-bitpay-raising-30m-ttv.html
[12] http://finance.yahoo.com/blogs/daily-ticker/does-bitcoin-have-a-future--marc-andreessen-thinks-so-141613056.html
[13] http://futurecapital.com.au/bitcoinfund/future-capital-bitcoin-fund-fcbf-launches-30m-bitcoin-fund.
[14] *Travelex Limited v Commissioner of Taxation* [2008] FCA 1961 ("Travelex") at [25].

general law concepts, the fact that bitcoins are widely used as money and are generally accepted as payment gives bitcoins the character of money.

2.3 A key differentiator between Bitcoin and other forms of non-cash payment, such as frequent flyer points, is that bitcoins are accepted without reference to the character or the credit of the person who offers the bitcoin, or the legal relationship between the parties to the transaction.

2.4 For example, a frequent flyer point is only accepted as payment because the person using the points has an account with the issuer of those points (e.g. Qantas). The acceptance of the frequent flyer point is contingent on the relationship between the owner of the point and the issuer or owner of the points program. The point is not accepted in its own right like cash or bitcoins are accepted.

2.5 The condition of membership of a centrally administered 'scheme' also limits the ability of a frequent flyer point to be generally accepted. Subject to limited exceptions, account holders are unable to transfer frequent flyer points to any other member. They can only be 'spent' by redemption for goods or services from the issuer.

2.6 In contrast, bitcoins are capable of being generally accepted. Just as cash can be accepted electronically by anybody with a bank account, bitcoins can be accepted electronically by anybody with a Bitcoin wallet. There is no cost to create a Bitcoin wallet and it can be done by anyone with internet access in a matter of minutes.

2.7 A bitcoin also shares the characteristic of 'negotiability' with cash. This means that when a bitcoin is transferred, ownership of the bitcoin transfers completely.

2.8 As the statistics show, bitcoins are being generally accepted as a medium of exchange for goods and services. Bitcoins are being used as money.

2.9 It is Bitcoin Australia's position that bitcoins are money within the ordinary meaning of money.

3 Bitcoin as 'money' under the GST Act

3.1 There are a number of reasons which together mean that Bitcoin should be treated as 'money' under the GST Act:

(a) the fundamental operation of the GST system, as a 'practical business tax', is to apply GST to supplies, and not to consideration for supplies;

(b) the fundamental operation of the GST system in this way is supported by the definition of 'money';

(c) on balance, the definition of money in the GST Act include Bitcoin under paragraph (e);

(d) there would be a significant compliance burden for taxpayers and administrative burden for the ATO if Bitcoin is not treated as money; and

(e) an interpretation that Bitcoin is 'money' under the expanded definition under the GST Act would not necessitate or imply the same conclusion in respect of the general definition of money – for example under corporations, banking or other regulatory legislation – meaning that the ATO could adopt a sensible, practical approach without disturbing the potential interpretations for other areas of law.

Operation of the GST Act – tax supplies, not consideration

3.2 The operation of the GST Act is based on the widest possible definition of 'supply' together with the application of a number of exclusions. One of the most important exclusions is to exclude 'money' from being a supply and from being an acquisition (except for money exchange transactions).

3.3 A supply of money is outside of the GST system in order to prevent GST from inappropriately being applied twice to one transaction. The Explanatory Memorandum to the bill introducing the GST Act states at paragraph 3.7

"Money that is provided as consideration (payment) for a supply is not in itself a supply – subsection 9-10(2). Otherwise money supplied as payment for a supply could be a taxable supply in itself. Money is defined in the Dictionary."

3.4 A fundamental premise of the GST system is that the payment of money for a supply should not in itself be treated as a supply. Therefore, the operation of the GST system requires a sensible interpretation of the definition of money.

3.5 The GST system is not intended to apply to consideration which is, in the context of the transaction, nothing more than a medium of exchange which facilitates the transaction. GST is only intended to apply twice to a true barter transaction.

3.6 The only uses of bitcoins are as a medium of exchange and a store of value. Regardless of the general definition of money, bitcoins function as money within the economy. They have no other purpose or use.

3.7 In addition to their purpose and use, bitcoins share similar characteristics to other forms of money. Just as a cash transaction can be valued in a combination of dollars and cents, a bitcoin is divisible to 100,000,000 base units (commonly known as satoshis).

3.8 Proper operation of the GST System requires bitcoins to be treated as money.

Definition of 'money' supports this interpretation

3.9 The definition of money in the GST Act is an inclusive definition, which should be interpreted in accordance with both general principles and a purposive interpretation of the Act which that definition serves.

3.10 The definition of money in the GST Act is intended to enlarge the ordinary meaning of the word, and it modifies the general definition of the word by:

(a) **including** things and systems which are used as a medium of exchange but are not money as traditionally understood – e.g. promissory notes, negotiable instruments, and account based transactions; and

(b) **excluding** things which are money as traditionally understood but are not being used as money – e.g. collectors' notes and coins.

3.11 The clear intention of the GST definition of money being structured this way is to include things used as money and to exclude situations where money is not being used as money.

3.12 Though it is not necessary for bitcoins to fall within any one of the paragraphs in the definition of money, Bitcoin Australia is of the view that it falls within paragraph (e).

3.13 The broad introductory words used in paragraph (e) of the definition are consistent with the intention to treat as money, anything which facilitates payment in one of the ways stated in the sub-paragraphs. The use of the words 'whatever is supplied' is necessarily broad, in order to deal with all possible rights and obligations that may arise when payment is made by one of the ways described in the sub-paragraphs. The use of these words is consistent with the intention to classify these ways of payments according to their true substance, without unnecessary analysis of the legal rights and obligations which may arise in the execution of these payments.

3.14 This broad definition of money is required to support the fundamental operation of the GST system by correctly classifying things which are used as consideration or payment. It correctly classifies these things by reference to their use and purpose in the context of the transaction, rather than their legal form.

Definition of 'money' includes bitcoins under paragraph (e)

3.15 Paragraph (e) of the definition of 'money' includes:

(e) whatever is supplied as payment by way of:

(i) credit card or debit card; or

(ii) crediting or debiting an account; or

(iii) creation or transfer of a debt.

3.16 At a fundamental level, a Bitcoin transaction involves the crediting and debiting of an account – debiting (reducing) the number of bitcoins recognised in the wallet used by the payer, and crediting (increasing) the number of bitcoins recognised in the wallet used by the recipient, by a corresponding amount.

3.17 The definition of the word 'account' is only found in the GST Regulations, not the GST Act. Parliament's intention is clearly that this definition should only apply in the context of the financial supply provisions, and not to the GST Act itself. This is accepted by the ATO in GSTR 2002/2 at paragraph 206.

3.18 A supply of bitcoins is therefore a supply of money under paragraph (e)(ii) of the definition of money.

Tax cost, compliance and administrative burden

3.19 If bitcoins are not considered 'money' for the purpose of the GST Act, there will be significant negative impacts on:

(a) a taxpayer who is registered or required to be registered for GST and who uses bitcoins to pay for goods or services (**Business Bitcoin User**); and

(b) a taxpayer who is registered or required to be registered for GST and operates as an exchange – selling bitcoins for Australian Dollars and vice-versa (**Bitcoin Exchange**).

3.20 We have provided the following issues and examples that would arise if Bitcoin is interpreted as not being money under the GST Act, and if a supply of bitcoins is not treated as input taxed.

	Issue	**Example**
1	When the Bitcoin Exchange supplies bitcoins to a person in Australia who is not registered or required to be registered for GST, this is a taxable supply, for which the recipient cannot claim an input tax credit. The market for bitcoins will not adjust to absorb the GST cost. GST applies to what is economically a financial supply.	Bitswap Pty Ltd, which is registered for GST, supplies 100 bitcoins to Cliff Jordan, who is an individual neither registered nor required to be registered for GST. Cliff pays Australian dollars in exchange for the bitcoins. The sale is set at a market rate by reference to other exchanges. Bitswap is not able to sell at a 'grossed up' price. Bitswap Pty Ltd has a GST liability of 1/11th of the price of the bitcoins.

2	When the Business Bitcoin User pays bitcoins to acquire something which is input taxed or GST-free then they will have a GST liability – which is clearly inconsistent with the operation of the GST Act. GST should not apply to input taxed or GST-free transactions	BitUser Pty Ltd which is registered for GST, pays 100 bitcoins to acquire a digital marketing business from BitPromo Pty Ltd as a going concern. BitPromo Pty Ltd provides all things necessary for the operation of the business and the transaction meets the other requirements to satisfy the going concern exemption. Despite this, Bitcoin Business User still has a GST liability equal to 1/11th of the purchase price.
3	For GST-free supplies, a credit would be available to the other party, which may accept a lower amount of bitcoins (a 'gross-down'), which would distort the market value of the thing being supplied.	Continuing the example above, BitUser Pty Ltd would need to negotiate a reduction in the agreed purchase price on the basis that BitPromo Pty Ltd would be able to claim an input tax credit on its acquisition of bitcoins. This distorts the real value of the business and adds unnecessary complexity. It also effectively requires BitPromo Pty Ltd to accept consideration in two forms, bitcoins from the buyer and input tax credits from the ATO.
4	When the Business Bitcoin User acquires something from an unregistered person, the price would not be able to be adjusted, and the Business Bitcoin User would bear the real cost of the unintended GST on the value of the transaction – effectively adding GST to a private transaction.	BitUser Pty Ltd pays an agreed price in bitcoins to acquire real property from an unregistered user, a transaction that would not ordinarily be subject to GST. BitUser Pty Ltd will make a taxable supply and incur a GST equal to 1/11th of the price of the bitcoins on a supply which is intended to be outside of the GST system.
5	In any case, the Business Bitcoin User would be required to issue a tax invoice for a taxable supply of bitcoins – which is inconsistent with the corresponding transaction in Australian dollars and will result in double invoicing in a number of circumstances	BitUser Pty Ltd acquires marketing services from BitPromo Pty Ltd for an agreed price in bitcoins. Both BitUser Pty Ltd and BitPromo Pty Ltd must each issue a tax invoice for a taxable supply. Each must adopt an appropriate bitcoin to AUD translation rate for the transaction

4 Bitcoin as a financial supply for GST purposes

4.1 In order to prevent the unintended operation of the GST Act where bitcoins are exchanged for Australian Dollars, Bitcoin Australia supports a sensible, practical view that a supply of bitcoins is a financial supply, either under:

(a) item 1 of GST Regulation 40-5.09;

(b) item 2 of GST Regulation 40-5.09;

(c) item 9 of GST Regulation 40-5.09; or

(d) item 11 of GST Regulation 40-5.09.

4.2 Unless a supply of bitcoins is treated as a financial supply, there is an anomalous and inconsistent result in situations where:

(a) a Bitcoin exchange supplies bitcoins to a private individual – where the exchange makes a taxable supply and the individual cannot claim an input tax credit (GST cost); and

(b) a Bitcoin exchange supplies bitcoins to a GST registered entity – where the exchange makes a taxable supply but the entity can claim an input tax credit (either an unintended distortion of the market price, in the best case, or a GST cost in the worst case, resulting in a windfall gain to the recipient of the bitcoins).

4.3 There would also be an anomalous and inconsistent result between situations where a GST registered entity converts bitcoins to Australian Dollars using:

(a) an Australian based exchange (taxable supply); and

(b) a non-resident exchange operating outside Australia (GST-free export).

4.4 In this situation, Australian Bitcoin businesses would simply use exchanges overseas when they need to convert bitcoins to other currencies, to the detriment of Australian exchanges.

4.5 Bitcoin Australia believes that a supply of bitcoins could be regarded as an interest in or under one or more table items of GST Regulation 40-5.09.

4.6 As a specific example, we note that the European Union central currency, the Euro, may, on a strictly legalistic view, not fall within Item 9 of GST Regulation 40-5.09, because it is not the currency of **a foreign country** – but is rather a unified currency of the European Union, which has been adopted as a currency by the Eurozone members. Clearly, a sensible interpretation of Item 9 includes the Euro. A similar interpretation is open in respect of bitcoins.

4.7 As a further specific example we note that the ATO view of the term 'account' as used in Item 1 of GST Regulation 40-5.09, as per GSTR 2002/2, could be broadened to include Bitcoin, being a non-ADI account which satisfies the other criteria.

5 Bitcoin as 'property'

5.1 In *Wily v St George* (1999) 84 FCR 423 Wilcox J stated at [6]: *"it is unwise to be dogmatic about the indicia of a proprietary interest".* The legal concept of property has been historically flexible in order to keep up with innovation and evolution in technology and commerce.

5.2 Although Bitcoin is a new technology, it satisfies the general law test for property for the following reasons:

(a) A bitcoin is definable.

(b) A bitcoin is identifiable to third parties.

(c) A bitcoin is capable of assumption.

(d) A bitcoin has permanence.

(e) A bitcoin holder has proprietary legal rights.

A Bitcoin holder exercises proprietary rights

5.3 The conceptual novelty of a bitcoin also does not preclude its definition as property. In *Yanner v Eaton* (1999) HCA 53, the high court stated that:

> *The word "property" is often used to refer to something that belongs to another…."property" does not refer to a thing; it is a description of a legal relationship with a thing. It refers to a degree of power that is recognised in law as power permissibly exercised over the thing. The concept of "property" may be elusive.*

5.4 The legal relationship that is key to the concept of property is not the relationship between the owner and third parties. It is the relationship between the owner and the property itself.

5.5 Bitcoins are owned, controlled, transferred, sold and traded as property. The holder of a bitcoin does not merely have a 'freedom' to deal with the bitcoin. The holder of a bitcoin can use and enjoy it, exclude others from it, and alienate it. The holder exercises a degree of power or control over the bitcoin that defines bitcoin as property.

5.6 It is also worth noting the commercial meaning of property. As explained by the courts in the context of floor space, if commerce regards a certain 'thing' as a proprietary right, "*The courts should do likewise*"[15]. Put another way, the law considers intangible interests to be objects "*because people are willing to buy them*".[16]

5.7 Bitcoin's market capitalisation currently sits at $6 billion USD. The Bitcoin Association of Australia estimates that the Australian share of this market capital is approximately 2%. This means that the market capitalisation for Australia is approximately $120 million. It is obvious that people are willing to buy bitcoins.

A bitcoin owner can enforce their rights against third parties

5.8 It is also important to note that a bitcoin owner can enforce their proprietary rights against third parties. There is a circular relationship between proprietary interests and the ability to enforce those interests against third parties. Enforceability against third parties is not the central indicia of property, but the ability to enforce rights against third parties is a strong indicator that the rights are proprietary in nature.

5.9 In paragraph 7 of *Wily v St George*, Sackville J states that when an interest in property is created by agreement, it can be useful to consider whether the holder of that property is able to enforce the interest against third parties. However, it is not a rigid test: "[t]*he law recognises many different forms of proprietary interest and classifications are not necessarily rigid."*

5.10 The degree of control a bitcoin owner exercises over the bitcoin constitutes proprietary rights that can be enforced against the world. For example, if a bitcoin is stolen or misappropriated, a court in equity could order an account of profits to compensate the owner for the loss of the bitcoin or grant specific performance to force transfer of the bitcoin back to the rightful owner.

5.11 A bitcoin has indicia of property. A bitcoin owner exercises proprietary rights. In commerce, bitcoins are used and traded like property. The rights of a bitcoin owner can be enforced against third parties. It is almost certain that any Australian court would consider bitcoins to be property.

5.12 It is the position of Bitcoin Australia that bitcoins should be considered property under Australian law.

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[15] Halwood Corporations Ltd v Chief Commissioner of Stamp Duties (1994) 33 NSWLR 395 (at 403)

[16] F H Lawson & Bernard Rudden, *The Law of Property* (3rd ed, 2002) at 21.

6 Bitcoin as a CGT Asset

6.1 Bitcoin Australia believes that a bitcoin should be treated as a CGT Asset, because it is property as discussed above.

Adopt a practical approach as per TD 2002/25

6.2 In TD 2002/25, the ATO concludes that Australian currency (which is clearly a CGT asset in the ordinary course) is not a CGT asset when it is used as legal tender – i.e. to facilitate a transaction. This view is an example of a sensible, practical interpretation taken by the ATO. It is necessary in order to prevent the intended operation of the CGT regime, which could otherwise be disrupted by an overly legalistic interpretation.

6.3 The ATO has the opportunity to take a similar practical view in respect of Bitcoin being a CGT Asset (and being similarly excluded where used to facilitate a transaction).

6.4 Treating bitcoins as CGT assets with a cost base would provide some certainty to Bitcoin users. Users may still face similar exchange gains and losses issues as with foreign currency , but the position about capital gains tax liabilities on the disposal of bitcoins would at least be clear.

6.5 Separately, consideration needs to be given to whether a CGT exemption should apply where a Bitcoin user makes a gain or loss that is of a private or domestic nature.

7 Summary

7.1 Bitcoin is a global phenomenon that will continue to grow in usage and adoption irrespective of the taxation treatment of any particular jurisdiction. However, it is important for the ATO to form a logical and practical approach to the taxation of bitcoins to ensure that investment in the local Bitcoin industry is not moved offshore.

7.2 Bitcoin Australia believes that the broad definition of 'money' in the GST Act[17] can be interpreted to include Bitcoin. This approach would be an accurate representation of the use and purpose of Bitcoin as a currency and it is in keeping with the fundamental operation of the GST system by correctly classifying a bitcoin as a form of consideration or payment.

7.3 Bitcoin Australia also believes that a bitcoin can be considered property under Australian law. Incorporating this approach into the CGT treatment of Bitcoin will avoid significant uncertainty and a complex administrative regime for users of Bitcoin.

[17] In this paper, the term 'GST Act' refers to *A New Tax System (Goods and Services Tax) Act* 1999 and the term 'GST Regulations' refers to *A New Tax System (Goods and Services Tax) Regulations* 1999.