Review of the tax treatment of digital assets and transactions

Consultation response

KPMG Australia

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KPMG.com.au

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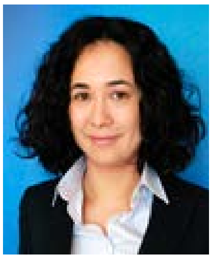
Executive Summary

KPMG Australia (KPMG) welcomes the opportunity to provide a submission to the Board of Taxation's Review of the Tax Treatment of Digital Assets and Transactions (the review).



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As the Board of Taxation's consultation paper states, the creation, trade and use of crypto assets is in an ongoing state of evolution, and it is important to ensure that the tax framework remains appropriate. KPMG is supportive of additional regulation in Australia to support investor confidence and provide certainty, which in turn will ensure that Australia retains its competitiveness and ability to attract investment.

Specifically, we consider that the tax treatment of crypto assets should not be left to existing ordinary tax principles. Instead, either a specific statutory regime, or some other statutory framework should be legislated to provide clarity and ensure tax outcomes are appropriate. These new rules should be based on the characterisation of digital assets, with alignment to the token mapping classification being undertaken by the Government.

The guidance provided by the Australian Tax Office (ATO) to date has been insufficient, primarily due to uncertainty in the application of existing law and a lack of resources at the ATO with the technical expertise needed to keep up with the rapidly changing digital asset economy. In our view, the reliance on ATO website guidance is not conducive to taxpayer compliance and does not give certainty of tax outcomes. Therefore, our view is that the ATO must be sufficiently resourced to be able to provide further guidance to taxpayers and tax advisors in the form of binding rulings.

Lastly, as noted above, the evolving nature and high degree of rapid change in the digital asset economy will require continual revision to ensure Australia's tax regime can correctly accommodate each evolution. As such, Treasury, the ATO and the Board of Taxation should consider establishing a form of ongoing consultation with taxpayers and tax practitioners in order to stay abreast of changes as they emerge.

If you would like to discuss the contents of this submission further, please do not hesitate to reach out.

Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

02

Recommendations

KPMG Recommendations

1

Recommendation 1

The tax treatment of crypto assets should not be left solely to ordinary tax principles without modifications to existing legislation. Instead, KPMG recommends either statutory provisions to deem applications of specific existing principles or regimes to identified classes of tokens arising from the token mapping process, or a broader statutory framework to provide certainty for taxpayers, the ATO, and tax practitioners, ensuring tax outcomes that are appropriate. The new regime should include some degree of regulator's discretion and flexibility to allow for quick adaptation when needed.

Further and ongoing public consultation is necessary to ensure the new rules can adapt to the rapidly developing digital asset ecosystem.

2

Recommendation 2

The new statutory regime or framework should dictate a tax treatment based on the characterisation of digital assets, with alignment to the token mapping exercise proposed to be undertaken by the Government.

Broadly, for income tax purposes, we propose that transactions be taxed in alignment with other transactions of a broadly similar character. For example, gains and losses from digital currencies and debt-like assets should be, by default, on revenue account, while gains and losses from non-fungible tokens (NFTs) and equity-like assets should be on capital account subject to the intention and business of the taxpayer.

These outcomes will not be commercially or economically appropriate in all circumstances or for all taxpayers, hence additional rules may be required in limited situations to dictate an alternate tax treatment (akin to the managed investment trust (MIT) capital account election) and to allow for changes in character of the token or transaction (such as rollovers).

For goods and services tax (GST) purposes, the characterisation of a digital asset should be determined by reference to the underlying asset, right or 'thing' that the value is derived from. For example, where a token is a digital representation of a 'security', the token should be treated for GST purposes as a financial supply, whilst a token that represents or provides an entitlement to goods or services, should be treated for GST purposes in the same manner as that good or service under the current GST regime. Where there is no traditional equivalent, the regime should appropriately prescribe a tax treatment, or characterisation to give an appropriate outcome.

3

Recommendation 3

The ATO should provide detailed guidance to taxpayers and tax advisors in the form of binding rulings. The publication of website guidance is not conducive to taxpayer compliance and does not give certainty of tax outcomes.

This may require the ATO being granted specific resources and funding to enable a centre of excellence capable of interpreting blockchain technical developments and applying relevant tax law to give commercially appropriate outcomes.

03

KPMG Insights

Response to consultation questions

Current tax treatment of crypto assets

1. Is the current tax treatment of crypto assets clear and understood under the Australian tax law? If not, what are the areas of uncertainty that may require clarification?

The scale of the current challenge is illustrated by the Commissioner's submission to the Federal Court that it would take nine months for him to form a view as to whether a taxpayer's crypto currency transactions were on revenue or capital account.[1]

Current state

KPMG acknowledges the efforts of the ATO at communicating basic guidance for private investors and, to a lesser extent, traders. The ATO is faced with significant challenges in providing confidence to taxpayers and the tax advisor community where the application of ordinary tax principles is uncertain or inapplicable.

To fully inform and educate all segments of the Australian economy based on the existing tax rules and a rapidly evolving digital asset and blockchain ecosystem is a difficult task with the resources the ATO currently has available and incongruities in the application of existing law.

Due to challenges within the existing tax rules and their administration, the ATO has been largely unable or unwilling to provide more comprehensive guidance to taxpayers and hence has largely been restricted to expressing its views in the form of non-binding, website materials.

This lack of guidance has led to significant uncertainty and hesitation amongst both tax practitioners and the public as, excluding the simplest examples, there is little to no certainty that any position taken based on current available guidance will continue to be correct.

We have seen existing guidance primarily focus on basic fungible tokens (i.e., Bitcoin) and investment activities, which is a narrow scope within the broader digital asset economy and the rapidly increasing complexity and evolution in the development and use of these technologies.

The ATO has issued minimal guidance and almost nothing by way of rulings (either public or private) to provide certainty for taxpayers for other common types of digital asset transactions, notably the following:

- Creating non-fungible tokens (NFTs);
- Earnings derived from NFTs (i.e., commissions);
- Wallet to wallet transfers held by same beneficial owner;
- Using tokens to purchase other digital assets;
- Deployment of entirely new tokens and classes, for example semi-fungible tokens (SFTs);
- Staking and staking rewards;
- Mining tokens earned through proof of work/proof of stake structures; and
- Decentralised Autonomous Organisation (DAO) structures.

There are also application and administration concerns for specific transaction types and use cases for digital assets which in many cases have no traditional equivalent for comparison, for example:

- Decentralised Finance (DeFi);
- Gamified use of tokens such as play to earn (P2E and GameFi), with the added concern that many users of these systems may be minors with limited to no experience or understanding of their potential tax obligations;
- Creative industries such as NFT creators and digital galleries, with consideration of whether these sorts of works should be characterised as artworks/ collectibles;

1 ASZ21 v Commissioner of Taxation [2021] FCA 1304

- Bridging tokens;
- Liquidity pools;
- Wrapped tokens;
- Stablecoins; and
- Changes to the character, nature or technology underpinning a token including Forks, Splits, Rebase Tokens, Merges and Redenominations.

From a tax law and regulation perspective, the list of tax implications which are uncertain or with limited/unclear guidance is extensive and continues to grow.

We have significant concerns over whether the existing approach of applying "ordinary tax principles" can ever correctly function for the taxation of gains or losses arising from digital assets, and whether the attempts to shoe-horn these assets into existing regimes by the ATO is technically correct, commercially reasonable or administratively efficient.

Common taxpayer concerns

While there is more specific detail later in this submission, these are some of the more common concerns raised by our clients:

- The current ATO view that for many investors a capital gains tax (CGT) treatment of gains/losses on investment in digital assets may, except in very limited or possibly no circumstances, be erroneous and in conflict with established legal principles related to the revenue versus capital distinction.

Thresholds and limitations for revenue treatment have not been comprehensively explored in ATO guidance materials. In particular, there are concerns with the limited discussion of a 'profit making intention' for any investor speculating on what are essentially high-risk assets. While there may be reasonably arguable positions each way in relation to whether investing in many classes of digital assets should be on revenue or capital account, without either binding guidance from the ATO, precedential case law or legislative intervention, the level of uncertainty is sufficiently high to deter economic activity.

In this regard, we refer to our previous response to the initial request by the Board of Tax dated 9 June 2022 for a further discussion on our views as to where the revenue versus capital distinction should be drawn for digital assets.

- The connection to and interpretation of international tax principles for various classes of tokens (for instance those with debt or equity-like characteristics), and broader considerations for ordinary principles around cross-border "smart contract" transactions recorded on blockchain is often raised by clients. Particularly:
  - Tax residency and source administration where transactions are anonymous, automated or decentralised (for example, the tax characterisation of DAO where the nature of the entity for tax purposes, tax residency and regulatory legality from a Corporations law perspective are all in question).
  - Withholding tax (WHT) issues and the characterisation of payments where tokens carry debt or equity-like characteristics and in many cases the recipient jurisdiction is not determinable.
  - Royalties for use of intellectual property (IP) where the nature and location of IP is not determinable.
  - Foreign exchange (FX) denominated transactions where fiat currency conversions do not arise until some later date (e.g., participation gains arising from a DAO)..

KPMG Recommendation

In light of the above concerns, we consider it is inappropriate to leave the tax treatment of digital assets to ordinary tax principles in their current form, and recommend the implementation of either statutory provisions to deem applications of specific existing principles or regimes to identified classes of tokens arising from the token mapping process, or alternatively a broader statutory framework to provide certainty for both taxpayers and the ATO.

We acknowledge there may be advantages to making limited modifications to existing legislation in an effort to adapt ordinary principles to digital assets, particularly given the comparative simplicity, and speed of drafting and implementing modifications to the rules over a complete overhaul or creation of a new regime. Accepting that alternative as an interim measure, it may be appropriate to make certain initial changes to ensure that existing provisions within the law operate as intended, in a similar vein to the current draft legislation for modifying the definition of 'foreign currency' under section 995-1 of the ITAA 1997.

However, we are concerned that such an approach would essentially be a temporary solution needing constant revision and would require the ATO to administer the rules in a more dynamic way than it is doing so at present as the digital asset economy continues to evolve.

As such, an overarching set of principles through specific statutory provisions which deem a tax treatment for various classes of digital assets and related transactions (i.e., as debt, equity, traditional securities, CGT assets etc) is preferred. This would allow existing legislative provisions to be applied without the current lack of certainty and allow existing binding guidance from the ATO to apply for the deemed classification if/when appropriate. This should then be supported by limited regulator's discretion to deem specific application to arrangements that do not fit within the framework.

Without implementing systemic changes that provide certainty, it is unclear how the ordinary rules can be successfully modified to operate appropriately and maintain agility to adapt to continuing developments in the digital asset economy.

Additionally, if genuine certainty in relation to the application of existing principles for the market will necessarily rely on the issuance of ATO rulings (private or public), or yet to be developed precedential case law, the time required may exceed the time needed for Treasury to develop a broader statutory framework. This time delay would have ongoing detrimental impacts on international investment in the Australian economy.

We understand that the existing uncertainty is already driving significant economic activity away from Australia, and without a clear and practical legislation for managing the tax implications in this space this trend will continue and Australia will miss out on long term opportunities.

Token mapping and alignment to tax reform

KPMG welcomes the move to undertake a token mapping exercise, and advocates for such an exercise to proceed. The classification of various token types together with a broader statutory framework will greatly simplify the determination of the application of income tax and GST treatments in many instances.

We strongly recommend that the tax rules are designed to align with the outcomes of that mapping exercise and classifications derived for various potential classes of tokens. For example, prescribing certain tokens a specific tax treatment based on classification from the token mapping exercise providing a consistent tax treatment where a token as similar characteristics to securities, equity or debt. The tax rules should also accommodate situations where the class to which a token is mapped changes, for example by rollover, where no economic realisation has occurred as a result.

There will still be certain transactions and arrangements which do not fit within the token mapping program and/or do not have a reasonable proxy to traditional assets or transactions (for example DAO). In order to provide taxpayers certainty, the newly designed regime should include provision for the alignment of these transactions with commercially appropriate outcomes either by deeming specific tax treatments based on the underlying character of the arrangement and taxpayers' intention, or deeming a character for the transaction itself to align the arrangement with an appropriate existing tax principle.

While there are a range of specific considerations for Treasury in preparing for and undertaking token mapping which we would expect to be identified and addressed through the consultation process for that program, here are a few examples of specific concerns which may need to be considered as part of any broader tax reforms:

– The token-mapping exercise should be undertaken with consultation from all relevant stakeholders, consistent with the Parliamentary Committee's recommendations.

– Treasury, the ATO, the Board of Taxation, tax practitioners and taxpayers should form an ongoing consultation process (such as a national working group) to continue to reinforce against future changes in the digital asset economy and maintain an open dialogue to manage future developments and any unintended consequences from implemented reforms.

– Asset-backed tokens (tied to value of a real-world asset). Some rigour will be required to properly identify a commercially appropriate proxy, for example, are they similar to derivatives? If so, should they be taxed as such?

– Digital twins, where a digital asset serves as the digital representation of a real-life asset. Should these assets be taxed in the same manner as the real-life asset or treated as some form of financial arrangement for the trading of those assets?

– Utility tokens that are redeemable for goods or services. Should these give rise to income tax and GST consequences solely on realisation by transaction to acquire such goods or services, or should they also have alternative tax outcomes for other realisation methods like other token classes.

– Security-equivalent tokens and their nexus to the debt-equity tests to inform their tax treatment, other considerations aside. Where tokens are specifically prescribed characteristics, this would also mitigate broader concerns such as 'debt like' tokens that can't clearly establish an effectively non-contingent obligation and/or the nature of returns for Division 974 purposes.

– How participation in DAOs should be viewed from a tax perspective. This includes the treatment of a DAO (e.g., from an entity perspective, as a taxpayer or a tax law partnership, their tax residence status, and source of income) and the appropriate method of income recognition (e.g., accruals or realisation).

We have no doubt that the list of concerns and issues will continue to grow, and the list above is not exhaustive. This highlights the need for both extensive consideration of the intricacies of the digital asset ecosystem, and the need for ongoing consultation around any reforms.

2. Do crypto assets and associated transactions feature particular characteristics that are 'incompatible' with current tax laws? If yes, what are these and why are they incompatible?

In many instances, crypto assets and associated transactions are not specifically 'incompatible' with current tax law, but rather that there are many instances where there is a lack of certainty on how best to align these assets and transactions with ordinary tax principles that must be overcome by additional rules (legislation or regulation) or guidance.

Examples where additional guidance is required include:

- Application of CGT rules to digital assets or blockchains, for example:
  - when a CGT event is considered to occur;
  - the specific CGT event which is most appropriate;
  - whether the CGT discount applies; and
  - whether the rollover rules apply.
  - Identifying and treating wallets ownership pursuant to relevant laws (i.e., DAO, constructive trusts, partnerships, joint ownership, etc.) particularly in circumstances where legal ownership may temporarily change but there is no change in underlying beneficial ownership.
  - Determining market values of certain digital assets (i.e., asset values), including appropriate valuation methods. There is further complexity where the tax laws seek to tax arrangements that don't result in a realisation transaction to or from a recognised fiat currency.
  - What deductions are allowable to the taxpayer (e.g., network fees) and in what circumstances.

As highlighted previously, there are extensive examples where there is either an absence of appropriate guidance and/or no clear nexus to existing tax principles that can realistically be relied upon. While the character, terms, technology and participation in such arrangements can vary wildly, we highlight the following as potential 'inconsistencies' that may need to be addressed:

- Due to the decentralised nature of DAO and other DeFi and Liquidity Pooling arrangements, there are a range of ordinary tax principles that can be difficult to correctly interpret:
  - The appropriate classification for tax purposes of ambiguous entities and distributed governance mechanisms (e.g., DAOs) where there is no clearly identifiable jurisdiction of residence or source, location that business is carried on, and location of central management and control/effective management.
  - Appropriate identification, classification and treatment for source jurisdiction for transactions, and treatment of income or capital gains resulting from the decentralised nature of blockchain networks.
  - Commercially appropriate determination (based on the terms of each distributed arrangement) of a taxpayer's participation in an 'entity', i.e., unincorporated association, tax law partnership, or something else.

We note that this is not a detailed review of various existing transactions and arrangements in the digital asset economy. We seek primarily to highlight the complexity and evolving nature of this space, and the need for any reforms to create a regime that can quickly adapt to entirely new and unexpected transactions or arrangements.

Awareness of the tax treatment of crypto assets

3 Do entities which carry on a business in relation to crypto assets or accept crypto assets as a form of payment, have a comprehensive awareness of the current tax treatment of crypto assets and their tax obligations?

4 Are retail investors aware of the current tax treatment of crypto assets? To what extent are they receiving professional tax advice?

5 Do wholesale investors understand the current tax treatment of crypto assets? To what extent are they receiving professional tax advice?

6 How can taxpayer awareness of the tax treatment of crypto assets be improved?

In our experience, the extent of awareness of the tax treatment of digital assets by taxpayers is wildly varied depending on sophistication and interest. Similarly, the extent to which taxpayers are receiving professional tax advice is varied.

Particular consideration should be given to the potentially significant percentage of investors that may be minors, who are likely to have minimal knowledge/experience in managing their tax affairs.

As a result, and due to the generally larger and more sophisticated nature of KPMG's client base, we do not have specific insights which are likely to be relevant for the purposes of questions 3 to 6.

We note that improvements in the regime to provide certainty to taxpayers, tax practitioners and the ATO should result in more accessibility and deeper comprehension for all forms of participants in the digital asset economy.

We also note for comparison guidance published by ASIC for product issuers and market operators on how they can meet their regulatory obligations in relation to crypto-asset exchange traded products (ETPs) and other investment products.[2]

2 https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-285mr-asic-releases-guidance-on-crypto-asset-related-investment-products/

Characteristics and features of crypto assets

7. Are there specific examples where regulations have limited opportunities to innovate through the adoption of AI or ADM?

While defining appropriate guardrails to ensure the safe adoption of AI and ADM technologies is essential, regulations need to achieve the right balance and stay up to date with the advancement of technologies to avoid excessive limitations and unrealistic expectations.

Examples of this include the unclear definition of explainability, and trying to enforce expectations of more conventional rule-based methods to the new techniques. Existing regulations in the financial industry, for example, require predictive risk models to be explainable to supervising bodies and are approved after human review of the logic. This approach has worked well with more conventional methods like logistic regression based on a limited number of data points. However, when it comes to complex models based on thousands of variables and methods like artificial neural networks, it won't be possible to explain them in the conventional form of human language rules. This has significantly limited the adoption of many of these techniques, even if they have proved to be more accurate and efficient through suitable and explainable scientific tests.

This demonstrates that fit for purpose regulation is essential to unlocking the innovation and benefits that technology advancements can provide. To minimise the limitations that regulatory frameworks can create, KPMG considers that regulations should be developed in consultation through a full industry consultation process, reviewed regularly, and aim to be as technology neutral as possible.

International tax treatment of crypto assets and experience

8. What lessons can Australia draw from the taxation of crypto assets in other comparable jurisdictions, including novel ways of taxing these transactions?

At the time of writing, approximately 190 jurisdictions have adopted some level of regulation in relation to crypto assets.[3] Whilst the approaches are varied, a number of jurisdictions have attempted to undertake an exercise to characterise or define the nature of the relevant crypto assets that are the subject of proposed reform.

Overlaying this, the current approach to crypto asset tax regulation thus far has mainly been provided by tax authorities in the form of published guidance on the tax treatment of crypto assets within existing statutory frameworks, and in some cases, the enactment of statutory provisions to include definitions of 'crypto assets' within current statutory frameworks (for example, in New Zealand[4]). There have been fewer instances where statutory frameworks have been implemented that are specific to crypto assets.

Jurisdictions that have released guidance in relation to the tax treatment of crypto assets have included:

- New Zealand's Inland Revenue Department (IRD) has considered that crypto assets may fall within several categories including 'payment tokens', 'security tokens' and 'utility tokens'.[5] For income tax purposes, the IRD has stated that 'crypto asset income' may include income from activities such as mining, staking, lending or airdrops, depending on a number of factors.

3 Cryptos-Report-Compendium-2022.pdf (thomsonreuters.com)
4 See Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Act 2022.
5 What cryptoassets are (ird.govt.nz)

- The UK Government has recently released a policy paper *Fact sheet: Cryptoassets technical*[6] and HMRC has previously issued the *Cryptoassets manual*[7] and related practical guidance on selling and receiving crypto assets.[8] HMRC considers there to be a number of categories of crypto assets including 'exchange tokens' (or payment token), 'utility token', security tokens and stablecoins, taking the view that the tax treatment of all types of tokens depends on the nature and use of the token, not how it is defined.
- The Canada Revenue Agency considers that cryptocurrencies are a type of virtual assets and for the purposes of the Income Tax Act, treats cryptocurrency as a commodity and has not issued guidance to further distinguish the nature of different tokens or crypto assets. This is unless it is used to pay for goods and services, in which case, the rules for barter transactions apply.[9] Further guidance has been provided in relation to mining and staking activities, with the resulting tax implications depending on whether the activities are business-like or a hobby.[10]

The emerging consensus across many jurisdictions has been to undertake (or express that they will undertake) a token mapping exercise to further explore and understand the nature of crypto assets, and associated activities (i.e., airdrops, staking, de-fi, etc.), prior to implementing specific statutory frameworks. This approach has been recommended in this submission as a critical next step to crypto asset reform in Australia.

In undertaking this exercise there is an ability to assess the appropriateness of existing statutory frameworks to regulate the tax treatment of crypto assets, at the same time, moving towards a level of global consistency and certainty, in determining 'what' is being taxed and 'where' it should be taxed. These considerations are fundamental to ensuring certainty for taxpayers operating in a global, borderless digital economy.

Whilst guidance released in other jurisdictions is relatively consistent with respect to the type/nature of tokens (e.g., NFTs, security tokens, payment tokens, utility tokens, asset/commodity tokens, etc.) the approach to taxation of associated activities has been more varied.

We consider that differing approaches to the taxation of associated activities, or the overall rate of taxation on the realisation of gains or ordinary income, should not prevent a global framework being established or be otherwise detrimental to crypto asset regulatory reform. As such, we consider it would be open for Australia to take an alternative approach to other jurisdictions in relation to the rate of taxation or any specific exemptions to be applied to crypto asset transactions.

However, the approach taken to taxation of associated activities by other jurisdictions may warrant further consideration by Australia, particularly in relation to the treatment of airdrops. The current guidance provided by the ATO focusses on whether the token is 'established' or an 'initial allocation' to determine whether the receipt of an airdrop will be treated as ordinary income.[11] More recent ATO guidance has outlined that capital gains or losses from disposing of crypto assets will be disregarded where the assets are personal use assets.[12] However, the ATO clarifies that in most situations, crypto assets would not be personal use assets and would therefore be subject to CGT, with discounts provided when the assets are held for more than 12 months.

For comparison:

- **New Zealand:** Limits the tax implications of airdrops (acquisitions/disposals) to circumstances where these activities are in the form of a business or profit-making venture, where consideration/services are provided for the airdrop, or the airdrop activities are undertaken by a crypto asset business (as well as some further limited circumstances).[13]
- **United Kingdom:** Income tax may not apply to airdropped tokens when received in a personal capacity, if the individual has not otherwise provided or done anything in return for the receipt of the tokens or the activities are not part of a trade or business involving exchange tokens or mining.[14] However, the disposal of a token received through an airdrop may be subject to capital gains tax, despite not being subject to income tax on receipt.

6 Fact sheet: cryptoassets technical - GOV.UK (www.gov.uk)
7 Cryptoassets Manual - HMRC internal manual - GOV.UK (www.gov.uk)
8 Check if you need to pay tax when you receive cryptoassets - GOV.UK (www.gov.uk)
9 Virtual Currency - Canada.ca
10 Guide for cryptocurrency users and tax professionals - Canada.ca
11 Staking rewards and airdrops | Australian Taxation Office (ato.gov.au)
12 Crypto asset investments and tax | Australian Taxation Office (ato.gov.au)
13 See New Zealand Publication number QB 21/06: Income tax - tax treatment of cryptoassets received from an airdrop
14 CRYPTO21250 - Cryptoassets for individuals: Income Tax: airdrops - HMRC internal manual - GOV.UK (www.gov.uk)

- Whilst several jurisdictions are following a similar path to Australia in relation to the way tax regulation is being considered, there have been instances of more novel approaches or considerations to crypto asset regulation, such as:
- In China, cryptocurrencies, exchanges and mining are illegal with China launching its own Central Bank Digital Currency (CBDC) the 'e-CNY'. As such, there is no regime that applies to crypto assets.
- The Law Commission of England and Wales has proposed a third category of property 'data objects' to encapsulate most crypto tokens, taking the view that the features of digital assets differ significantly from traditional property.[15]
- India has introduced a new taxation regime for income relating to Virtual Digital Assets (VDAs) where such assets will be taxed at 30% for income tax purposes, with no deduction (other than acquisition cost) or set-off of any losses against any other income is allowed with respect to VDA income. The regime also provides that assets may be included or excluded from the regime by notification.[16] The Central Board of Direct Taxes (CBDT) has issued two notifications for the purpose of defining VDA pursuant to the new tax regime under the Finance Act 2022.
- Thailand announced a value added tax (VAT) exemption that applies for the period 1 April 2022 to 31 December 2023 in relation to certain transfers approved by the Minister of Finance, in addition to a personal income tax exemption from 14 May 2018 on the transfer of cryptocurrencies and digital tokens on approved platforms.[17]

We have outlined the need for clarity in relation to the tax treatment of crypto assets in other parts of this submission. Given the global and borderless nature of the digital asset economy, a level of consistency in the understanding of the nature of crypto assets as part of a global framework would be desirable. We consider this is required to a lesser extent in relation to the taxation of associated activities, provided there is a consistent understanding of what these activities are and the relevant taxing jurisdiction (i.e., where to tax).

The appropriateness of implementing a novel approach to crypto asset regulation, including unreasonably aggressive or high rates of taxation (or in the alternative, tax exemptions), or a regime that characterises crypto assets in an inconsistent manner with other jurisdictions, would need to be considered as part of Australia's broader digital economy strategy.

However, Australia can still look to other jurisdictions that are currently implementing differing approaches to the taxation of NFTs, airdrops, staking, etc., to determine the appropriateness and overall workability of such approaches, before implementing specific statutory reforms relating to these activities. However, until a level of consensus or a global framework is established, it would be important that the Australian regime be adaptable to changing views around the taxation of (and overall regulatory framework and nature of) crypto assets to keep up with the fast-paced changing nature of this ecosystem and economy.

15 Digital assets | Law Commission.
16 CBDT issues notifications on the definition of virtual digital asset, prescribes list of excluded assets and defines non-fungible tokens (kpmg.com)
17 Tax Measures to Support the Trading of Digital Assets - KPMG Thailand (home.kpmg)

Changes to Australia's taxation laws for crypto assets

9. What changes, if any, should be made to Australia's taxation laws in relation to crypto assets, whilst maintaining the integrity of the tax system? If changes are required, please specify the reasons.

As noted in response to question 1, our recommended approach to modifying Australian tax laws is broadly a middle ground between modifying existing rules and implementing a specific regime for the tax treatment of digital assets. We propose a system be designed which includes statutory interference to modify the classification of digital assets and related transactions to allow ordinary tax principles to apply appropriately.

Our view, for both consistency with existing economic principles and simplicity of application, would be for all transactions involving digital assets to be prescribed a 'default' treatment consistent with other assets with similar characteristics.

The default could be altered by exception, for example, a transaction considered to be on revenue account (i.e., income from a security-like token) would be attributed a capital treatment where that is a commercially appropriate outcome. We consider this approach would remove elements of uncertainty, particularly the need for reliance on the development of new ATO guidance materials, and could be established to prescribe specific tax outcomes regardless of any unexpected or unusual developments in the digital asset economy.

As noted previously, we hold significant doubt that the current 'default' capital treatment as suggested by the ATO is appropriate in many cases or would hold up to review by the Courts, given the nature of the assets, risk associated with investing in cryptocurrencies and profit-driven intention of many taxpayers entering into such investments.

Any new regime should, by design, align with the proposed token mapping process, utilising an agreed set of classifications for relevant tax treatments. The regime would also need mechanisms to allow for conversions from one classification to another (i.e., where the nature of a token is changed to no longer align with a certain classification) providing certain realisation events and/or rollovers as needed to ensure appropriate economic and commercial outcomes.

While we understand the desire of the ATO to effectively quarantine losses arising from such transactions away from ordinary income of many taxpayers. We perceive a conflict with existing ordinary tax principles in relying on the CGT regime to achieve this outcome which may make the ATO's desired outcomes legally ineffective.

For the purposes of precedent to such a prescriptive regime, there are numerous existing examples where legislative regimes displace ordinary tax principles and prescribe tax outcomes to give a more economically or commercially appropriate outcome. For example, regimes that give rise to statutory income or losses on transactions which may otherwise have been classified on capital account, include:

- Division 775 of the *Income Tax Assessment Act* 1997 (ITAA97) with specific realisation events for certain foreign currency transactions. These provisions include certain elections and exceptions to ensure such an application is appropriate and administratively efficient.
- Division 230 of the ITAA97 which prescribes a revenue account treatment for gains and losses on financial arrangements.
- Sections 26BB and 70B of the *Income Tax Assessment Act* 1936 (ITAA36) which treat gains and certain losses from the disposal of traditional securities as being on revenue account, while retaining a capital account treatment for certain losses.
- Subdivision 275-B of the ITAA97 allowing the Trustee of a Managed Investment Trust (MIT) to choose to treat covered assets as being held on capital account, displacing ordinary principles to align the tax rules with the intended commercial outcome.
- We also note the non-commercial loss rules in Division 35 of the ITAA 1997 as an example of the tax rules displacing the ordinary treatment of revenue losses to quarantine them in certain situations.

Given the need for an accessible and clear solution for various stakeholders, consideration should be given to directly regulating the tax treatment of various transactions related to classes of digital assets and align classes of assets which exhibit similar features. For example, the tax outcomes relating to tokens with characteristics akin to traditional securities should mirror the tax outcomes of traditional securities.

As noted above, for situations where the prescribed outcome is commercially inappropriate or inequitable, any new rules should also include appropriate exceptions or elections for certain taxpayers to opt in or out of a specific tax treatment. Elections that exist in other regimes, which could be adopted in a modified form for digital asset purposes include:

- A one-off election to apply CGT treatment for certain assets, akin to the MIT capital account election in Section 275-115 of the ITAA97.
- A limited balance test election, akin to Section 775-230 of the ITAA97, which would operate to minimise the compliance burden for certain taxpayers for transfers in, between and out of digital currencies with a de minimis threshold.

In relation to the effective quarantining of losses arising from digital asset transactions given the application of CGT rules, to the extent this is economically and commercially appropriate, there is sufficient precedent in existing tax laws to prescribe a similar quarantining. The non-commercial loss rules in Division 35 of the ITAA97 are one such example, where the tax law ringfences certain losses to only be available to offset income when commercially appropriate.

While our view is that crystalised losses arising from digital asset transactions should not be quarantined for many taxpayers, there may be economic value in quarantining losses to only be available to be offset against similar gains, where the losses arise from events where no economic realisation has occurred. For example, the notional gains and losses arising from transactions without a cash convertible acquisition or disposal (i.e., gains or losses arising from a liquidity pool which are not realisable until the tokens and gains are returned to the investor via a transaction recorded to the blockchain).

In relation to some specific concerns with existing legislative rules, we set out below examples where consideration should be given to expanding current legislative definitions to clarify their operation in relation to digital assets:

- Section 102M of the ITAA36 which defines an 'eligible investment business'. This definition's lack of flexibility indicates that Division 6C may appear to treat any public unit trust with interests in digital currency as a public trading trust.
- A MIT's access to capital account treatment is restricted to 'covered assets' (Section 275-105 of the ITAA97). The current definitions and supporting guidance leave it unclear if and how digital assets are considered in this context.
- 'Tainted assets' as defined in Section 317 of the ITAA36. Again, it is unclear if and how digital assets are considered in this context.

While this is not an exhaustive list, these specific examples have been raised by our clients as directly limiting their ability to participate in the digital asset economy and drive investment away from such assets in Australia.

We would also request that the Board of Tax and Treasury carefully consider whether any modifications to tax law should be applied solely prospectively, or should also apply retrospectively.

There is likely significant benefit to taxpayers, the ATO and tax practitioners in applying the rules retrospectively to remove any uncertainty over historic positions taken by taxpayers in relation to various transactions. However, this should be tempered with certain safe harbours or administrative protections to ensure taxpayers are not unfairly prejudiced where they had relied on previous guidance in good faith.

Lastly, we would recommend further consideration of the Senate Select Committee's recommendation to only tax transactions related to digital assets where there are 'clearly definable gains'. Due to the nature of many transactions in the digital asset economy, often the proceeds from transactions are not readily convertible to fiat currency and as such, many taxpayers may find themselves without a readily available source of funds to settle tax liabilities where such transactions give rise to tax consequences. Additionally, restricting the application of tax laws to such gains should simplify compliance and administration for taxpayers and the ATO alike.

Certain integrity measures may also be appropriate, in addition to existing anti-avoidance rules, to avoid manipulation of such a regime. However, any deferral of revenue should be solely a timing issue, and any simplification to the regime will likely encourage greater economic activity increasing the overall pool of revenue being derived by Australian taxpayers.

Changes to Australia's taxation laws for crypto assets

10. How could tax laws be designed to ensure that they keep pace with the rapidly evolving nature of crypto assets?

KPMG concedes there is no clear and definitive answer to this issue, and would recommend both Treasury and the ATO implement a program of ongoing consultation around digital assets to attempt to keep pace with developments. We propose the formation of a working group between Treasury, the ATO, the Board of Taxation, tax practitioners and taxpayers to allow for direct and ongoing consultation between the regulators and industry.

However, there are a range of avenues which may provide some degree of resilience to any framework or regime implemented by Government, and these should be considered as part of the development of reforms in this area. These include:

– The robustness of the token mapping exercise with an ability to deal with changes and evolutions to digital assets through classification of tokens and related transactions will be critical. This may need inclusion of certain discretions for the regulators to deem classifications where particular characteristics are unclear or unable to be determined on an ongoing basis.

On the basis that the tax rules are reformed to rely on specific classifications and to the extent the tokens continue to be successfully mapped, the tax rules should apply as intended, this should establish a framework capable of some resilience in the face of continual technological and commercial advancement.

– A commitment and framework for ongoing consultation between Treasury, the ATO, the Board of Tax, taxpayers and tax practitioners including both tax and digital asset technical expertise to properly inform discussion related to ongoing developments in the digital asset economy.

– Regulation versus legislative change – in a similar vein to the draft legislation recently released to modify the Section 995-1 definition of "foreign currency", inclusion of regulatory powers to deem specific outcomes where there is no clear application of existing provisions would allow more agility for the rules to quickly accommodate unexpected changes.

However, our caution with this sort of power is the degree to which such discretion should be delimited. For example, the draft legislation modifying the definition of foreign currency prescribes only the power to make regulations to exclude specific arrangements from being treated as foreign currency. This may be too restrictive if we envisage a scenario where a token is created that should be appropriately treated as a foreign currency, but there is no power to include it in the foreign currency definition by way of regulation.

– Stability and clear outcomes in legislation to give the ATO confidence to provide timely binding guidance. By implementing a legislative framework with clear, intentional and practical applications, the need for ATO interpretation will be lessened, and it should be easier for the ATO to develop and publish such interpretations when needed in a timely manner.

Further, to the extent any new regime aligns tax treatments with existing provisions, it may be possible for taxpayers to rely on existing binding guidance on comparable asset classes to give additional certainty.

– An appropriately skilled, resourced and funded team created at the ATO with deep technical knowledge of both digital assets and transactions, and the relevant tax laws that may apply. The intention being to create a centre of excellence within the ATO to manage and administer the taxation of digital assets including development of binding guidance (both public and private), and provide a mechanism for the ATO to remain up to date with developments in the industry.

Administration of Australia's taxation laws for crypto assets

11. How can the existing tax treatment of crypto assets be improved to ensure better compliance and administration?

Data collection

The ATO's crypto asset data-matching program began in April 2019 and collects bulk records from Australian cryptocurrency designed service providers as a part of a data matching program to ensure compliance with applicable tax treatment of crypto assets.

Whilst the program is currently utilised to identify taxpayers who may be failing to meet their registration and lodgement obligations, KPMG considers that the information may also be leveraged to pre-fill tax returns.

Further, it may be appropriate to extend this program (possibly on an opt-in basis) to allow taxpayers to utilise data from wallets, exchanges or crypto tax solutions (such as Koinly.io or CryptoTaxCalculator) or another source of data to automatically pre-fill tax returns with default assumptions about the treatment of relevant transactions to simplify compliance for many taxpayers.

International framework

Blockchain technology allows crypto assets to be issued, recorded, transferred and stored in a decentralised manner which circumvents the traditional financial intermediaries and central administrators.

Under the current Common Reporting Standard (CRS) framework, financial institutions are required to collect and report on financial account information on foreign and domestic tax residents. Digital assets, in most instances, should fall outside the definition of financial assets and fiat currencies, and therefore the scope of the CRS reporting obligations.

Notwithstanding, where digital assets could fall within the definition of financial assets, crypto exchanges or wallet providers are unlikely to be required to report these transactions to the tax authorities as they are subject to limited regulatory oversight.

In line with the OCED's public consultation document concerning the Crypto-Asset Reporting Framework (CARF) and Amendments to the CRS, KPMG considers that the compliance and administration would be improved where the CRS framework is expanded to encompass the automatic exchange of information on Crypto-Assets In particular, the OECD proposal to amendment CRS to:

– extend the scope of the CRS to cover economic money products and central bank digital currencies;

– include indirect investments in crypto assets through investment entities and derivatives; and

– improve the due diligence procedures and reporting outcomes aimed at increasing the usability of CRS information for tax administrations and limit burdens on financial institutions.

12. What data sources are available to assist taxpayers in completing their tax obligations and/or the ATO in implementing its compliance activities?

There are a range of data sources, including transaction reports exportable from centralised exchanges (CEXs) of cryptocurrency, which are also available as Application Programming Interfaces (APIs) for taxpayers to aggregate their transactions across multiple CEXs.

Given that the CEXs perform Know Your Customer (KYC) and Anti-Money Laundering (AML) checks on users, the ATO is able to run data matching on taxpayers based on their interactions on CEXs to identify potential cryptocurrency transactions to alert them of their potential tax obligations. These obligations for CEXs will be refined as part of the Crypto asset secondary service providers: Licensing and custody requirements.[18]

Some CEXs offer native cryptocurrency tax estimators such as the KPMG Crypto Tax Estimator with Independent Reserve.

For transactions performed 'on-chain' via public blockchains such as Bitcoin and Ethereum, including transfers between cryptocurrency wallets, swapping of cryptocurrencies on Decentralised Exchanges (DEXs), adding to liquidity pools or staking on Decentralised Finance (DeFi) platforms, and NFT transactions, the data sources include blockchain explorers such as Etherscan and Blockchain.com.

Since all on-chain transactions are publicly available, there has been growing popularity in the adoption of cryptocurrency tax calculation service providers (crypto tax providers) such as Koinly and Crypto Tax Calculator, which integrate both the application programming interfaces (APIs) from CEXs as well as the on-chain data associated with a taxpayer's public wallet address to aggregate the total transaction history of the taxpayer and produce a tax report based on the assumptions set for the calculations. However, these crypto tax providers are not tax agents and instead refer to list a professional directory of tax agents. This approach will need to be reviewed under TASA given the popularity and growing reliance by taxpayers on the tax reports generated by crypto tax providers.

The ATO may consider adopting a similar technology offered by the crypto tax providers to create an automated process around the delivery of information using the APIs from CEXs, and opt-in solutions for taxpayers to integrate their cryptocurrency wallets to enable a pre-fill of their tax returns through the myTax solution.

There is also the issue of having international parties to comply for Australian taxpayers, as well as considerations of the travel rule for Australian sourced income.

13. Are there intermediaries (such as exchanges) that are involved in particular crypto asset transactions that could play a role in the administration of the tax laws? If so, what would their involvement look like?

KPMG's submission on licencing and custody requirements for crypto asset secondary service providers discussed proposed obligations on providers that aim to support consumer confidence and provide regulatory certainty to crypto businesses and service providers.[19] Some of these obligations on providers could also play a role in the administration of tax laws.

KPMG believes the token mapping exercise will form a foundational role in defining crypto assets and the corresponding regulatory requirements, and will also provide guidance in determining the assets that should be subject to oversight, reporting, disclosure and record-keeping requirements by intermediaries.

We also note the difficulty of enforcing obligations on large international providers delivering services from overseas. However, in our view, the distributed and global nature of these services should not be a basis for excluding them from regulation in Australia.

18 https://home.kpmg/au/en/home/insights/2022/07/crypto-assets-kpmg-submission.html
19 https://assets.kpmg/content/dam/kpmg/au/pdf/2022/crypto-asset-secondary-service-providers.pdf

14. How can taxpayers be further supported to understand their tax obligations in relation to crypto assets?

15. What additional support can be provided to the tax adviser community to assist them in advising their clients in relation to the tax treatment of crypto assets?

In response to questions 14 and 15, further formalised ATO guidance is necessary in order to provide support to taxpayers and tax advisers.

With the exception of several public rulings issued in 2015, we understand the ATO's primary current approach is to provide guidance via general information published on its website.[20] While this allows the ATO to provide direction to taxpayers in 'real time' in response to what is a dynamic and complex area, this approach should not be preferred. Our experience is that the website guidance is continually altered and updated, which can present challenges for both taxpayers and tax advisers as it difficult to keep abreast of the ATO's views at any given time (e.g., the information is contained in different web pages, and it can be onerous to monitor website changes).

We therefore recommend that the ATO develops further public binding ruling(s), which are aligned with the token mapping classification, in order to provide a greater level of certainty in relation to its interpretation of the tax law in this area.[21] Such rulings must be accompanied by extensive public consultation to ensure the ATO's advice is fit-for-purpose and operates as intended.

In relation to the ATO guidance currently available, we make the following additional observations:

– The website information (e.g., *What are crypto assets? | Australian Taxation Office* (ato.gov.au)) does not explicitly provide guidance in relation to a taxpayer who should be considered to make gains or losses from crypto assets that are on revenue account, on the basis the taxpayer has a purpose of profit-making in relation to the crypto assets (without necessarily having the assets form part of a business activity). The ATO should give due consideration to this point.

– Some of the ATO's edited private binding rulings (PBRs) contain inconsistencies (noting they cannot be relied upon by taxpayers in any event). For example, PBR 1051694175099 dated 1 October 2020 states the following in relation to NFTs:

"ATO guidance paper "Tax treatment of crypto-currencies in Australia - specifically bitcoin" confirms that the tax treatment of bitcoin can be applied to other crypto or digital currencies that have the same characteristics as bitcoin. Non-Fungible Tokens have the same characteristics as bitcoin. Therefore, Non-Fungible Tokens are CGT assets."

While the conclusion that NFTs are CGT assets may be correct, we consider the rationale provided by the ATO in this PBR to be imprecise, particularly given NFTs are not crypto or digital currencies, but instead, their own distinct type of digital asset.

20 For example, Cryptocurrency and tax | Australian Taxation Office (ato.gov.au) and Crypto asset investments | Australian Taxation Office (ato.gov.au); as well as website announcements such as Taking the cryptic out of crypto this tax time | Australian Taxation Office (ato.gov.au).

21 For example, consideration should be given to the issuance of an ATO public ruling akin to the UK's HMRC internal manual 'Cryptoassets manual', which provides guidance in relation to the tax implications of the main transactions involving crypto assets.

04

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