Taxing Bitcoin

Cryptocurrencies, like Bitcoin, are independent and not regulated by any central authority. Until recently, these digital currencies were not treated in the same way as cash for tax purposes in Australia. New legislation passed by Parliament last month seeks to change all of that by removing GST from currency exchanges.

How are cryptocurrencies taxed?

Under GST law, a 10% GST applies to supplies of goods and services. Money receives special treatment because it's a medium of exchange and not something for final private consumption. Up until recently, the Australian Taxation Office (ATO) took the view that cryptocurrencies did not meet the definition of 'money' because they have an independent value rather than being a debt, credit or promise to make a payment, and they don't meet the definition of money under GST law. The impact was that when people used digital currencies as payment, this could trigger GST twice; once on the goods or services being purchased, and also on the supply of the digital currency to the other party. So, the Government has changed the definition of money for GST purposes from 1 July 2017. Now, trades of cryptocurrency are disregarded for GST purposes, unless the trade is for a payment of money or digital currency (for example you are in the business of trading cryptocurrencies). Cryptocurrencies are now taxed in a similar way for GST purposes to foreign currency.

But it's not just GST to consider. Income tax and capital gains tax (CGT) issues might also arise in transactions involving cryptocurrency depending on how and why you are using it.

Individuals trading in cryptocurrencies

If you hold cryptocurrency for your own personal use and you paid $10,000 or less to acquire the digital currency, then there is generally no tax impact when you dispose of the currency. However, if the cryptocurrency is not held for your personal use and enjoyment then there are some tax issues that can arise.

If the cryptocurrency is held as an investment (i.e., not for personal use and enjoyment) or the cost is more than $10,000 then CGT might apply when you sell or exchange the currency. At the time of writing the price of Bitcoin was just under US$6,000 – up from just under US$1,000 at the beginning of 2017 (and just over $13 at the start of 2013). The taxing point for CGT purposes is normally when a contract is entered into. If there is no contact (which is often the case with digital currencies) the taxing point is when ownership changes.

The line between personal use and investment can be very thin. It will be difficult to argue that you hold cryptocurrency for personal use if you use it irregularly to purchase goods and services and you made a large gain from holding and trading it.

Businesses trading in cryptocurrencies

If your business accepts cryptocurrency as payment for goods or services, these payments are treated in the same way as any other. That is, if your business is registered for GST, the price paid by the person paying in the digital currency should include GST. Likewise, if you purchase goods or services for use in your business then you should generally be able to claim GST credits on the transaction in your activity statement, even if you used digital currency to make the purchase.

If you are in the business of trading cryptocurrencies and your business is registered for GST, you charge GST on the exchange of the currency and claim the GST credits in your activity statement. The new legislation does not prevent GST from applying to the supply of cryptocurrencies in exchange for a payment of money or digital currency.

It is also possible that someone could hold cryptocurrency as trading stock if it is held for the purpose of sale or exchange in the ordinary course of a business. Any gains from the trades are then taxed in the business's income tax return (or individual tax return for sole traders). CGT concessions and exemptions are not generally available in this case. If you are in the business of trading cryptocurrencies, that is, you approach the trading in a business-like manner, then you can generally claim losses and other business expenses.

The tax laws can be complex in this area and it's important to ensure that you get the right advice.

Can your SMSF invest in cryptocurrencies?

Arguably, an SMSF can invest in cryptocurrencies but there are several factors to take into account before investing. Cryptocurrencies are a high risk product as they are blockchain driven and unregulated. While there have been numerous stories in the media about massive gains made on the currency by early investors, the price fluctuates, cryptocurrencies face new competitors, and "hard forks" occur - where the blockchain is split and forms a permanent divergence from the original. Bitcoin, for example, has broken into Bitcoin, Bitcoin Cash and now Bitcoin Gold. The danger is that you end up on the wrong fork. There is also the danger of hacker's breaching your fund's digital wallet and stealing your investment.

Trustees of the fund need to ensure that any investment in cryptocurrency is in line with the investment strategy of the fund, the Trust Deed allows for it at the time the investment is made, and it is an appropriate investment. In particular, the sole purpose test in the Superannuation Industry (Supervision) Act 1993 requires that the fund is maintained for the sole purpose of providing retirement benefits to your members, or to their dependants if a member dies before retirement. Trustees need to ensure that the risk associated to these currencies is in the best interests of the fund. A minute documenting the decision to invest in the cryptocurrency would be beneficial.

For tax purposes, gains and losses in the fund are treated in the same way as other assets in the fund. That is, CGT may apply to any gains made on the sale or exchange of the currency.

If your fund invests in cryptocurrency, there are a few practical issues. Your SMSF auditor needs to confirm the ownership, existence, and value of the cryptocurrency. As a result, the digital wallet for your currency should be in the name of your fund or the corporate trustee. You need to ensure that your personal assets, and the assets of your fund, are kept separate at all times. Once money is deposited into your fund, it may not simply be a case of being able to withdraw these amounts, and they may be 'stuck' in the fund until a condition of release is met, which usually means attaining retirement age. And, you need to be able to trace your transactions to identify trades, the value of the trade, and the time and date they occurred.

Documentation to keep the ATO happy

If you are using cryptocurrencies for whatever purpose, it's important to keep records of the transactions to ensure that if the ATO challenges your tax treatment of the currency, you can prove your position.

Cleaners and couriers latest black economy target

The detail of the Government's crackdown on cleaning and courier companies was revealed late last month.

From 1 July 2018, the taxable payments reporting system will extend beyond the building industry to cleaning and courier businesses. This means that these businesses will need to report payments they make to contractors (individual and total for the year) to the ATO. By 'payment' the ATO means any form of consideration including non-cash benefits and constructive payments.

The building industry has had this form of "enhanced reporting" since 2012-13. The result was an additional $2.3 billion in income tax and GST liabilities collected through voluntary reporting in the first year alone.

What is a cleaning and courier service?

The terms 'cleaning service' and 'courier service' take their ordinary meaning.

Courier services include activities where items or goods are collected from, and/or delivered to, any place in Australia using a variety of methods including by truck, car, station wagon, van, ute, motorcycle, motorised scooter, bicycle or other non-powered means of transport, or on foot. Freight services, blood and blood product couriers, and passenger transport are not affected.

A cleaning service is any service where a structure, vehicle, place, surface, machinery or equipment has been subject to a process in which dirt or similar material has been removed from it. This includes office cleaning, road sweeping or street cleaning, swimming pool cleaning, park and facilities cleaning, or cleaning for certain types of cultural or sporting events.

Mixed business that supply services including courier or cleaning services will also be affected.

What you need to do

The first annual report for affected cleaning and courier companies is due by 29 August 2019 for the

2018-19 year. The types of information reported to the ATO about contractors include:

- ABN (where known)
- Name
- Address
- Total paid to the contractor (including GST) for the financial year, and
- Total GST included in the gross amount that was paid.

If an invoice you receive from a contractor includes both labour and materials, whether itemised or combined, you will need to report the total amount of the payment.

If your business is likely to be affected by the new requirements and you currently do not have systems in place that allow you to readily access the information required by the ATO, it's important to start your planning now.

New legislation restricts access to the reduced company tax rate

Legislation restricting access to the small business company tax rate reduction entered Parliament last month. The changes specifically preclude companies with passive investments such as rental property income from qualifying for the small business entity tax rate of 27.5%.

For the 2017 income year a company could access the reduced company tax rate if it was carrying on a business and it had an aggregated turnover of less than $10 million. The changes replace the 'carrying on a business test' with a 'passive income test' from the 2018 income year onwards. Under the new rules, to access the reduced company tax rate, 80% or less of the entity's assessable income must be passive in nature.

The passive income test is not simple. Where a company is receiving income from trusts or partnerships, you need to trace through to determine the nature of the income that was derived by that trust or partnership, and this might need to be done on multiple levels. For example, Trust 1 might distribute income to Trust 2, which then distributes income to a company. Whether dividends are treated as passive income will depend on the shareholding percentage involved.

These changes mean that companies that only hold rental properties will not qualify for the lower tax rate, even if the rental activities amount to a business under general principles. However, a company that receives distributions from a related trust could still qualify for the lower rate if 20% or more of its income is attributable to trading profits (directly or indirectly through the trust).

Under the proposed new rules, it will no longer be necessary to determine whether the company carries on a business in its own right under ordinary principles to determine its tax rate. The removal of the 'carrying on a business test' should eliminate some of the uncertainty that is currently faced when trying to determine the tax rate that applies to many private companies. However, this would still be relevant in determining whether a company can access other concessions that are available to small business entities.

Changes will also be made to the maximum franking percentage rules. In determining a company's maximum franking rate for a particular income year, you need to look at the tax rate that would apply in the current year if the following assumptions are made:

- The company's aggregated turnover in the current year is the same as in the previous year;
- The company's assessable income in the current year is the same as in the previous year; and
- The company's passive income in the current year is the same as in the previous year.

There have been a lot of changes to the company tax rules and who and what they apply to. This development should finally provide some much needed certainty around which companies can qualify for the lower corporate tax rate and the flow-on impact that this has on franking rates for dividends paid by companies.

How small subsidiaries are being caught by Australia's new multinational tax crackdown

Entities with a global parent or that are part of a large group of companies are being caught in the multinational tax crackdown regardless of their size in Australia.

With effect from 1 July 2016, many smaller entities connected to a larger parent or group are now only grappling with the changes prior to the lodgement of the 2016-17 tax returns.

A series of laws targeting multinationals came into effect from 1 July 2016 to ensure that tax is paid on economic activity in Australia. But it's not just entities with revenues of $1bn or more that are affected. Subsidiaries may be caught by the new rules if they:

- Have a large global parent with annual global income of A$1bn or more, or
- Form part of a group of entities consolidated for accounting purposes where the global parent entity has an annual global income of A$1 billion or more.

This includes Australian headquartered entities (with or without foreign operations) and local operations of foreign head-quartered multinationals.

Australian entities (or a foreign entity with a permanent establishment) that meet these criteria are considered significant global entities (SGE). An SGE has additional reporting requirements if:

- It is not required to lodge general purpose financial statements with the Australian Securities and Investments Commission (ASIC). Many wholly or partially owned foreign entities rely on the reporting exemption from ASIC.
- A corporate tax entity a company, corporate limited partnership or public trading trust.
- An Australian resident or a foreign resident operating an Australian permanent establishment (PE), at the end of the income year.

The additional reporting requirements are to ensure that profits and economic gains from activities in Australia are not diverted.

If the Australian entity does not already lodge general purpose financial statements with ASIC, where for example the entity might be exempt, then these financial statements need to be lodged with the ATO prior to the entity's tax return being lodged.

So, you could run a local subsidiary of a multinational that might be generating very little income and still be subject to the same reporting requirements as billion dollar companies.

Being classified as an SGE has broader implications than just the additional paperwork. The administrative penalties that apply to SGEs for entering into a scheme to reduce the amount of tax payable in Australia, failing to lodge tax returns and the accompanying financial statements, and failing to lodge on time, all attract much more significant penalties than if the entity was not an SGE.

ASIC penalties 'the cost of doing business'

The Australian Securities and Investment Commission (ASIC) is set to increase penalties for corporate and financial sector misconduct to deter the fines being seen as the cost of doing business.

The impact of the proposed changes would be to expand the range of civil penalty provisions and to increase maximum civil penalty amounts in the Corporations Act 2001 and National Consumer Credit Protection Act 2009 (Credit Act) to:

- for individuals, 2,500 penalty units ($525,000); and
- for corporations, the greater of: 12,500 penalty units ($2.625 million), or three times the benefit gained (or loss avoided) or 10% annual turnover.

This would mean increases from $200,000 (individuals) and $1 million (corporations) in the Corporations Act and 2,000 penalty units ($420,000) for individuals and 10,000 penalty units ($2.1 million) for corporations in the Credit Act.

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ASIC is also seeking to expand its powers to enable it to remove benefits illegally obtained or losses avoided.

Maximum terms of imprisonment would also be increased for a range of offences to the highest maximum penalty available; 10 years imprisonment and substantial fines.

Quote of the month

"It is better to fail in originality than to succeed in imitation."
Herman Melville