



KPMG Tax Chat



LIFTING THE LID ON CRYPTOCURRENCIES

A son asks his mother for \$13,675 to buy a bitcoin for his birthday. His mother replies, "\$14,890? There's no way I'm giving you that much for your birthday. Save up your own \$11,456 to buy a bitcoin if you really want one".

This was a joke heard during the summer BBQ circuit over the recent Xmas and New Year holidays. While somewhat tongue-in-cheek, it does highlight the extreme volatility in bitcoin values in late 2017 and also reminds us how much bitcoin surged in value during 2017. From a January 2017 value of US\$960, bitcoin rocketed in value to US\$13,820 by the end of the year, after briefly peaking at over US\$19,000 in value.

Gains of such extraordinary magnitude naturally raise questions about whether those who have invested in bitcoin and other cryptocurrencies have to pay tax on gains they have made, which in some cases could be substantial.

The question is complex, mainly because it is not clear exactly what a cryptocurrency is. Is it money or some form of foreign currency? Is it an asset? Is it a security? And further, not all cryptocurrencies are the same. While the famous bitcoin is becoming well understood, the features of other cryptocurrencies are different, which has the potential to lead to different tax outcomes.

Inland Revenue has not yet issued any formal guidance on the question for New Zealand. Other jurisdictions have though. In the US, while more detailed analysis is yet to come, the view of the IRS is that cryptocurrencies are an asset, with any gains made on the disposal of bitcoin (whether by sale of the bitcoin or using the bitcoin to acquire another asset) being taxable as capital gains or ordinary income.

Similarly in Australia the ATO has also formed the view that cryptocurrencies are an asset, again meaning any gains on disposal are taxable either as capital gains or as ordinary income.

Unlike the US and Australia, New Zealand does not (currently) tax capital gains. So the question here is whether bitcoin gains are taxable as ordinary income. To determine the answer we have to return to the question, what is a cryptocurrency? If it is an asset as suggested by the IRS and the ATO, the overarching tax principle for this modern invention is the century-old distinction between assets held on capital vs. revenue account - an analysis focussed on the intention of the investor and use of the asset.

Although New Zealand does not tax capital gains, assets acquired for disposal are deemed to be held on revenue account. Any gains on disposal of revenue account assets are taxable.

Given that bitcoin does not pay interest, the only way to realise any return on investment is to dispose them in exchange for other currencies or property. It would therefore be very difficult to argue that any gain on disposal is a capital receipt and not taxable.

If bitcoin is treated as a foreign currency, it will be governed by the financial arrangement regime. With some exceptions, gains under this regime are taxed on an unrealised basis. In the volatile world of cryptocurrency, investors may be struck with a large tax bill without the immediate cash to pay for it.

With new cryptocurrencies constantly being created, and countries regulating (or looking to regulate) the mining and/or use of cryptocurrencies, their true nature for tax purposes may also evolve.

Regardless of the technicalities, it seems clear that in New Zealand, as elsewhere, the old saying about death and taxes remains relevant in even in the brave new world of cryptocurrencies. While we hope guidance on this issue from Inland Revenue will be forthcoming, it seems pretty clear for most people gains made from cryptocurrency ownership are going to be subject to tax. The flip side for anyone who bought bitcoin at US\$19,000 and is now facing a price of US\$11,000 (as at the time writing – who knows what will have happened by the time you read this!) any loss on disposal is likely to be tax deductible, which could provide a small silver lining to their trading loss.



Bruce Bernacchi
Partner



Gordon Lung
Assistant Manager