

IRAS issues Guidelines for taxation of transactions involving digital tokens



Introduction

On 17 April 2020, the Inland Revenue Authority of Singapore (IRAS) issued an e-tax guide (Guidelines) for the taxation of transactions involving digital tokens. The Guidelines were further revised on 9 October 2020 to provide further clarification that security tokens can be used in the form of any other security or investment assets / instruments. This tax alert provides a summary of the clarifications made by the IRAS on the security tokens.

Background

A digital token refers to any cryptographically-secured digital representation of value that can be transferred, stored or traded electronically. It is a digital

representation of a token holder's right to receive a benefit or to perform specified functions.

Digital tokens can be categorised into 3 types:

1. Payment token – used as a mode of payment
2. Utility token – provides the token holder with a right to use or benefit from services
3. Security token – gives the token holder ownership or rights to an underlying asset or security

The income tax treatment for digital tokens differs depending on the type of digital token being used in the transaction. Briefly, the tax treatment for payment token, utility token and security token are summarised on the next page.

Payment token

Where a business receives payment tokens for the goods or services it has provided, the business would be taxed on the value of the underlying goods provided / services performed. Conversely, where a business uses payment tokens to pay for goods and services, the business is allowed to claim a deduction based on the value of the underlying goods purchased / services received, subject to general tax deduction rules.

Utility token

When a person acquires a utility token to exchange for goods or services to be provided in future, the amount incurred to purchase the relevant utility token will be treated as a prepayment.

At the point when the utility token is used to exchange for the goods or service, subject to tax deduction rules, a deduction will be allowed on the amount incurred.

Security token

The tax treatment of the return derived from a security token depends on the nature of the return, which could be interests, dividends or other distributions and follows the normal income taxation rules.

Where the security token is disposed of by the holder, the taxation of the disposal gain / loss depends on whether the security token is held as a capital (not taxable) or revenue asset (generally taxable).

With regards to Initial Coin Offerings (ICOs), the tax treatment of the ICO proceeds largely depends on the rights and functions of the tokens (i.e. payment token / utility token / security token) issued to the investors.

Our comments

On 9 October 2020, the IRAS updated the Guidelines to clarify that a security token which is essentially a tokenised form of traditional securities can be in the form of any other security or investment assets / instruments. Accordingly, the rights and obligations tied to the security token which determines the nature of the returns derived from the security token, could be interests, dividends or other distributions (based on the categorisation of the security token as debt, equity, other securities or investments assets / instruments).

Proceeds from the issuance of security token in an ICO is alike to proceeds from the issuance of securities or other investment assets / instruments. Such proceeds would be considered as capital in nature and not subject to tax. For the issuer of such security tokens, the deductibility of any payments of interests, dividends or other distributions to the token

holders would follow the normal taxation rules.

We observe that the income tax treatment for digital tokens is largely in line with the general taxation rules. Notwithstanding, the application of the rules in the context of transactions involving digital tokens such as determining the source of income arising from these tokens may not be an easy exercise and would depend on the specific facts of the case.

With the rise in transactions involving digital tokens in recent years and more companies transacting in security tokens as a form of investment assets, the clarification on the income tax treatment surrounding security token by IRAS is welcomed and timely. As the technology for digital tokens continues to evolve and the nature of digital tokens continues to vary over time, we expect further clarification and updates to be issued by the IRAS on the taxation of digital tokens.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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