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IFRS Today

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EPISODE TRANSCRIPT

Cryptoassets – Accounting and tax

Speakers

- Brian O'Donovan
- Charlotte Lo
- Susanne Dixon
- James Bowe (Host)

James

Last year saw huge price volatility in cryptocurrencies and their credibility was questioned as a result.

But, today, much of that hype has settled down and the market is showing signs of maturing. And, certainly, the underlying tech – blockchain – isn't going away any time soon…

Today, I've invited three KPMG colleagues to discuss what this means for businesses: **Brian O'Donovan**, from our International Standards Group; **Charlotte Lo**, from the advisory side of the business; and **Susanne Dixon**, from the UK firm's tax practice. Thank you all for joining us!

First, Charlotte. How close an eye should companies be keeping on developments in the cryptoassets market?

Charlotte

Well, James, I would say that they need to keep a very close eye on developments in this area for two reasons:

- first, the use of cryptocurrencies and cryptoassets is on the rise and the risk for businesses may manifest in many forms – not just as a direct investment but throughout their supply chain; and
- second, we're seeing heightened efforts from accounting, tax and regulatory bodies to issue guidance to help drive consistent practice in this area, raising the compliance burden and compliance risk.

Brian

Yes, that's right, Charlotte.

For example, the IFRIC has recently issued the nearest thing we've seen to accounting guidance – in the form of a **tentative agenda decision** – to explain how existing IFRSs might apply to holdings of cryptocurrencies.

Personally, I think this is a very welcome development. However, this tentative agenda decision deals only with holdings of cryptocurrencies. It doesn't talk at all about other types of cryptoassets. So it's really quite limited in scope.

Susanne

Agreed. It might be helpful for our listeners if we pause here and explain that there are two main types of cryptoasset.

- So one type is *cryptocurrencies* such as Bitcoin – which most people are familiar with.
- The other type is *crypto-tokens*. These are a medium of exchange that give the holder a right to something of value, which for some may only be realisable in the future.

James

Okay. Thanks, Susanne. We'll come back to *crypto-tokens* later, but let's focus on *cryptocurrencies* to start with.

Charlotte – to date, what accounting treatment have companies been applying?

Charlotte

Given the inherent volatility of cryptocurrencies, many people think that the obvious accounting treatment is to recognise these 'things' at fair value through profit or loss (FVTPL).

However, the IFRIC's proposed guidance has actually ruled this out.

Brian

Well, Charlotte, the IFRIC is certainly saying you can't just jump to fair value through P&L. IFRIC says you have to look at the nature of the item you're holding. A cryptocurrency is probably an intangible asset. Most people – when they're accounting for intangible assets – do it at cost. It's only if you can demonstrate that there's an active market that you get to fair value for an intangible and even then any fair market gains and losses will go to equity, not to P&L.

The other possibility depends on the business model. If you're holding cryptoassets to buy and sell in the ordinary course of your business, then maybe they're inventory.

Charlotte

In essence, Brian, this accounting reflects the IASB's view that cryptocurrencies are not cash. They're just not that liquid, at least not yet – and they're not financial assets as defined in IAS 32 because there's no right or obligation to receive or pay cash.

Brian

That's right. So, if we follow on from the intangible inventory analysis that the IFRIC is pushing, there's only one route left to fair value through P&L and that's if you're a broker-trader, if you're buying and selling purely to make a trading margin.

So you started, Charlotte, by saying, "Surely it's got to be fair value though P&L?" But the IFRIC are saying, "That is only the answer in really very limited circumstances". If you – if anybody listening – disagrees with that I would say to you, this is a *tentative* agenda decision. That means it's open for comment. The comment window expires on 15 May.

Charlotte

Yes, and for those of you listening in and thinking that there's a lot to take in, there are more details available in our **flyer** that's available to download from our website.

James

Thanks, Charlotte. Susanne, you touched on another type of cryptoasset earlier – crypto-tokens. Can you start by telling us a bit more about what they are?

Susanne

Yes, absolutely. So, a crypto-token is a digital asset that gives the holder a right to something of underlying value.

Generally, there are two types of crypto-token.

- One akin to a *security (or equity)* – giving the holder an economic interest in a legal entity – e.g. voting rights, a right to dividends or a return of borrowed funds.
- The other, akin to a *utility*-type transaction – giving the holder access to goods or services

Tokens are commonly created through an initial coin offering, also known as an 'ICO'.

Brian

That's right, Susanne. Honestly, tokens are just so diverse… The diversity is almost the defining characteristic. It's a real challenge in thinking about them generally. It's not uncommon to see tokens with more than one of those characteristics. This creates added complexity when you're thinking about how to classify them and even raises the possibility that you might have to bifurcate them – with all the additional challenges that would involve.

Charlotte

That's true, Brian. The ownership of these assets will often be recorded on a blockchain. So proving legal ownership could create some challenges, both for the holders and their auditors.

It's important to note that although the term 'initial coin offering' gives you the impression that it is a kind of initial public offering (IPO), it is *unlikely* to be the case unless the 'coin' gives you identical rights to an equity interest in a business. ICOs generally give the holder of the coin the right to access goods or services.

Brian

So that means that any party seeking to issue, any party seeking to acquire, tokens really, really, *really* needs to understand the rights that that particular token conveys. Honestly, I sound like a broken record sometimes on that point!

I think the other thing to remember is that if you're thinking of issuing or acquiring digital tokens, if you're looking at an ICO, the chances are it's not going to be subject to the same rigorous regulatory requirements that you would have for a traditional IPO – at least, not at the moment. We'll talk briefly about that later.

James

Okay. Brian – just stepping back for a moment to IFRIC's proposals… How would IFRIC's proposed guidance apply to *crypto-tokens* specifically?

Brian

James, the short answer is: it doesn't. The IFRIC agenda decision relates *only* to cryptocurrencies, things like Bitcoin, the things we were talking about at the beginning of this session. It has nothing to say about other types of digital assets.

So if you're holding or if you're issuing something else you're coming back to: "What's the substance of the transaction? What are the underlying rights and obligations conveyed by the token?" And then you're going to have to use a bit of good old-fashioned judgement.

Our **flyer** provides more detail about these issues.

James

Okay. Thanks Brian. Now, a question for you, Susanne. It really sounds as though the accounting bodies are starting to engage with digital assets, but what about those other bodies such as tax authorities and regulators?

Susanne

Well, we are seeing movement there, as well. And from a tax perspective, as always, the tax treatment will depend on the jurisdiction.

For example, from a UK perspective digital assets are being fitted into existing legislation. HMRC is providing overarching policies and supporting guidance – based on existing UK tax laws – and companies should take it from there.

James

Okay. And are there any broad principles that companies can follow?

Susanne

As mentioned, the tax laws of a particular jurisdiction will apply, but what is key when considering the tax treatment of a cryptoasset is *the purpose* of that holding.

So, for example, if you're *trading* in cryptoassets *regularly* – as defined by the tax rules – it's likely that the tax will follow the entries in the profit or loss account. This could give rise to tax volatility from period to period, if the assets change in value.

However, conversely, if you're *holding cryptoassets as an investment* for longer-term appreciation, then as a general principle it's likely that a form of *capital* taxation will apply. This would mean that the accounting entries in the income statement are largely ignored and tax arises on the difference between the asset's disposal proceeds and its acquisition cost.

Brian

Well, Susanne, it's as if you're teeing up another one of my broken records. Don't forget about deferred tax! So, for holders of cryptocurrencies, if the accounting and tax treatments differ, that's something else to think about. Don't forget about deferred tax.

James

Thanks, Brian. So, Charlotte, what if you hold a utility token and the issuer of that token ceases to operate or just can't meet its obligations anymore?

Charlotte

I am beginning to realise I have been given the more difficult exam questions in this podcast. Let's look at the accounting for this. In our experience, a utility token may be treated as a prepayment because it gives a right to a future good or service and is therefore recognised as an asset on the balance sheet.

But if the holder now expects no future benefits to accrue from that prepayment asset, then it will most certainly be written off or written down to the recoverable value of the good or service.

Susanne

And for tax purposes, the treatment would ultimately be *fact-specific*…

For example, if the token still exists, as would a shareholding in a badly performing 'traditional' business, then a client would have to look to relieving provisions such as a negligible value claim.

Alternatively, if it could be considered for tax purposes as a bad debt, then the relevant tax rules for these types of expenses may be applicable.

James

Okay. And what are the potential challenges of cryptocurrencies generally to consider from a tax perspective?

Susanne

So, first, companies should ensure that they're in compliance with their tax requirements – such as record keeping and including these items appropriately in their tax return. It's no longer viable to claim that these are proceeds of gambling, if indeed it ever was.

Companies should also think about whether the purpose for holding cryptoassets might change over time. It'll be important to document any change of purpose.

There could also be issues with a company's ability to offset any losses against taxable gains in particular jurisdictions.

James

All right. But it does sounds like a lot of 'could's. Has any specific guidance been issued on this?

Susanne

So here in the UK, HMRC has recently **issued guidance for individuals on how cryptoassets should be taxed**. Guidance for companies is expected later this year; this is taking slightly longer due to the intangible asset rules that apply to companies. Other jurisdictions are following suit.

James

Thanks, Susanne. Charlotte – what about regulators?

Charlotte

Well, James, regulators are generally averse to cryptocurrencies. In almost all cases, central banks are not fans of cryptocurrencies and have issued warnings of the pitfalls of investing in them.

Certain regulators have gone beyond warnings and have expanded their laws on money laundering, counter-terrorism and anything bad that you can think of to include cryptocurrencies – imposing due diligence for financial institutions that operate in these markets.

Susanne

However, Charlotte, some jurisdictions have gone the other way to attract business and are actively legislating in this area – such as Switzerland, Gibraltar and Singapore.

James

Interesting. To wrap up, it would be really useful if each of you could summarise your key points for our listeners. Starting with Charlotte…

Charlotte

If you are thinking of investing or acquiring cryptocurrencies, be cautious as the prices of these items are very volatile. If we are talking about cryptoassets then you need to understand your rights, whether you are the issuer or acquirer.

In all cases, you'll need to consider what they really are to know how to classify and measure them, because they will directly impact your balance sheet and key performance measures.

Brian

For me, from a pure accounting perspective, I would say, "Don't assume you can go straight to fair value through P&L, however intuitive that accounting model might seem!"

On the IFRIC discussion, and the tentative agenda decision, we're in the middle of a 60-day comment period that expires on 15 May. Have your say!

Susanne

And from my perspective, the taxation of cryptoassets is an emerging area with tax authorities globally trying to keep up with progress. The fact is that these assets are expected to be taxable.

So, if you're holding or issuing cryptoassets, consider the tax issues in the same way as you would for any other transaction – and seek specialist advice!

James

Okay. Thank you, everybody! You'll be able to find out more about some of the issues we've discussed today on our website – including our cryptoasset **flyer**.

And if you like what you've heard, please subscribe to *IFRS Today* – on iTunes, Google Play or any other podcast app.

But for now, thank you all very much for taking the time to listen to this edition of *IFRS Today*.

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