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TREASURY LAWS AMENDMENT (2017 MEASURES NO. #) BILL 2017

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EXPOSURE DRAFT EXPLANATORY MATERIAL



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## ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
Commissioner	Commissioner of Taxation
GST	goods and services tax
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
GST Regulations	<i>A New Tax System (Goods and Services Tax) Regulations 1999</i>



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# **Chapter 1**

## ***GST and digital currency***

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### **Outline of chapter**

1.1 Schedule # to this Bill would amend the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) and the *A New Tax System (Goods and Services Tax) Regulations 1999* (GST Regulations) to ensure that supplies of digital currency receive equivalent goods and services tax (GST) treatment to supplies of money.

1.2 All legislative references are references to the GST Act unless the contrary is indicated.

### **Context of amendments**

#### **Operation of the existing law**

##### ***GST and money***

1.3 Currently, supplies of money receive special treatment under the GST law. Generally, a supply of money is not a supply (subsection 9-10(4)). This means that entities paying consideration in money are not liable for GST on the supply of the money. Money is treated in this way because it is generally considered purely a medium of exchange that is not consumed and is therefore not subject to GST which seeks to effectively apply tax to final private consumption.

1.4 However, a supply of money is a supply if it is provided as consideration for another supply of money. In cases where one entity is paying another entity for money it is not being used exclusively as a medium of exchange to purchase goods, services or property – a valuable service is being provided (for example, activities involving the exchange of money for other money such as debt trading and foreign currency speculation are carried on for profit).

1.5 If a supply of money is a supply, the supply will generally be an input taxed financial supply see section 40-5 and item 9 of the table in subregulation 40-5.09(3) of the GST Regulations.

***Money and digital currency***

1.6 Money has a specific definition under the GST law. The definition, set out in section 195-1, provides that money includes:

- currency (both Australian and foreign);
- promissory notes, bills of exchange;
- negotiable instruments used, circulated or intended for use or circulation as currency;
- postal notes and money orders; and
- payments by way of credit or debit cards, crediting or debiting an account or the creation or transfer of a debt.

1.7 However, the definition also provides that money does not include:

- collector's pieces;
- investment articles;
- items of numismatic interest; and
- currency the market value of which exceeds its stated value as legal tender in the country of issue.

1.8 In Goods and Services Tax Ruling GSTR 2014/3, the Commissioner of Taxation (Commissioner) has advised that bitcoin is unlikely to be money. Specifically, while digital means of exchange such as bitcoin are often referred to as digital currencies, the Commissioner considers they are not currencies as the term is used in Australian law as they are not issued by a government (see for example *Leask v Commonwealth* [1996] HCA 29).

1.9 As digital currencies have independent value rather than being a debt, credit or promise to make a payment they are unlikely to meet any other items specifically included in the GST definition of money. The limited use of digital currencies in Australia also does not support an argument that they may be money in some broader sense.

***GST and digital currency***

1.10 As digital currency is not money for the purposes of the GST law, a payment of digital currency is considered to be a supply of that



currency. If it is a payment that is made by an enterprise that is registered or required to be registered for GST, the supply will generally be a taxable supply.

1.11 The GST treatment of digital currency was considered by the Senate Economics References Committee and the Productivity Commission in separate inquiries in 2015.<sup>1</sup> Both bodies identified the current treatment as a deterrent to the use of digital currency in Australia and recommended changes to the law to provide GST treatment more consistent with money.

## Summary of new law

1.12 The proposed amendments would provide that supplies and acquisitions of digital currency are generally disregarded for the purposes of GST. Consistent with supplies of money, supplies of digital currency would only be recognised for the purposes of GST if the supply is made in exchange for money or digital currency. Also consistent with supplies of money, supplies of digital currency that are recognised for the purposes of GST would be input taxed.

1.13 For the purpose of these amendments, digital currency means fungible digital units of consideration, that do not have a value based on the value of any other thing or associated entitlements.

1.14 The amendments make a number of additional changes to ensure consistent treatment between money and digital currency.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<b>Digital currency supplies and acquisitions</b>	
Supplies and acquisitions of money and digital currency are disregarded, unless the supply or acquisition is undertaken in exchange for a payment of money or digital	Supplies and acquisitions of money are disregarded, unless the supply or acquisition is undertaken in exchange for a payment of money. No special rules apply to supplies and

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<sup>1</sup> Senate Economics References Committee, Commonwealth Parliament, *Digital Currency—game changer or bit player* (2015) and Productivity Commission, *Business Set-up, Transfer and Closure* (2015).

<i>New law</i>	<i>Current law</i>
currency. Digital currency means fungible digital units of consideration, that do not have a value based on the value of any other thing or associated entitlements.	acquisitions of digital currency.
<b>Digital currency, financial supplies and reduced input tax credits</b>	
Supplies of Australian, foreign and digital currency (as well as agreements to buy and sell currency) that are not disregarded are financial supplies. Reduced input tax credits (RITCs) may be available for certain acquisitions related to these supplies.	Supplies of Australian and foreign currency (as well as agreements to buy and sell currency) that are not disregarded are financial supplies. RITCs may be available for certain acquisitions related to these supplies.
<b>Commissioner may determine method for valuing foreign or digital currency</b>	
The Commissioner may determine how to work out the value in Australian currency of a taxable supply where consideration was provided in foreign currency or digital currency.	The Commissioner may determine how to work out the value in Australian currency of a taxable supply where consideration was provided in foreign currency.

## **Detailed explanation of new law**

1.15 The proposed legislation would amend the GST law so that digital currency would receive equivalent treatment to money, in particular foreign currency.

### **Defining digital currency**

1.16 To ensure digital currency has equivalent GST treatment to foreign currency, it is necessary to define what is meant by digital currency for the purposes of the GST law.

1.17 These proposed amendments are being made because of the growth in the use of a particular type of medium of exchange – digital assets secured by cryptography operating through a public, automated and consensus-based distributed ledger that records and validates transactions (often taking the form of a blockchain). These cryptographic currencies, which most prominently include bitcoin, are commonly referred to as ‘digital currency’.

1.18 However, this is an area subject to ongoing technical change and development. There is a significant risk that any definition based on the current architecture of cryptographic currencies may lose relevance if new technical approaches emerge.

1.19 At the same time, there are a number of types of digital assets that bear some similarities to currency or digital currencies but which are not appropriately treated as a currency, generally because they either are rights to particular things rather than having value only as a medium of exchange or they are dealt with appropriately under the existing law.

1.20 The amendments would define digital currency as needing to broadly have the same features as state fiat currencies. In particular, in the same way as state fiat currencies, the value of a digital currency must derive from the market's assessment of the value of the currency for the purposes of exchange, despite it having no intrinsic value. *[Schedule #, item 27, the definition of 'digital currency' in section 195-1]*

***Requirements of the digital currency definition***

1.21 Consistent with this overall purpose, the definition identifies a number of requirements that digital units of value must satisfy to have the required similarity to state fiat currencies.

1.22 The units must be fungible – that is fully interchangeable for the purposes of their use as consideration. Digital assets that are valuable because of their specific features, such as photographs, would not be digital currency. *[Schedule #, item 27, paragraph (a) of the definition of 'digital currency' in section 195-1]*

1.23 They must also be capable of being consideration for any type of supply and generally available to the public free of any restrictions on their use as consideration. *[Schedule #, item 27, paragraphs (b) and (c) of the definition of 'digital currency' in section 195-1]*

1.24 This requires that digital currencies must be suitable for use as a medium of exchange. Digital assets that are not suitable for use as consideration, or which are only available to the public subject to restrictions of their use, such as loyalty points provided by retailers that may be redeemed for products or 'currencies' used in many online multiplayer games, are not within the scope of digital currency as they cannot be used in the same way as money.

1.25 While digital currencies must be suitable for use as a medium of exchange, there is no minimum level of use required to meet the definition. For example, when a digital currency is first launched there may be few, if any, parties that initially accept it as payment, but it can still be a digital currency provided the design and features of the currency

allow it to be used in this way. This ensures that there are no barriers to entry for new digital currencies.

1.26 It should also be noted that the use of distributed ledger technology for other applications such as record-keeping or ‘smart’ contracts will not result in the creation of a digital currency as this does not involve fungible units suitable for use as consideration.

1.27 The definition also requires that digital currency must not have a value based on the value of anything else. Hence, units are not digital currency if they are denominated in another currency, for example with a value pegged to the US dollar. *[Schedule #, item 27, paragraph (d) of the definition of ‘digital currency’ in section 195-1]*

1.28 Similarly units with a value that is derived from or dependent on anything else are not digital currency. Accordingly, money, property rights and interests, as well as shares, derivatives and other financial instruments are not digital currencies. They have a value separate from their use as consideration. This is the case whether the unit is a direct property interest, such as a share, an indirect property interest, like an option, or an instrument with a value dependent on something more that is not property, such as an interest rate or market index. *[Schedule #, item 27, paragraph (e) of the definition of ‘digital currency’ in section 195-1]*

1.29 Finally units are not digital currency even if they have independent value and are fully transferrable, if they are only or principally valuable because they provide the holder with benefits, entitlements or privileges, such as memberships or vouchers. Unlike money, such units or instruments are valuable because they carry specific entitlements and are appropriately dealt with under existing rules. *[Schedule #, item 27, paragraph (f) of the definition of ‘digital currency’ in section 195-1]*

1.30 The definition of digital currency excludes both money and existing financial supplies. It is unlikely that there is currently any overlap between these definitions. No government currently issues currency that would be digital currency, while other forms of money and existing financial supplies either carry valuable entitlements or have a value derived from something else. *[Schedule #, item 27, paragraphs (g) and (h) of the definition of ‘digital currency’ in section 195-1]*

1.31 However, it is possible this could change, such as if a government were to issue currency that is digital currency or adopt an existing digital currency as legal tender. If this occurred, the currency would be money (as a foreign currency) and thus, despite satisfying most of the elements of the definition, would not be digital currency. The proposed definition provides clarity and avoids any future issues by

making clear the relationship between money, digital currency and existing financial supplies and preventing any overlap.

### **Example 1.1 Digital currencies**

Ozcoin is a cryptographic currency utilising a public consensus-based distributed ledger. It is made up of interchangeable digital units called Ozcoins.

A large number of Ozcoins are held by OzCo, which created the currency, and more are issued which are provided to entities that collect and verify new transactions to update this ledger (ie miners). Entities that wish to transact in Ozcoins can purchase Ozcoins from OzCo, miners or other purchasers of the currency, generally without being subject to any restriction about the subsequent use of the currency.

Ozcoin is only valuable for its use as a medium of exchange – it does not have a value derived from anything else and does not have valuable rights attached to it.

As a result, Ozcoin is a digital currency. It is made up of interchangeable digital units that are generally available to the public for use as consideration. Further, these units are only valuable as a medium of exchange. It should be noted that it does not matter that the current value of the Ozcoin may be low or that an entity may hold the currency for speculative purposes; if it is not valuable for any reason other than its use or future use as consideration then it satisfies the requirements of the definition.

A number of countries have rules that restrict or prohibit the use of Ozcoin as payment in those jurisdictions as a result of foreign exchange controls or other regulations. These rules do not affect the conclusion that Ozcoin is a digital currency. Ozcoin is capable of serving as consideration for supplies, and it is available to the public generally without restriction on its use – externally imposed restrictions by foreign jurisdictions are not relevant to the outcome.

### **Example 1.2 Things that are not digital currency – restrictions on use**

Yellow Co is an Australian retailer. It issues its customers Amber points when they spend money on its products. These points are awarded and tracked in an electronic database maintained by Yellow Co.

The points can be redeemed from Yellow Co for discounts and specified products but the points are not transferrable and may only be used in the way specified by Yellow Co.

Amber points are not a digital currency. While the points are fungible, they are not available to the public free of restrictions on how they may be used as consideration –given the nature of how they operate it is not clear they serve as consideration at all. Additionally, their value comes solely from the entitlement to redeem the points from Yellow Co for particular rewards.

### **Example 1.3 Things that are not digital currency – external value**

Finance Ltd is an Australian company that raises money by issuing bonds to investors. The bonds entitle the holder to an annual payment by Finance Co, indexed based on the cash rate published by the Reserve Bank of Australia.

The bonds issued by Finance Co are digital, fungible and can freely be used as consideration. However, they are not digital currency. The bonds have a value that is dependent upon the Reserve Bank of Australia cash rate. Moreover, they are valuable solely because they entitle the bearer to payments from Finance Co.

In addition, even if the bonds met the general requirements to be digital currency, their supply would be a financial supply, and so they could not be digital currency.

### **Supplies and acquisitions of digital currency**

1.32 If something meets the definition of digital currency, the proposed legislation would ensure that payments of the digital currency receive equivalent treatment to payments of money.

1.33 There are three elements to this treatment. First, subsections 9-10(4) and 11-10(3) provide that supplies or acquisitions of money are generally not supplies or acquisitions under the GST law. Therefore, the proposed amendments extend this so that supplies and acquisitions of digital currency are also generally not supplies or acquisitions under the GST law. [*Schedule #, items 1 and 4, subsections 9-10(4) and 11-10(3)*]

1.34 Secondly, subsections 9-10(4) and 11-10(3) also provide a key exception to this rule – supplies of money in exchange for other money are treated as supplies of money and acquisitions of money in exchange for other money are treated as acquisitions. The proposed amendments similarly extend this treatment to digital currency. In this context, equivalent treatment means that money and digital currency should be interchangeable – the same treatment will apply to supplies of digital currency for other digital currency, money for digital currency, money and digital currency for money etc. [*Schedule #, items 1 and 4, subsections 9-10(4) and 11-10(3)*]

1.35 Finally, where a payment of foreign currency is a supply (ie. because the consideration for the supply is money and/or digital currency), it is a financial supply (see item 9 of the GST Regulations). These amendments would extend this so that payments of digital currency are similarly financial supplies. *[Schedule # to the Instrument, item 1, table item 9 in subregulation 40-5.09(3) of the GST Regulations]*

#### **Example 1.4 Acquiring and spending digital currency**

David, an Australian consumer, acquires 500 Ozcoins (a digital currency) from Ozco, an Australian resident company that is registered for GST, paying partly in Australian dollars and partly in US dollars.

The supply of the Ozcoins by Ozco to David is a supply of digital currency. It is not disregarded for the purposes of GST as it is a supply of digital currency for money (specifically Australian and foreign currency). Instead, the supply by Ozco is an input taxed financial supply.

As a result, the supply by Ozco is not a taxable supply and input tax credits are not generally available for any related acquisitions Ozco may have made.

David's supply of money to Ozco is also not disregarded as it is a supply of money for digital currency. However, as David is not registered or required to be registered for GST no further consequences apply.

David subsequently uses 11 Ozcoins to purchase a coffee and donut from Loretta's Bakery, an Australian resident company.

David's supply of digital currency to Loretta's Bakery is not considered a supply for the purposes of GST (although in this case it does not matter as David is not registered or required to be registered for GST).

The GST law applies normally to the supply of the coffee and donut by Loretta's Bakery – the fact that the consideration was digital currency is irrelevant. If the supply is a taxable supply, Loretta's Bakery must remit 1/11<sup>th</sup> of the consideration provided by David in relation to the supply (ie. an amount of money equivalent in value to one Ozcoin in Australian dollars) to the Commissioner as GST.

All of these outcomes would be the same if David had instead acquired and spent money.

#### ***Minor amendments – financial supplies***

1.36 The proposed legislation would also make amendments to the financial supplies provisions to ensure equivalent treatment for foreign

currency and digital currency. *[Schedule # to the Instrument, items 2 to 5 and 7, table items 4 and 16 in regulation 40-5.12, paragraph (c) of table item 21 in subregulation 70-5.02(2) and table item 22 in subregulation 70-5.02(2) of the GST Regulations and the definition of 'payment system' in the Dictionary to the GST Regulations]*

1.37 These amendments would include amendments to the list of supplies that are not financial supplies and the definition of payment system. *[Schedule # to the Instrument, items 2, 3 and 7, table items 4 and 16 in regulation 40-5.12 of the GST Regulations and the definition of 'payment system' in the Dictionary to the GST Regulations]*

1.38 These changes generally ensure that these provisions will apply to digital currency in the same way as a foreign currency. The changes relating to payment systems would also address ambiguities that might otherwise arise in relation to types of digital currency that inherently have some elements of a payment system incorporated into their function (such as many cryptographic currencies). The amendments make clear that these features do not prevent supplies of these currencies being a financial supply.

1.39 The amendments to the financial supplies provisions would also revise the scope of acquisitions that are reduced credit acquisitions. This would allow taxpayers to obtain reduced input tax credits for those acquisitions even if the acquisitions relate to the making of financial supplies. While many items would not be relevant to supplies of digital currency, and others apply without any need for change, the reduced input tax credit provisions relating to capital markets and financial instruments services make specific reference to foreign currencies. The amendments would revise these references to also include digital currencies to ensure comparable treatment. *[Schedule # to the Instrument, items 4 and 5, paragraph (c) of table item 21 in subregulation 70-5.02(2) and table item 22 in subregulation 70-5.02(2) of the GST Regulations]*

#### ***Minor amendments – references to money and currency***

1.40 The proposed legislation would also make a number of minor amendments to other provisions that specifically refer to money or currency. *[Schedule #, items 2, 5 to 26 and 28 to 29, subsections 9-85(2) and 78-10(1), paragraph (a) of step 1 of the method statement in subsection 78-15(4), subsections 78-20(1), 78-35(1) and 78-75(1), paragraph 78-110(a), 79-65(1)(c), 79-90(1)(a), 79-90(2)(a) and 79-90(2)(b), paragraph (a) of step 1 on the method statements in subsections 79-95(3), 80-30(2) and 80-70(2), paragraph (b) of the definition of total monetary prizes in subsection 126-10(1), subsection 126-32(1), subparagraphs 134-5(1)(c)(i), (ii) and (iii), and 134-10(1)(c)(i), (ii) and (iii), paragraph 188-22(a), section 188-35 and paragraphs (a) and (b) of the definition of monetary prize in section 195-1]*

1.41 Most importantly this would allow the Commissioner to determine methods for converting digital currency into Australian currency when valuing supplies, consistent with the Commissioner's



existing powers in relation to foreign currency. The amendments would also ensure that this change did not affect the validity of existing determinations made by the Commissioner in relation to foreign currency. *[Schedule #, items 2 and 3, subsection 9-85(2)]*

1.42 However, it would also amend provisions referring to payments in money, including in the provisions dealing with insurance, third party payments and gambling. The amendments would revise these provisions to also apply to digital currency where this is required to provide consistent treatment.

## **Application and transitional provisions**

1.43 The proposed legislation would apply to supplies and payments made on or after 1 July 2017. *[Schedule #, item 30 and Schedule # to the Instrument, item 6, item 107 of Schedule 15 to the GST Regulations]*

1.44 This start date, which was announced in the 2017-18 Budget, ensures that the use of digital currency in Australia does not face additional disincentives that may otherwise arise from changes to the GST law in relation to offshore supplies to Australian consumers of things other than goods or real property that apply from this day. As the changes will only benefit taxpayers and advance notice of the measure and its application date has been provided the potential retrospective application is not considered to have any adverse impact on taxpayers.