



Director
Corporate Tax Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: CryptoTax@treasury.gov.au

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Dear Sir / Madam

Thank you for the opportunity to comment on the digital currency amendments to the *Income Tax Assessment Act 1997 (Cth) (Tax Act)* and *A New Tax System (Goods and Services Tax Act) 2001 (Cth) (GST Act)* (together, **Proposed Amendments**).

Overarching comments on language in the Explanatory Memorandum

We welcome the Government's intention to clarify the tax laws relating to digital assets.

It is important that the nature of these assets is clarified in legislation so that desired policy outcomes are not disrupted by legal challenge, and we appreciate that this is why retrospective amendments are proposed. However, we caution against simplifying messages as to the current nature of these assets and provide some examples in the draft EM that require consideration.

Statement that the consequence of amendment is that digital assets are on capital account

We refer to our submission to the Board of Tax in relation to other key aspects of the tax law which should be clarified in relation to digital assets. A key matter that we identify in that submission is what we believe is a currently simplified approach to treat all digital assets as capable of being on capital account.

We appreciate that the reason for this approach may include protecting the revenue base from highly volatile digital assets giving rise to deductible losses and understand the reasoning for this. Digital assets are not synonymous and have many types. The most common, bitcoin, has limited realisable value unless it is sold. As a form of "digital gold", there is an argument that - at common law - bitcoin, like gold, is incapable of having its value realised except through a sale, such that an acquisition of bitcoin is likely to involve a profit-making undertaking in a wide range of scenarios. While there will be exceptions to this view (e.g. hobbyists), the current presumption that bitcoin is held on capital account may be overly simplistic, when the true nature of the asset is considered. A separate (and likely different) analysis is required for other digital assets, such as ether, stablecoins, etc, which highlights the challenge of this area.

The ATO has to date adopted an approach of treating digital assets on capital account where the features of this are present, based on treating the assets *as if they were other types of property* (e.g. shares). While it may be correct to say that digital assets are capable of being CGT assets, it is not

PricewaterhouseCoopers, ABN 52 780 433 757
One International Towers Sydney, Watermans Quay, Barangaroo NSW 2000,
GPO BOX 2650 Sydney NSW 2001
www.pwcaetuarial.com
T: +61 2 8266 0000, F: +61 2 8266 9999, www.pwc.com.au

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necessarily correct to imply that the reflex of transacting in a digital asset is only capable of being on capital account, or that this is the “normal” transaction that arises in the market.

It is not Treasury's task to interrogate the above issue at this time, however, we caution against language that feeds into this presumption. We refer in particular to paragraph 1.9 of the Draft Explanatory Memorandum which states that “an investment in bitcoin is typically held on capital account”. This simplifies an issue that is debatable and is an unnecessary comment. In due course, further legislation to articulate/confirm that a digital asset like bitcoin can be held on capital account, may be necessary.

Statement that bitcoin is not currently a foreign currency

While we appreciate that there are policy sensitivities that necessitate digital assets being treated as non-monetary in nature, there are arguments that we believe that the technical application of the law may lead to bitcoin in particular being classified as money or currency in nature.

We note that the Draft Explanatory Memorandum contains an underlying statement that these assets are currently not money or currency. It may be difficult to substantiate this position technically, in a court. We appreciate that this is why the proposed legislation is retrospective and understand the policy drivers for this. However, we caution against use of language that simplifies a technical issue that could be the subject of reasonable debate if challenged.

Impact of amendments on stablecoins and CBDCs

The changes to the definition of digital currency are workable for payment tokens such as bitcoin and ether. The examples in the Explanatory Memorandum also illustrate how the amendments are applicable when a country issues a central bank digital currency (**CBDC**).

However, the current wording does not necessarily cater for stablecoins.

Stablecoins are different from CBDCs and other digital assets (e.g. bitcoin/ether)

Stablecoins are digital assets that are issued by a party (either a centralised entity, such as Circle (USDC) or a decentralised entity, such as the DAI token issued on the MakerDAO protocol). They are different to central bank digital currencies (CBDCs) which are issued by a government authority (e.g. Bahamian Sand Dollar and China's pilot of the Digital Yuan).¹

Stablecoins make up a significant part of the crypto economy and are used interchangeably with digital assets in many decentralised finance arrangements. For example, on 18 September 2022, three of the Top 10 coins by market capitalisation were stablecoins.²

A stablecoin is generally pegged to another asset, usually a currency. Its “denomination” may refer directly to that currency (e.g. USD Coin). Stablecoins are not issued by a government authority, and their characteristics vary quite dramatically.

¹ For a basic overview, see <https://crypto.com/university/what-are-stablecoins>.

² CoinMarketCap, 18 September 2022, <https://coinmarketcap.com/>.

For example:

1. Collateralised stablecoins such as USD Coin, which are issued by a centralised entity (Circle) and fully backed by USD held in custody. USDC can be redeemed 1:1 for USD. Circle is a registered money transmitter under US state law and is managed by the Centre consortium (Circle, backed by Goldman Sachs) and Coinbase.³ USDT (issued by Tether Limited), is also redeemable for cash, however Tether Limited has not been audited or issued details of how its collateral is held.⁴
2. Commodity-backed stablecoins (similar to #1 but backed by commodities). An example is the Perth Mint Gold Token which is 100% backed by gold stores at the Perth Mint.⁵
3. Cryptocurrency-backed stablecoins, such as DAI, that maintains its peg to the USD by reference to another asset (e.g. ETH) that is over-collateralised and held in a vault.
4. Algorithmic stablecoins, where an algorithm maintains the peg between the coin and a currency, such as the failed TerraUSD. These are the most complex stablecoins and may work in tandem with another coin (in Terra's case, LUNA), to maintain the peg. LUNA could be exchanged for TerraUSD on a 1:1 basis, with market participants being incentivised to buy LUNA when its price was below USD1 and to sell LUNA when its price was above TerraUSD.⁶

As this demonstrates, the difference between a stablecoin and a CBDC varies vastly, depending on the coin. There is a risk that the holder takes, vis-a-vis the creditworthiness of the stablecoin issuer or - in the case of a decentralised issuer or DAO (e.g. MakerDAO or Terra Labs) - the effectiveness of the stablecoin's protocol. While this risk is lower where the stablecoin is fully collateralised and exchangeable 1:1, this is clearly not the same as holding a CBDC.

Stablecoin policy is evolving but will likely involve regulation

Stablecoins remain the subject of considerable debate. For example, the US Treasury released a Report on Stablecoins in 2021 identifying a number of risks relating to stablecoins, including the risk of digital asset runs, payment system risk, and noting inconsistencies on how/when collateralised stablecoins can be redeemed. The US Treasury recommended urgent action to regulate stablecoins and introduce a federal prudential framework.⁷

The UK has also introduced law that designates stablecoins as digital settlement assets, with the US making promising remarks about further regulation this year.⁸ Australia's Reserve Bank Governor Phillip Lowe has confirmed that stablecoins have promise but must be regulated.⁹

³ <https://www.finder.com/usd-coin-vs-tether>

⁴ Ibid.

⁵ For details see <https://pmgt.io/>.

⁶ See DeCrypto for a good article on how this protocol operated: "Before you can buy UST, you'll have to mint some. To do so, you'll pay the going rate in LUNA. The protocol takes those LUNA and burns them, which constricts their supply and makes the price of LUNA go up just a bit. The same works in reverse: to mint LUNA, you'll convert UST stablecoins. Those get burned and the price of UST goes up ever so slightly." <https://decrypt.co/resources/what-is-terra-algorithmic-stablecoin-protocol-explained>. Algorithmic stablecoins are notoriously difficult to achieve in practice and many have failed.

⁷ https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf.

⁸ For an excellent summary of the current position, see Michael Bacina et al's article at <https://piperladerman.com.au/insight/blockchain-bites-regulation-by-enforcement-stablecoins-lead-regulation-race-barclays-sees-gold-in-copper-sec-investigates-coinbase/>

⁹ <https://www.afr.com/companies/financial-services/stablecoins-need-to-be-regulated-like-bank-deposits-low-20220720-p5b322>



Current treatment of stablecoins under the tax law

There is no legislated or case law guidance on the current treatment of stablecoins in Australia. The ATO has treated them as synonymous with other digital assets in non-binding guidance.¹⁰

Matters that remain unresolved include:

- Whether stablecoins are traditional securities.
- Whether stablecoins are commodities for TOFA purposes.
- Whether stablecoins are derivative financial arrangements for TOFA purposes.
- Whether stablecoins are debt interests.
- Whether stablecoins are a right to receive foreign currency.

All of these matters could compromise the existing presumption that stablecoins are transacted on capital account. It is important that - to the extent the current amendments **intend to** cover stablecoins (discussed further below) - these complexities are acknowledged.

A stablecoin can be seen as:

- An instrument that represents a right to receive foreign currency (e.g. USDC/USDT).
- A derivative that moves by reference to an underlying currency, albeit with more volatility due to the credit risk of the issuer (which may be a centralised organisation or a decentralised protocol). Volatility is greater where the stablecoin is not collateralised (e.g. DAI) or the creditworthiness of the issuer is under doubt.

While stablecoins are used in the digital space as a proxy for fiat currency, they are clearly very different to fiat or to CBDCs for the above reasons.

Concept of stablecoins under the "digital currency" definition is unclear

Stablecoins may not currently fall within the GST Act definition of "digital currency" or "money".

The two terms are extracted below, as currently drafted in section 195-1 of the GST Act:

"digital currency" means digital units of value that:

- are designed to be fungible; and
 - can be provided as *consideration for a supply; and
 - are generally available to members of the public without any substantial restrictions on their use as consideration; and
 - are not denominated in any country's currency; and
 - do not have a value that depends on, or is derived from, the value of anything else; and
 - do not give an entitlement to receive, or to direct the supply of, a particular thing or things, unless the entitlement is incidental to:
 - holding the digital units of value; or
 - using the digital units of value as consideration;
- but does not include:
- *money; or

¹⁰ For example, see <https://community.ato.gov.au/s/question/a0J9s00000011Nr/p00046969>



(h) a thing that, if supplied, would be a *financial supply for a reason other than being a supply of one or more digital units of value to which paragraphs (a) to (f) apply.

"money" includes:

- (a) **currency** (whether of Australia or of any other country); and
- (b) **promissory notes** and bills of exchange; and
- (c) **any negotiable instrument used or circulated, or intended for use or circulation, as currency** (whether of Australia or of any other country); and
- (d) postal notes and money orders; and
- (e) whatever is supplied as payment by way of:
 - (i) credit card or debit card; or
 - (ii) crediting or debiting an account; or
 - (iii) **creation or transfer of a debt.**

However, it does not include:

- (f) a collector's piece; or
- (g) an investment article; or
- (h) an item of numismatic interest; or
- (i) currency the market value of which exceeds its stated value as legal tender in the country of issue.

The highlighted items above pose a range of challenges for the characterisation of stablecoins as digital assets, notwithstanding that we believe the ATO has treated them this way in practice. It may be the case that stablecoins are closer to the current definition of "money" (excluding, of course, asset backed stablecoins which are not exchangeable or denominated in currency).

The Explanatory Memorandum to the Treasury Laws Amendment (2017 Measures No. 6) Bill 2017 suggests that stablecoins **are not** intended to be digital currencies:

1.31 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 Australian or US dollar. [Schedule 1, item 27, paragraph (d) of the definition of digital currency in section 195-1]

The implication is that these coins are money; albeit we question whether this is desirable noting the regulatory comments above, and intended.

Clarity on the treatment of stablecoins is desirable

As stablecoins represent a considerable portion of the digital assets marketplace, it is desirable to confirm how they are treated under the tax law, even if this is only addressing a foundational issue such as whether they are currency for income tax and GST purposes.

While simplistic, stablecoins are used interchangeably with other, highly liquid digital assets such as bitcoin and ether, and therefore as a policy matter it is desirable to confirm the treatment of these assets. We acknowledge this is beyond the current mandate of Treasury.

Of course, the more complex questions relating to stablecoins remain outstanding and are most likely to require detailed technical analysis, possibly following the Board of Tax Review.



Treatment of stablecoins under the current amendments

In our view, the proposed amendments to the digital currency definition do not resolve the treatment of stablecoins for several reasons. In order to do this, stablecoins must be covered by each of the paragraphs in the digital currency definition.

Accepting that subparagraphs (a) to (c) should be met, and focusing on the remaining subparagraphs of the definition in turn:

Current wording in the tax law	Proposed revised wording in the exposure draft	Impact
(d) are not denominated in any country's currency; and	(d) either: (i) are not denominated in any country's currency; or (ii) are denominated in a currency that is not issued by, or under the authority, of an *Australian government agency or a foreign government agency...	Arguably USDC/USDT are denominated in their "own" currency and not USD (but this is tenuous). If this can be satisfied, (ii) would not need to be met. However, the original EM to the "digital currency" definition implies that stablecoins that are pegged to the value of another currency are denominated in that currency, meaning that to satisfy the proposed amended definition of digital currency, paragraph (ii) needs to be met under the "either" test. The current language makes this difficult as the "currency" that USDC is denominated in (on this interpretation) is USD, which is issued by a foreign government.
(e) do not have a value that depends on, or is derived from, the value of anything else; and	Unchanged	Stablecoins all have a value that is derived from the value of something else, even if in some cases it wavers (e.g. TerraUSD's value was derived from the value of LUNA, and dropped to close to nil when the Terra/LUNA peg was lost). As such, this limb of the definition would also be failed.
(f) do not give an entitlement to receive, or to direct the supply of, a particular thing or things, unless the entitlement is incidental to: (i) holding the digital units of	Unchanged	For collateralised stablecoins that are redeemable 1:1 (e.g. USDC/USDT), it is arguable that the entitlement to receive USD is incidental to holding the units of value or using them as



<p>value; or (ii) using the digital units of value as consideration;</p>		<p>consideration; however, the value of the units is driven by the right to redeem, so this argument remains tenuous at best. In practice it is likely that the entitlement is treated as incidental by some, however there have been 'runs' on redemption in the past.¹¹ It may be harder to substantiate these arguments for algorithmic stablecoins. It is therefore unclear on the current reading as to whether stablecoins meet this limb.</p>
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Given the interpretative difficulties with all three paragraphs of the definition of digital currency, it may be necessary to explicitly state their desired treatment.

If Treasury confirms that it does not have a mandate to address the treatment of stablecoins, that should be stated in the Explanatory Memorandum. The amendments should also consider what “denomination” means; for example, DAI is pegged 1:1 to the USD, meaning its value is quoted in USD, but is not necessarily “denominated” in USD. It may be necessary to provide an EM example for DAI or USDC to clarify that they remain outside of the scope of the digital currency definition (if this is Treasury’s intention).

Impact of treating stablecoins as not digital currency

The impact of treating stablecoins as digital currency vs money is moot for the purposes of the GST Act. However, as indicated above, stablecoins may also not be characterised as “money”. If this is the case, stablecoins may actually be an input taxed supply at present, unless they qualify as GST free.

However, for income tax purposes, treating stablecoins as digital currency would confirm that they are not foreign currency or a right to receive currency, which is counter to the outcome that arises in practice for USDC and USDT, which can be redeemed for USD.

We believe that it is appropriate to separately address the treatment of stablecoins and not disrupt the current position through the amendments to “digital currency” for bitcoin, etc.

Treatment of CBDCs under the current amendments

The Explanatory Memorandum clearly indicates at Example 2 (“Coin B”) that CBDCs are intended to be treated as money, where they are issued by the Australian government or an overseas government authority. In Example 2, “Coin B” is not a digital currency because it is denominated in the currency of a foreign country and issued by a foreign government.

¹¹ <https://decrypt.co/103391/tether-billions-redemptions-circle-usdc-gaining-ground>. See the statement regarding USD7bn of Tether being redeemed in May this year following the Terra/Luna crash.



We suggest that the tax treatment of local and foreign CBDCs should be considered in a future consultation process. Under the legislation as amended, we suspect that a foreign CBDC would be treated as currency if it was recognised as legal tender in a foreign country.

Minor comments on Explanatory Memorandum

Digital assets are a complex area and therefore we offer some minor comments as clarifications rather than critiques of the Explanatory Memorandum.

- Paragraph 1.10 states that the amendments apply to bitcoin and “other similar assets”. In fact bitcoin is quite unique relative to some other digital currencies (e.g. ether) in that it is less sophisticated, does not allow for smart contracts, etc. Perhaps the language “bitcoin, ether and other similar assets” would be more appropriate.
- Paragraph 1.16 states that “apart from the instance of bitcoin, there is unlikely to be any current overlap between the definitions of *money* and *digital currency*”. This may be the case where Treasury is very confident on the treatment of stablecoins. However, the lack of any commentary on stablecoins leaves this issue clearly “hanging” in the EM.

Closing remarks

We again thank Treasury for tackling such a difficult, novel area of the market and congratulate Treasury on the progress that has been made. We hope that this submission helps to provide some further areas for consideration and would welcome the opportunity to discuss.

Yours sincerely

Sarah Hickey
Partner
FS Tax Leader