Cryptoassets and tax

The cryptoasset sector is still developing. From the start, it has attracted people who are fascinated by the emerging technology and others who are keen to explore its possibility to create wealth. But investors are running with it and tax and regulatory bodies are developing approaches to it.

There is currently no standard terminology and what there is sounds like magic beans met Dr Who. But when regulators start to lay out the taxation framework, we're back to earth. Generally, tax consequences involving cryptoassets arise when they are:

- bought and sold (trading)
- acquired and held on to as an investment
- received as payment for goods and services
- used to pay for goods and services.

Common terms

Cryptoassets are units of value that are transferred, stored, or traded electronically and secured cryptographically. They can also be called:

- cryptocurrencies
- cryptographic assets
- digital financial assets
- digital tokens
- virtual currencies

There is already a wide range of cryptoassets, including:

- payment tokens: a means of payment or exchange, for example Bitcoin and Litecoin. They are also called exchange tokens, intrinsic tokens or simply cryptocurrencies.
- security tokens: represent existing property or financial assets, and so mirror securities like shares or debt. They grant the holder an ownership right in an asset (e.g. shares, bonds, commodities, real estate, personal property etc) and they may also be called asset tokens.
- utility tokens: these are more like traditional payment vouchers. They can be used to gain direct access to specified goods or services by granting the holder the right to obtain a product or service.

Blockchain

Whatever you call cryptoassets, whatever you use them for, you need some way of keeping tracking of them. This is where blockchain comes in.

A blockchain stores information electronically in digital format as a database. It can be used to maintain a secure, decentralised record of transactions. It guarantees the recorded data's fidelity and security and generates trust without the need for a trusted third party. It's a ledger technology.

Airdrops and hard forks

There is new and emerging language for cryptocurrency activities and transactions, such as:

- Airdrop: when a cryptoasset is distributed for free to participants, commonly to help a cryptoasset gain attention.
- Hard fork: when a change in the protocol of a blockchain network results in a new cryptoasset diverging from the existing one.

Mining cryptoassets

Mining cryptoassets is a process that creates new blocks and achieves consensus on the blocks to add to the blockchain. Miners can receive cryptoasset rewards in return for verifying additions to the blockchain. Different consensus models are possible, for example:

- proof of work, using computer resources to validate transactions and maintain the blockchain transaction ledger. A proof of work miner may choose to mine cryptoassets alone, or as part of a mining pool, where miners combine their processing power to earn rewards, splitting the rewards proportionate to their individual contributions.
- proof of stake, requiring an investment in the cryptoasset itself. Users are generally required to lock a certain number of cryptoassets into the network as their stake. A pseudo-random election process selects a user to be the validator of the next block. Some people choose to take part in proof of stake mining through a third party staking-as-a-service provider or a staking pool rather than staking on their own.

The tax position so far

Cryptoassets are generally treated as a form of property for tax purposes, and the tax treatment will depend on the characteristics and use of the cryptoasset. Note cryptoassets are not treated as financial arrangements for tax purposes (therefore only realised gains/losses are taxable, as opposed to unrealised gains or losses).

Buying and selling of cryptoassets

When cryptoassets are disposed (which includes exchanging for a different type of cryptocurrency or conversion into a traditional currency), the tax impact is the same as disposing of a traditional asset. That is, tax may arise (or entitlement to a loss) where the cryptoassets were acquired for resale, part of a profit-making scheme, or part of a business (i.e. regular transactions have occurred).

Where cryptoassets are bought as an investment, the same rules will apply.

Received for or used to pay for goods or services

Receiving cryptoassets as a form of payment for a business transaction is the same as receiving payment for the transaction, and the cryptoasset will need to be converted into NZD at the time of receipt and any subsequent disposal.

Mining cryptoassets

Generally, cryptoassets received from mining will be taxable income, and also any profit made on a subsequent sale or exchange of these cryptoassets will also be taxable.

Using cryptoassets for employee remuneration

Inland Revenue have released public rulings on the provision of cryptoassets by employers to employees:

- as salary, wages, and bonuses – these are subject to the PAYE rules
- as a provision of cryptoassets – subject to Fringe Benefit Tax (provided lock-in periods are meet and the employee remains employed and becomes entitled to the cryptoasset)
- as shares – if the employee is not required to pay market value for the cryptoassets issued as shares, the cryptoassets provided will be subject to the Employee Share Scheme rules

Airdrops and hard forks

Inland Revenue have released guidance on the tax treatments of airdrops and hard forks. This states that new cryptoassets generated from either airdrops or hard forks may be taxable on either receipt, disposal, or both. Generally, no deduction will be available for the cost of acquiring the cryptoassets from an airdrop or hard fork. In some limited cases, a deduction may be available when you are taxed both on receipt and disposal.

When you do not have an income stream

You may have cryptoassets that do not provide an income stream or any other benefits while you hold them. Inland Revenue's view is that this strongly suggests you acquired them for the purpose of selling or exchanging them. This is because the only benefit you get is when you sell or exchange those cryptoassets. Inland Revenue's position on cryptoassets in this kind of situation is like their position on gold bullion: as with any personal property, amounts derived on the disposal of cryptoassets will be income if the cryptoassets were acquired for the dominant purpose of disposal.

Tax returns

As with other income tax returns for different entities, cryptoasset owners will need to complete tax returns appropriate for their business entity structure.

Before you can put your cryptoasset net income (or loss) in your tax return you need to:

- calculate the New Zealand dollar value of your cryptoasset transactions
- work out your cryptoasset income and expenses.

If you held cryptoassets that were stolen, you may be able to claim a deduction for the loss.

As for all other taxable activities, it's important to keep good records for all your transactions with cryptoassets.

Cryptoassets and GST

Cryptoassets are excluded from GST. This means buying and selling cryptoassets is not subject to GST.

If you receive cryptoassets as payment for goods and services you provide, GST will still need to be charged on those goods and services. You'll need to return GST on the value in NZD of the amount of cryptoassets you receive as payment.

Non-fungible tokens (NFTs)

Non-fungible tokens (NFTs) are digital assets that represent real-world objects like art, music, in-game and videos. They are traded online, with many buyers and sellers using cryptocurrency as payment. They are similar to cryptoassets as they rely on the same programming technology and exist on distributed ledgers. However, they are not the same as cryptoassets as they are not interchangeable.

Tax may be payable on any profit made from selling NFTs depending on whether the NFT was acquired for resale, part of a profit-making scheme, or part of a business (i.e. regular transactions have occurred).

A NFT is classified as a service for GST, therefore selling NFTs is subject to GST. Accordingly, if your sales of goods including NFTs exceed $60,000 in a 12-month period, then GST registration will be required and GST charged on these sales.

Keep in mind

It's still a relatively new field. We can expect to see more rules emerging over time. Cryptoassets can be stolen and cryptoasset fraud, malware and exchange scams are a rising tide.

Keep in touch with us about it if you're engaged in business activities involving cryptoassets, particularly if they generate profit.