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Division Head
Financial System Division
The Treasury
Langton Crescent, Parkes ACT 2600

By email – ICO@treasury.gov.au

Dear Sir/ Madam

Initial Coin Offerings Issues Paper

CPA Australia represents the diverse interests of more than 163,000 members working in 125 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

CPA Australia sees significant value in the ongoing development of distributed ledger technology such as blockchain and its potential to transform business. Given this, the Government may wish to consider policy measures that support Initial Coin Offerings (ICO), including removing unnecessary barriers to ICOs. Further, the regulatory framework for the digital environment should be broad-based to accommodate the emergence of new technologies.

On the tax issues raised in the consultation paper, CPA Australia submits that:

1. The tax issues faced by ICOs and token market participants are not unique or significantly different to those faced by participants in other financial markets and products.
2. There are some challenges in characterising the nature of coins for tax purposes, mainly driven by the limited tax awareness of participants in the ICO market and the rapid evolution of token characteristics.
3. Greater guidance and pre-ICO engagement is required to ensure that participants are aware of their tax obligations.
4. ICO offerings should be regulated and harmonised as much as possible with existing regulatory regimes, and the ICO industry should be subject to taxation.

5. Where the government wishes to incentivise the development of digital technologies in Australia, there may be a policy case for preferential tax treatment specific to the industry.

CPA Australia's comments on the questions raised on the taxation treatment of ICOs in the consultation paper are in the enclosed Attachment.

We make no comments on the other questions at this time.

If you have any queries do not hesitate to contact Gavan Ord, Manager Business and Investment Policy at CPA Australia on gavan.ord@cpaaustralia.com.au or 03 9606 9695.

Yours sincerely



Dr. Gary Pflugrath CPA
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Encl.

Tax treatment of ICOs

The rapid global evolution of coins or tokens as an alternative to established currencies has led to new funding and payment-for-service models that may not fit neatly into traditional economic, financial and tax concepts. Even the characterisation of these units of exchange as 'coins' has evolved to a concept of 'tokens' – that is, the traded units are not necessarily digital currency but rather units of exchange which may be backed by crypto-currencies or other assets (e.g. gold, music rights).

The nature of the tokens lies across a spectrum which can be broadly grouped into the following¹:

1. **Currency tokens:** tokens meant to be spent on real transactions. Examples include Bitcoin and Litecoin. Alternative to fiat currencies.
2. **Security tokens:** token holds value and will appreciate/depreciate. Holders can receive returns like dividends. Similar to a digital-version of shares.
3. **Utility tokens:** some characteristics of currency tokens but can only be used to purchase products or services from the issuer. Often offered in an ICO.
4. **Asset tokens:** can purchase a share in a real-world, tangible asset but without taking possession. Similar to tradeable certificates for gold.
5. **Reward tokens:** negligible value and given to users of a particular platform.

Other token concepts such as stablecoin and sovereign tokens are also emerging. These are similar to indexed funds or pegged currencies with current offerings being collateralised with their own tokens/underlying crypto-currency.

CPA Australia supports efforts to bring ICOs and token issuers into the Australian regulatory framework to ensure their legitimacy, protect consumers and form part of the Australian tax base. However, ICOs should be placed within broader, future-proofed regulatory reform which can accommodate new technological developments and innovations with existing technologies such as blockchain.

There is also evidence that crypto-industry participants are adapting to the existing regulatory environment with the emergence of Security Token Offerings that provide financial rights including dividends and shares².

¹ Butler, L., *Guide to Crypto Token Types*, 8 July 2018 <https://cryptohead.io/cryptocurrency/guide-to-crypto-token-types/>

² PwC and Crypto Valley, *4th ICO/STO Report – A Strategic Perspective*, March 2019 <https://www.pwc.ch/en/publications/2019/ch-20190308-strategyand-ico-sto-report-q1-2019.pdf>

5.1. Does the current tax treatment pose any impediments for issuers in undertaking capital raising activities through ICOs? If so, how?

The two main impediments to Australian-based ICOs are:

- Uncertainty of tax treatment arising from the nature of the tokens at the ICO and the potential for a change in their nature over time; and
- Higher tax rates in Australia compared to other jurisdictions.

ICO teams tend to be small start-ups with limited capital and the cost of seeking expert tax advice is often beyond their resources. There are a limited number of tax advisors with experience and knowledge of the ICO industry which restricts the ability of ICO teams to be properly informed. The ATO requires ruling applications to be supported by a detailed proposal of the tax treatment of the ICO prior to a binding decision being made.

ICOs are accompanied by White Papers which do not discuss the tax characterisation of the token. This can be due to the differing treatments across jurisdictions, a lack of advice or no requirement to disclose to potential investors.

There is a limited amount of ATO public guidance that can be applied to ICOs. Much of the guidance³ is focused on holders, users and traders of tokens, rather than the issuers. It is also centred on currency tokens such as Bitcoin and does not directly address newer concepts such as security and utility tokens.

CPA Australia recognises the efforts of the ATO to align the tax treatment of tokens to existing legislation and case law. To the extent that this maintains tax system integrity and fully covers the spectrum of tokens entering the market, this is the most reasonable and fairest approach. Where this approach leads to a perverse or detrimental outcome, those issues should be identified and separated for further consideration.

The broader debate around Australia's corporate tax system, rates of company tax and the disincentives for foreign investors related to the dividend imputation system also manifest in the ICO environment. These issues impact all businesses choosing to raise capital or participate in the Australian economy and are not unique to ICOs.

The other challenge is how ICO teams choose the most appropriate corporate structure for their operations. The tax treatment of profits from incorporated entities, limited liability partnerships and unit trusts are well-established, however new structures with different forms of ownership and voting rights such as digital decentralised autonomous organisations (DAOs) may pose challenges in determining ownership and control, residence and source of income as well as liability⁴.

³ ATO, Tax treatment of crypto-currencies in Australia – specifically bitcoin, 8 November 2018

<https://www.ato.gov.au/printfriendly.aspx?url=/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/>

⁴ The U.S. Securities & Exchange Commission has determined that DAO-issued tokens are subject to federal securities laws. It finds that those participating in unregistered offerings may be liable for violations of securities laws. SEC, *SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, were securities*, 25 July 2017 <https://www.sec.gov/news/press-release/2017-131>

CPA Australia recommends:

- The Government establish a cross-agency working group to determine administrative positions, share knowledge and come to complementary regulatory positions related to ICOs.
- The ATO publish ICO-specific administratively binding guidance based on characteristics of the most common forms of token offerings.
- The ATO consider developing a streamlined Class Rulings process for ICOs.
- The ATO consider the establishment of a dedicated crypto-currency unit with relevant expertise to provide timely, consistent advice to ICO participants.
- The ATO provide clarity on whether certain token ownership models give rise to a tax law partnership where all token holders become jointly and severally liable.
- ICO White Papers be required to include sufficient information to enable characterisation of the offering for Australian tax purposes.
- Any proposals for deferrals or exemptions of tax in relation to ICOs are compared to the tax treatment of comparable products (e.g. initial public offerings of shares or pre-payment for products/services) to ensure parity of tax outcomes.
- The Government continue to reassess Australia's corporate tax policy in the context of global tax competition, maintaining the integrity of the tax base and broader economic policy.

5.2. Is the tax treatment of tokens appropriate for token holders?

The ATO guidance issued for token holders is generally useful and provides appropriate examples for the majority of currency token holders. They are based on established taxation principles and aligned with the treatment for similar situations.

Further guidance is required on other forms of tokens to provide certainty. It may be beneficial for the ATO to address common token-holder questions such as:

- Should utility tokens be treated as pre-payments for products/services and be classified as personal use assets for non-business consumers, or is it a speculative asset? If speculative, then confirmation should be given to ICO teams that funds raised are placed on the capital account (e.g. not reported or taxed as revenue).
- Are dividends, distributions or comparable income streams from security tokens treated in the same manner as dividends received from company shares or distributions from unit trusts?
- Would gains/losses on asset tokens be treated similarly to tax on options trades?⁵

⁵ Deloitte, *Taxation treatment of Exchange Traded Options*, 18 May 2011, ASX
https://www.asx.com.au/documents/products/taxation_of_exchange_traded_options_may_2011.pdf

- How do I treat multi-characteristic tokens⁶ for tax purposes?

For businesses that hold, mine and trade tokens, it is critical that they seek professional tax advice and maintain appropriate records.

The cross-border nature of token markets also raises cross-jurisdictional issues and treaty arrangements that would be unfamiliar to many token holders. The current Australian non-resident withholding tax regime could be modified to include withholding tax on returns on capital arising from token investments.

Further, legislative changes may be required to include tokens within the scope of certain provisions such as foreign currency⁷, early stage innovation company⁸ or venture capital investments⁹ in order to support investment in ICOs.

The below table sets out some of the other tax issues that ICOs raise by entity type.

Table 1: Non-exhaustive list of issues based on type of tax entity

Type	Issues
Australian resident individuals	<ul style="list-style-type: none"> • Assessable on worldwide income • Entitlement to foreign tax credits • Overseas jurisdiction reporting obligations • Conversion to AUD currency when exchanges report in non-AUD currency • Issues of revenue versus capital • Eligibility for personal use asset • Tax treatment of utility tokens • Awareness of record-keeping and tax obligations
Non-residents	<ul style="list-style-type: none"> • Application of Division 855 <i>ITAA 1997</i> CGT exemption for non-residents • Access to venture capital limited partnership incentives • Potential issues determining Australian source income
Australian resident companies	<ul style="list-style-type: none"> • Issues of revenue versus capital • Treatment of income and expenses related to mining and proof of stake activities • Income tax and GST treatment of services/products obtained through utility token ICOs

⁶ Multi-characteristic tokens are those with features of both utility and security tokens, given they may be traded but can only be used to purchase specific products/services.

⁷ See provisions in sub-division 960C of the *Income Tax Assessment Act 1997* related to special translation rules for foreign currency

⁸ See provisions in subdivision 360-A of the *Income Tax Assessment Act 1997* related to companies

⁹ See provisions in section 118-505 of the *Income Tax Assessment Act 1997* related to venture capital equity

Type	Issues
Australian controlled foreign companies	<ul style="list-style-type: none"> • Application of active income test – confirming that tokens are trading stock and gains/losses are active income • Clarification of thresholds/parameters for tainted assets
Australian resident crypto-currency exchanges	<ul style="list-style-type: none"> • Design systems to record token-holder and transaction data for tax and anti-money laundering purposes • Potential role as withholder and remitter of tax
Permanent establishments	<ul style="list-style-type: none"> • Clarity on when an Australian permanent establishment may arise

CPA Australia recommends:

- The ATO continue to develop token-holder specific guidance for newer forms of tokens and review existing guidance to incorporate emerging common issues.
- The ATO consider developing an interactive tool for token holders to determine how to treat their token holdings for tax purposes.¹⁰
- The ATO establish a working group with crypto/token businesses to improve awareness of tax obligations and raise issues.
- The ATO convert its published guidance to administratively binding rulings to provide certainty.
- The ATO work with professional bodies and tax experts to create professional development products for advisors related to crypto and token-related taxation.
- The ATO continue its data matching activities to pre-fill individual income tax returns with token transaction data and check compliance.
- Treasury reviews tax legislation to ensure the inclusion of token-based securities and currencies in provisions to ensure equal treatment and access to incentives.
- Treasury considers a withholding tax for non-residents similar to the non-resident interest and dividend withholding tax regime.
- Treasury review sDouble Tax Agreements, Tax Information Exchange Agreements and other protocols to ensure treatment of tokens is included and consistent with the treatment of similar products as well as incorporating information sharing mechanisms for token exchanges, transactions and participants.

¹⁰ The ATO has produced an extensive array of tool and calculators to assist taxpayers <https://www.ato.gov.au/Calculators-and-tools/?duration=2019/2020&sorttype=SortByTopic>

5.3. Is there a need for changes to be made to the current tax treatment? If yes, what is the justification for these changes?

As already stated, CPA Australia submits that the current approach to the tax treatment of ICOs is appropriate given its alignment to existing and substantially similar products available in financial and consumer product/service markets. The inclusion of ICOs and the broader token market within Australia's regulatory framework is critical to the sustainability and corporate integrity of the industry.

As noted, there may be specific instances where ICOs/tokens are excluded from beneficial provisions due to their nature and these should be identified and corrected where reasonable. However, the broader tax policy settings should not be modified specifically for ICOs where they face a lower tax burden than comparable capital raising activities.

The exception to this is where the government wishes to incentivise the development of Australian-generated products and intellectual property and ICOs are critical to raising capital to support the new industry. In such a case, the government may wish to consider industry, ICO or technology-specific incentives to encourage industry participation and growth.

As the industry evolves, new concepts and specific issues may arise that do not neatly fit into the existing paradigms. In particular, the concepts of double non-taxation and the creation of value extrinsic to the traditional factors of production (i.e. capital and labour) are of concern to governments globally, with ongoing deliberation as to how best to allocate profits/gains across the global participants and tax appropriately.

There are also broader issues around legal liability, ownership and control, as well as residency of a non-domiciled network, which may arise. Consideration should be given to the practical challenges for the ATO in engaging with authorised representatives (e.g. the equivalent of a public officer or trustee), information gathering, undertaking audits, issuing adjustments and collecting liabilities.