GST TO BE REMOVED FROM BITCOIN TRANSACTIONS - HOW BEST TO FIX THE "DOUBLE TAXING" OF DIGITAL CURRENCY?

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On 21 March 2016, the Treasurer, Scott Morrison, released the Government's statement on "Backing Australian FinTech" (**"the FinTech Statement"**)[1]. The FinTech Statement sets out priority issues facing Australia's FinTech Industry and the Government's response to each. One of the key priorities is the removal of GST from digital currency transactions to avoid "double tax". The issue is addressed in the FinTech Statement in two paragraphs which read as follows:

> *The Government recognises that the current treatment of digital currency under GST law means that consumers are "double taxed" when using digital currency to buy anything already subject to GST. The Government is committed to addressing the "double taxation" of digital currencies and will work with the industry on legislative options to reform the law relating to GST as it is applied to digital currencies.*
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> *Currently, there are more than 600 digital currencies available, with different protocols for transaction processing and confirmation, and with different approaches to the growth in the supply of digital currency units. Removing the "double taxation" treatment for GST on digital currencies and applying adequate anti money laundering and counter terrorism financing rules may facilitate further developments or use in the future.*

1. When does "double tax" arise?

The comment in the FinTech Statement that "*consumers* are 'double taxed'" is not completely accurate. Rather, it is GST registered business that may potentially be double taxed on supplies that are made within Australia.

For example, assume that one bitcoin (the currency symbol for bitcoin is **"BTC"**) is valued at AU$300. RetailCo, a GST registered business, is selling coffee machines for a price of either AU$300 or 1 BTC. RetailCo has recently sold a coffee machine to a consumer for 1 BTC. This sale triggers a GST liability for RetailCo of $27.27 in the usual fashion (being 1/11th of the GST inclusive market value of the 1 BTC received).

[1] http://fintech.treasury.gov.au/

RetailCo then needs to decide what it will do with the 1 BTC it has received. RetailCo could either exchange the 1 BTC for Australian currency, or it could use the 1 BTC to acquire goods and services from another merchant that accepts bitcoin. Either way, if RetailCo supplies the 1 BTC in Australia, it will make a taxable supply and it will have a second GST liability for $27.27.

This second GST liability would not have arisen if RetailCo had accepted Australian currency (or for that matter foreign currency) instead of the 1 BTC.

As a practical matter, RetailCo is most likely to exchange the 1 BTC for Australian currency. Some bitcoin payment processors will acquire all bitcoins received by their merchant customers, so that the merchants always ultimately receive Australian currency for their sales (albeit the merchant's customers may have paid for goods or services using bitcoin).

For consumers, the main issue is whether they are prepared to pay GST to acquire a bitcoin from a GST registered business in Australia (such as a bitcoin exchange operator who sells as principal). For example, would a consumer pay AU$300, plus GST of AU$30, to purchase 1 BTC in Australia. The answer for sophisticated consumers would be "no".

2. GST and cross-border supplies of digital currency - Impact of the "Netflix Tax"

Presently, GST does not apply to most cross-border supplies of bitcoin. Under current GST law, a supply of bitcoin by a non-resident supplier from outside of Australia will not generally be "connected with the indirect tax zone" (ie is not connected with Australia) and hence does not attract GST.

Conversely, a supply of bitcoin by a GST registered business in Australia to an entity outside of Australia (as either a payment or as part of an exchange transaction) will generally be a GST-free export supply.

This has resulted in Australian bitcoin exchange operators modifying their businesses so that either:

- they have relocated to outside of Australia and hence are not liable for GST on sales of bitcoin to Australian customers; or
- they merely act as an agent / broker for a third party (generally a non-resident) who is not liable for GST on any bitcoin sales. In this later scenario, GST still applies if the exchange operator separately charges Australian customers for the agency/brokerage services.

The current rules also mean that Australian GST registered businesses that need to exchange bitcoins are likely to do so by selling to a non-resident that is outside of Australia (being either an exchange that is operated by a non-resident outside Australia, or via an Australian exchange which is merely an agent / broker for a non-resident purchaser).

While the above are currently viable options for overcoming the incidence of Australian GST on domestic bitcoin supply transactions, it needs to be borne in mind that the "Netflix Tax" is intended to commence in Australia on 1 July 2017. The Netflix Tax is the extension of GST to inbound intangible supplies which are made by non-resident suppliers from outside of Australia to "Australian consumers". It is proposed to be legislated by the *Tax and Superannuation Laws Amendment (2016 Measures No 1) Bill 2016*, introduced on 10 February 2016 – see 2016 WTB 6 [160] – the Bill has passed the House of Reps without amendment and is currently before the Senate. In the absence of any GST reforms for digital currencies, the Netflix Tax will apply to inbound supplies of bitcoin and other digital currencies which are made to "Australian consumers" (ie Australian resident individuals and business entities which are not GST registered) from 1 July 2017.

3. Reform considerations for the Government and the FinTech Industry

While the Government's GST pronouncements in the FinTech Statement are a highly positive development for the FinTech Industry, there is still much work to be done. Specifically, the following issues will need to be considered and addressed:

- ***Timing***: The reform measures should ideally be introduced ***before*** 1 July 2017 (or at least apply with effect from that date, if not earlier). This will ensure that the Netflix Tax does not apply to inbound bitcoin or other digital currency supplies from 1 July 2017.

Amendments to the GST Act often take considerable time, particularly if the consent of all eight States and Territories is required for a change to the GST base. Industry consultation can add further delays. These timing issues are compounded in a Federal election year.

- ***Arriving at a suitable definition of "digital currency"*** may be difficult, yet will be critical to the success of any GST reform measures. As noted in the FinTech Statement, there are more than 600 digital currencies presently available and the reforms should not be limited solely to bitcoin. However, the Government will not want to broaden any new GST exemption to all things that can be transferred digitally and which may potentially be used as a substitute for fiat currency. For example, it is unlikely the Government would intend for transferrable reward / frequent flyer points to be viewed as a "digital currency".
- ***"Financial supplies" and complexity***: If bitcoin and other digital currency is treated consistently with foreign currency (fiat currency), then digital currency sales made by GST registered businesses within Australia will be "financial supplies" and "input taxed". This means that GST won't apply to the sale of the digital currency. However, a GST registered business that has made an input taxed supply may not be entitled to full input tax credits (GST credits) for GST incurred on expenses that relate (directly or indirectly) to making such supplies. The availability of full credits may depend on factors such as whether the "financial acquisitions threshold" has been exceeded. If the threshold is exceed, full input tax credits may not be available for rent, electricity, computer equipment, internet and telecommunication services, advertising services, etc that are acquired in connection with digital currency sales in Australia. This would introduce significant additional GST complexity and compliance costs for bitcoin exchange operators and other GST registered businesses which supply bitcoins in Australia. It may also result in "GST leakage" on acquisitions that do not qualify for a full input tax credit. These GST costs may mean that digital currency exchange operators will continue to have an incentive to relocate or to continue conducting their businesses from outside of Australia.
- ***GST-free supplies***: Alternatively, the GST law could be amended so that sales of digital currency within Australia are GST-free supplies (rather than input taxed). This would also mean that GST does not apply to sales of digital currency, but it would ensure that full input tax credits remain available for GST incurred on related acquisitions. A potential problem with later this approach is that it would arguably provide digital currency exchange operators with a GST benefit (ie access to full input tax credits) that is not currently available to traditional foreign currency exchange operators.

The FinTech Statement does note that the Government intends to work with industry on these important GST reforms. While such consultation will be both useful and necessary, the reforms will need to ideally address all of the above in order to fully maximise the benefits for the FinTech industry.

MORE INFORMATION

For further information, please contact:

Matthew Cridland
Partner - Tax
T +61 2 9286 8202
matthew.cridland@dlapiper.com

BRISBANE

Level 9, 480 Queen Street
Brisbane QLD 4000
T +61 7 3246 4000
F +61 7 3229 4077
brisbane@dlapiper.com

CANBERRA

Level 3, 55 Wentworth Avenue
Kingston ACT 2604
T +61 2 6201 8787
F +61 2 6230 7848
canberra@dlapiper.com

MELBOURNE

Level 21, 140 William Street
Melbourne VIC 3000
T +61 3 9274 5000
F +61 3 9274 5111
melbourne@dlapiper.com

PERTH

Level 31, Central Park
152–158 St Georges Terrace
Perth WA 6000
T +61 8 6467 6000
F +61 8 6467 6001
perth@dlapiper.com

SYDNEY

Level 22, No. 1 Martin Place
Sydney NSW 2000
T +61 2 9286 8000
F +61 2 9286 4144
sydney@dlapiper.com

www.dlapiper.com

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