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ATO crypto guidance draws attention to need for legislative clarity

Michael Bacina, Steven Pettigrove, and Luke Higgins of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

The Australian Taxation Office (ATO) has released [new non-binding web guidance](#) addressing the taxation of crypto assets for individuals engaging in crypto asset activities.

The newly updated guidance is provided across three subsections, being:-

1. [crypto asset transactions with gift cards or debit cards](#);
2. [crypto asset prizes and gambling winnings](#); and
3. [decentralised finance and wrapping crypto](#).

The ATO's definition of "crypto assets"

Despite the lack of a formal definition of "crypto assets" in the Australian taxation legislation, the ATO [has defined "crypto assets" in their non-binding web guidance](#) as:

"...a subset of digital assets that use cryptography to protect digital data and distributed ledger technology to record transactions. They may run on their own blockchain or use an existing platform such as Ethereum..."

...[t]here are no special tax rules for crypto assets. The tax treatment will depend on how you acquire, hold, and dispose of the asset."

For tax purposes, crypto assets are not a form of money. The GST Act has [a definition of "digital currency"](#) and trading digital currency is largely a GST free activity.

Crypto asset transactions with gift cards or debit cards

The ATO has carved out three particular examples. First, the guidance states that a capital gains tax (CGT) event occurs when an individual uses (i.e. disposes of) crypto assets to acquire a gift card. This CGT event occurs regardless of whether the gift card is denominated in AUD or crypto assets.

Example: acquiring a gift card with crypto assets

Raj buys 50 ABC tokens for \$50. Raj later uses these tokens to buy a \$100 gift card. A CGT event happens when Raj buys the gift card, as he disposes of 50 ABC tokens in exchange for the gift card. Raj has a capital gain of \$50.

A CGT event also occurs when loading or topping up a gift or debit card using crypto assets. If an individual transfers crypto assets to the digital wallet of the gift or debit card provider for the purpose of loading or topping up the card, the transfer of the crypto assets into that digital wallet is a deemed CGT disposal. The proceeds for this CGT event are equal to the amount by which the available balance of the card is increased (in AUD equivalent).

Example: loading a debit card using crypto assets

Yindi has a debit card that is linked to her crypto wallet. Yindi uses her debit card to buy a television for \$2,000. The debit card provider draws crypto assets from Yindi's crypto wallet and converts them to AUD to pay to the

merchant. The capital proceeds for the disposal of crypto assets are \$2,000.

The release of this particular guidance is timely, given the increase in the number of “crypto debit card” like products being offered on the market today (see for example [CryptoSpend](#), the [Crypto.com VISA Debit Card](#) and the [Binance Visa Card](#)).

Where taxpayers use a gift or debit card that is denominated in crypto assets, the AUD value of the available balance changes as the price of the crypto assets change. The ATO provides the following example of how such dealings may be taxed:

Example: using a gift card denominated in crypto assets

Olivia has a gift card denominated in XRP. Olivia paid 500 XRP to acquire the gift card and it has an available balance of 500 XRP. At the time Olivia acquired the gift card, XRP had a market value of \$1 [per XRP]. Olivia uses the gift card to buy a guitar costing 400 XRP. At the time Olivia acquires the guitar, XRP had a market value of \$0.95. Olivia has a capital loss of \$20 and a remaining balance of 100 XRP on the gift card.

This creates complexities for individual taxpayers using crypto asset denominated cards. Given the inherent volatility of crypto assets, taxpayers should be aware of the compliance (record keeping) burden is placed on them when transacting with their card as the price of crypto assets can change rapidly and often dramatically.

Crypto asset prizes and gambling winnings

Subject to certain situations, prizes won in ordinary lotteries (like lotto draws and raffles) and on game shows are not generally considered ordinary income. The ATO guidance states that individuals usually do not need to include details of capital gains and capital losses made directly from gambling or prize games, a re-statement of the ATO’s findings in [Taxation Ruling IT 2584](#). It is important to note that individuals who dispose of CGT assets (e.g. investments) for gambling purposes still have a CGT event.

If an individual wins a crypto asset, the ATO guidance states that that individual may hold the asset won as an investment. In such circumstances, the ATO states that the eventual disposal of that crypto asset may be subject to CGT, with the cost base of that crypto asset being its market value as of the time of the win.

Example: crypto asset won in a lottery is held as investment

Anwar pays \$100 for tickets in an online lottery where the prize is crypto assets. Anwar wins the lottery prize of \$20,000 worth of crypto assets. The winnings from the prize are not ordinary income and any capital gain is disregarded.

Of course, any gains on the price of winnings of crypto-assets when sold later will still be assessable for tax.

Decentralised finance and wrapping crypto

The ATO defines decentralised finance or “DeFi” as *“a blockchain-based form of finance that is conducted without relying on a financial intermediary (peer-to-peer).”*

The ATO warns that CGT events can arise in a DeFi environment, usually in the form of [CGT events A1 \(Disposal of a CGT asset\)](#), [C2 \(Cancellation, surrender and similar endings\)](#), [E2 \(Transferring a CGT asset to a trust\)](#), or [H2 \(Receipt for an event relating to a CGT asset\)](#). Contentiously, this can be the case even where an “equivalent” transaction or dealing takes place in a non-DeFi environment (i.e. with “traditional finance” assets or arrangements like lending and borrowing). The ATO states that CGT events occur in DeFi scenarios as the beneficial ownership of the relevant crypto asset ends due to the arrangement.

The ATO also expresses a view that a CGT event will generally arise where an individual taxpayer transfers a fungible crypto asset (for example, ETH or a similar ERC-20 compliant token) to an address that the individual doesn’t control and/or that already has a balance of the same fungible crypto asset. In this scenario, the capital proceeds from the CGT event are equal to the market value of the asset received by the taxpayer in return for transferring the crypto asset.

The ATO provides the following example of a lending arrangement with a DeFi platform:

Example: CGT treatment when you lend to a DeFi platform

Mika buys 100 ZYX coins for \$1,000 and ‘lends’ them to a DeFi platform. The terms of the contract are unclear about whether Mika retains beneficial ownership of the 100 ZYX coins. The DeFi platform pools the ZYX coins that Mika ‘lends’ at the same address as the ZYX coins it receives from other ‘lenders’. As ZYX coins are fungible, a CGT event happens in respect of Mika’s ZYX coins at the time of the initial ‘loan’. Under the contract, Mika has a right to

receive 100 ZYX coins from the DeFi platform at a future time. At the time Mika receives the right (being the time she made the initial 'loan'), each ZYX coin had a market value of \$9. Mika's right was valued at \$900, so she has a capital loss of \$100. Mika's right has a cost base of \$900. Three months later, the 'loan' is repaid and Mika's right to receive 100 ZYX coins from the DeFi platform is satisfied by the transfer of 100 ZYX coins to her. At that time the market value of each ZYX coin is \$10, so Mika makes a capital gain of \$100. Mika now has acquired 100 ZYX coins with a cost base of \$1,000.

On the topic of liquidity pools and providers, the ATO states that a CGT event happens when an individual deposits crypto assets into a liquidity pool. The capital proceeds of this event are equal to the market value of the property received by the tax payer in return for deposited crypto assets. When the individual withdraws the crypto assets from the liquidity pool, a CGT event occurs in relation to the crypto asset or a right received from the original deposit, with the proceeds being equal to the market value of the withdrawal.

Example: exchange of crypto asset through the liquidity pool

Martha is a liquidity provider who deposits one EH to the XA liquidity pool. In exchange for the one EH, she receives 20 XA tokens representing her share of the liquidity pool. Martha acquired the one EH 3 years ago at a price of \$2. The 20 XA tokens have a market value of \$20 at the time of contribution. The deposit of one EH into the liquidity pool is a CGT event. Martha has a capital gain of \$18. Martha may be eligible for the CGT 50% discount.

Finally, the ATO deals with the controversial issue of wrapped tokens. The ATO defines wrapped tokens as a "tokenised representation of another crypto asset". Wrapping is essentially a function that allows a user to use the value of their crypto asset on another blockchain. By way of analogy, it is like allowing a PC game to run on a Mac computer - it won't work properly unless you have special software.

Despite [the contention from tax professionals](#) that a wrapping event should simply be a non-taxable activity performed to provide software compatibility to a token, the ATO considers that a wrapping event creates a CGT event. Under that logic, when individuals wrap or unwrap a crypto asset, they exchange one crypto asset for another and a CGT event happens. The capital proceeds from this CGT event equal the market value of the wrapped token at the time of the exchange. The ATO provides the following example:

Example: CGT treatment when exchanging wrapped tokens

Kal bought 1 BTC for \$60,000 in January 2022 and then wrapped it through a smart contract for 1 WBTC in April 2022. The market value of WBTC at the time of the exchange was \$70,000. A CGT event happens when the BTC is wrapped through that smart contract. Kal will have a capital gain of \$10,000.

This could very well lead to unexpected and potentially absurd results. For example, the unwrapping of a token will also be a CGT event. Continuing the ATO's example of Kal above, if Kal were to use a miniscule portion of the wrapped bitcoin, WBTC, on another blockchain (say 0.0002 WBTC) before unwrapping the remaining WBTC almost immediately, Kal would likely be unwrapping a near equivalent amount of \$70,000. Although the capital gain or loss in this instance would be nominal (as Kal's cost base for the WBTC would be similar to the proceeds of the unwrapped BTC given the short time frame), Kal has still incurred a ~\$10,000 capital gain on the initial wrapping event simply for converting his existing asset into a software compatible form to perform a single nominal transaction on a different blockchain.

In a more straightforward example, the simple act of wrapping and unwrapping a token, without an actual substantive disposal, can create *huge* inadvertent income tax liabilities for individuals.

This approach is not surprising, and has in fact been the assumed position of the ATO by industry professionals for years.

Conclusion

In the ever evolving landscape of the blockchain ecosystem, it is important that regulatory bodies take into account the unique nature of blockchain and distributed ledger technology when making laws and industry guidance, but ultimately until there is legislative clarity regulators can only enforce the laws which are on the books. Individual taxpayers must proceed with caution, noting the significant tax compliance burdens which the ATO is signalling around crypto-asset activities.

There remains significant uncertainty in relation to the taxation of crypto assets, and with the Board of Taxation review now [due in February 2024](#) (following several delays), taxpayers will have to wait a little longer for clarity on taxation of crypto-assets.