Tax treatment of digital assets

The New Zealand experience to date

November 2018 | Jarrod Walker, Chapman Tripp
Overview

• Context – the New Zealand tax system
• Economic and political context
• Tax treatment of cryptocurrencies
• Tax treatment of tokens
• Particular issues on “token generation events”
• Future reforms?
Overview of New Zealand tax system

- Income tax
  - modern and (reasonably) accessible legislation
  - “broad based low rate”
  - residence and source concept
    - residents taxed on world wide income
    - non-residents taxed on New Zealand sourced income
  - rates of tax relatively stable and aligned
    - top personal tax rate of 33% (income over NZ$70,000 pa)
    - corporate tax rate 28%
    - trust tax rate 33% (transparent if income distributed)
- income
  - common law concepts underpin legislation
  - legislation includes gains on sale of property acquired for resale
Overview of New Zealand tax system

– income (cont)
  • no generic capital gains tax, but under consideration
  • various gains deemed to be income e.g. gains on residential property sold within 5 years of acquisition (main home exemption)
  • “financial arrangements” rules for debt / debt-like instruments

– self assessment system
  • provisional tax (periodic payment) system for business and self-employed taxpayers
  • onerous penalties for non-compliance (e.g. 100% penalty tax for avoidance plus punitive use-of-money interest rate)
  • generally “user friendly” Inland Revenue Department
  • binding rulings system available
  • legislated pre-court disputes process
  • no specialist higher tax court
Overview of New Zealand tax system

– withholding tax systems
  • passive income (interest, dividends and royalties)
  • employee salary, wages and bonuses
  • “fringe benefit tax” for non-cash employee rewards
– tax must be paid in NZ dollars
Overview of New Zealand tax system

• GST
  – applicable to supplies of most goods and services
  – general rate 15%
  – financial services are exempt (e.g. loans, equities)
  – supplies to offshore purchasers are zero-rated
  – “value added tax” - input tax credits on purchases
  – applies to barter transactions (two supplies)
  – registration threshold of NZ$60,000 pa
  – New Zealand’s gift to Australia (they gave us possums)
Overview of New Zealand tax system

• Other taxes
  – no gift duty
  – no stamp duty
  – no land taxes
  – no financial transactions taxes
  – no wealth taxes
  – no death duties
  – no inheritance taxes

• Initial report of Tax Working Group – no major changes in the tax system apart from potentially capital gains tax
Tax treatment of cryptocurrencies

• General principles
  – not fiat currency
  – personal property

• Income tax treatment
  – categorisation as personal property crucial
  – no CGT, but gains on sale of property acquired for purposes of resale are subject to income tax
  – cryptocurrency arguably has no purpose other than to be disposed of (barter transaction)
  – analogy to gold bullion
  – requires valuation in NZ$ and payment of tax in NZ$
Tax treatment of cryptocurrencies

• GST
  – taxable supply, if taxpayer is over the registration threshold
  – for businesses which accept payment in cryptocurrency, exchange is treated as a barter transaction (two taxable supplies)
  – requires valuation in NZ$ and payment of tax in NZ$
Tax treatment of cryptocurrencies

• Recent publications by Inland Revenue
  – 2017 Q&A on cryptocurrencies
  – 2018 Issues Paper – Treatment of payments to employees in cryptocurrencies
    • clearly taxable
    • issue is whether subject to PAYE system (withholding tax on employee salary and wages) or FBT system (equivalent tax payable by employer on benefits provided to employees)
    • initial view from IRD is that payment in cryptocurrencies is payment of “salary or wages” and therefore subject to PAYE
    • surprising given context but policy driven?
  – No public comments of any substance on TGEs
  – Compare Financial Markets Authority (FMA) publications
Tax treatment of tokens

• Cryptocurrency just a form of digital asset
• Tokens – the “next big thing”
• Different forms of tokens
  – debt securities
  – equity securities
  – utility tokens
  – “currencies”
  – others (e.g. derivatives)
Tax treatment of tokens

• Analysis of the contractual arrangements required:
  – does it have features of traditional debt:
    • transfer of money with promise to repay
    • right to interest (even if rolled up)
    • does not carry other rights (profit participation / voting / ability to exchange receivable for goods or services)
  – does it have features of traditional equity:
    • principal “at risk”, but right to participate in net assets on winding up, profit distributions
    • does not usually carry other rights such as exchange for goods and services (but may give discount rights)
  – is it just a prepayment for goods or services?
  – does it have hybrid features
    • e.g. equity and “utility” token features
Tax treatment of Token Generation Events

• TGEs / Token generation events:
  – Alternative to traditional equity and debt raisings
  – Similar to “initial coin offerings” (ICOs)
• Similar issues as to other offerings in terms of regulator oversight
• Tax issues follow from analysis of tokens:
  – tax status of receipt of issue proceeds crucial
    • debt or equity – receipt for issue non-taxable and exempt from GST
    • pre-sale of goods or services – taxable and subject to GST (may be zero-rated if offshore purchaser)
    • hybrids
  – can mean the difference between issuing in New Zealand or moving offshore
Token generation events

- Tax issues for holders of tokens going forward:
  - As above – will depend on the status of the tokens for New Zealand tax purposes
  - If interest return (debt instrument):
    - taxable
    - withholding tax (double tax agreement treatment)
  - If profit share (dividend) return (equity instrument):
    - taxable
    - withholding tax (DTA treatment)
    - gain on sale if sold (may have DTA protection – New Zealand the “situs” of the property)
  - Personal asset structuring:
    - no rollover relief if transferred to family / trusts
    - no death duties applicable
Future reforms?

• Unlikely to be major reforms to New Zealand’s tax system for one asset type
• Suspect the IRD is taking a “wait and see” approach
  – dealing with minor issues as they arise e.g. employee remuneration
  – Rulings unit open for business on TGEs
• Resource issues at IRD:
  – Committed significant resources to OECDs BEPS project / international tax reforms
  – “Business transformation” project at IRD
  – Business as usual issue