1 December 2020
Global Tax Alert

New Zealand introduces new tax guidance for cryptoassets

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Executive summary

New Zealand's Inland Revenue has updated their guidance[1] on the tax treatment of cryptoassets.[2] This release clarifies the application of the tax rules for businesses or individuals buying, selling, trading or mining cryptoassets.

This latest guidance will assist taxpayers with more straightforward arrangements, but the inherent ambiguity in this fast-moving area has not been completely resolved. Nevertheless, investors and advisors alike will welcome Inland Revenue's continued efforts to develop their approach. Given the evolving landscape, there is a need for the guidance to continue to move with the times.

This Tax Alert summarizes the key points of the guidance.

Detailed discussion

Overview of the guidance

Following the trend seen in earlier rulings[3] on cryptoassets, Inland Revenue has confirmed that digital assets should be treated as a form of property for tax purposes, as opposed to currency. Given that New Zealand does not have a broad capital gains regime, this means that, generally, cryptoassets will be taxable only when the taxpayer:

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- Acquires the cryptoasset for the *purpose of resale*
- *Trades or deals* in cryptoassets with sufficient effort and time-investment
- Uses cryptoassets in a coherent and pre-planned *scheme with the purpose of making a profit*

Inland Revenue has also advised that income earned from mining cryptoassets will typically be taxable both for the service provided through mining, and on the later sale of those cryptoassets. Examples in the guidance suggest that if mining is a "hobby" the activity won't be taxable. The difference therefore between whether some mining activity is taxable or not will largely depend on the intention of the taxpayer at the time of such activity. What is not clear at this stage is how that intention may be tested, and it appears that this may be a difficult exemption to utilize in practice.

For many taxpayers, the updated rules will provide confirmation of the treatment that they have already been applying. However, there may be some taxpayers who need to review their arrangements in light of this new guidance. Taxpayers in these situations should seek advice from their local tax professional or may wish to contact Inland Revenue for further clarifications.

Classification and taxation of cryptoassets

The guidance may complicate matters for taxpayers whose cryptoassets are increasingly difficult to classify as a form of "property." For example, products are available on the market that allow "staking" – holding cryptocurrency to verify transactions and support the network in exchange for a reward. Investors who earn income through staking could consider their investment less like property and more akin to a share that allows active involvement in the business. They earn income from the transaction processing activity (analogous to a dividend) as well as maintaining their right to the future value of the asset created (analogous to any capital gains from an increase in the stock value).

This is an important distinction as New Zealand does not have a broad capital gains tax. Instead, taxes on capital gains are payable only if gains are generated from assets held on revenue account. For example, while dividends received are almost always taxable to the holder in New Zealand, the gains on the sale of those shares are only taxable for shares held on revenue account – typically frequently traded shares. For taxpayers who earn income from staking, applying this guidance would result in an obligation at the point the reward is received, and at the point of later sale of the underlying staked assets regardless of the nature of their holding. This treatment implies that these investors purchase their assets not for the purpose of income generation from staking, but for the purpose of resale; fundamentally changing the application of the capital/revenue boundary for them.

Officials are faced with a difficult question then – how can they design guidance that accommodates for a constantly evolving set of products and application?

The simple answer is that cryptoassets as a broad category includes a variety of different products with different uses and rights. As a consequence, fitting all of these various cryptoassets within a single pre-existing regime is challenging. To date, Inland Revenue has relied on comparisons to existing products (for example to property or to gold) to draw their legal conclusions. Increasingly, these analogies are becoming strained. This guidance illustrates how incompatible conventional tax rules are with the growing digital economy, and the need for a bespoke set of rules for the industry. Alternatively, rules that are designed more broadly with the digital world in mind would be useful.

Evolution of cryptocurrency taxation

It is expected that there will continue to be a degree of uncertainty in this area for the time being, but some law changes are on the horizon. Earlier this year, Inland Revenue released a tax policy discussion document[4] proposing changes to the Goods and Services tax (GST) rules which included comments on the potential application of GST to cryptoassets. Broadly, officials proposed to progress law changes to clarify the treatment of cryptoassets for the purposes of GST as well as certain rules that apply to the taxation of financial arrangements. Taxpayers engaged in cryptocurrency lending and derivatives will welcome clarity in this area, particularly if the decision is made that the GST and financial arrangement rules don't apply.

Inland Revenue has also recently used its information gathering powers to request details from certain businesses dealing in cryptocurrencies. This follows similar moves made by the Australian and US tax authorities. Officials suggest that the information requested will help Inland Revenue to better understand the current cryptoasset market in New Zealand, and to use the information to better design future rules. Further industry review and enforcement activity as well as potential law changes, at this stage appear likely.

Endnotes

1. https://www.ird.govt.nz/cryptoassets.
2. A broad catch-all that encompasses cryptocurrencies, crypto interests and other virtual currencies.
3. https://www.taxtechnical.ird.govt.nz/browse-rulings.
4. https://taxpolicy.ird.govt.nz/publications/2020/2020-ip-gst-issues.

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