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WEEKLY COMMENT: FRIDAY 19 AUGUST 2022

1. This week I continue my review of the taxation of cryptoassets (the term used by Inland Revenue to refer to virtual currencies) in New Zealand. I look at the GST implications of cryptoassets, the non-application of the financial arrangements rules, and the tax treatment of non-fungible tokens ("NFTs").

GST implications

2. Cryptoassets are not subject to GST when they are bought or sold, but do have GST implications when they are received as payment for normal business activities.

3. The *Taxation (Annual Rates for 2021-22, GST, and Remedial Matters)Act 2022* ("the March 2022 Tax Act") received the Royal assent on 30 March 2022 and introduced new rules on the GST treatment of cryptoassets. For GST purposes, applying retrospectively from 1 January 2009:

   (a) "Cryptoasset" is defined in s 2(1) as meaning a digital representation of value that exists in:

      (i) A database that is secured cryptographically and contains ledgers, recording transactions and contracts involving digital representations of value, that are maintained in decentralised form and shared across different locations and persons; or

      (ii) Another application of the same technology performing an equivalent function;

   (b) "Cryptocurrency" is defined in s 2(1) as meaning a cryptoasset that is not a non-fungible token;

   (c) "Non-fungible token" is defined in s 2(1) as meaning a cryptoasset that contains unique distinguishing identification codes or metadata;

   (d) The definition of "services" in s 2(1) was amended to exclude cryptocurrency;

   (e) The definition of "goods" in s 2(1) was amended so as to exclude cryptocurrency.

4. Inland Revenue notes in *Tax Information Bulletin* Vol. 34, No. 5, June 2022 ("the TIB Item") that:

   (a) Cryptoasset is defined widely as a digital representation of value that exists in a distributed ledger (such as a blockchain) and is secured cryptographically to record the ownership and transactions involving cryptoassets;

(b) The definition is future proofed against any technological advancements in the blockchain and cryptography area by including another application of the same technology performing an equivalent function;

(c) To meet the definition of cryptoasset, the asset in question must also be fungible: the fungibility requirement has been included to exclude non-fungible asset classes, such as non-fungible tokens (NTFs), which certify a digital asset to be unique and are not interchangeable (they are generally used to represent items such as photos or videos and can be owned or traded using a blockchain);

(d) GST will continue to apply to supplies of goods and services which are bought using cryptoassets (the same as if those goods or services had been purchased using money or swapped for another good or service) – for example, say cryptoasset tokens are issued by a software developer to fund a new project, and when the project is launched, the issued tokens can be redeemed for software services:

(i) The supply of the cryptoasset tokens is not a taxable supply and the issue of the tokens is, therefore, not subject to GST; but

(ii) The supply of the software services is a taxable supply, at the standard rate of 15% from New Zealand customers and zero-rated to non-resident customers, and GST applies accordingly to the redemption of the tokens – i.e. GST applies in the same way as if the tokens were vouchers that are being redeemed; and

(e) Supplies of non-fungible tokens will remain subject to GST if supplied by a registered person – for example, say a GST registered web developer develops a series of non-fungible tokens: the sale of the NFTs will be subject to GST.

Excepted financial arrangements for income tax and financial services for GST

5. The *Income Tax Act 2007* has been amended so that, effective from 1 January 2009, cryptoassets are excluded from the financial arrangements rules, and so is an option to acquire or to dispose of cryptocurrency. The definitions in the Income Tax Act mirror the definitions in the GST Act:

(a) A new definition of "cryptoasset" has been inserted in s YA 1, meaning a digital representation of value that exists in:

(i) A database that is secured cryptographically and contains ledgers, recording transactions and contracts involving digital representations of value, that are maintained in decentralised form and shared across different locations and persons; or

(ii) Another application of the same technology performing an equivalent function.

(b) "Cryptocurrency" is also defined in s YA 1, as meaning a cryptoasset that is not a non-fungible token.

6. Section 96 of the March 2022 Tax Act amends s EW 5 by inserting s EW 5(3BA), EW 5(3BAB) and EW 5(13B) as follows:

   (a) Section EW 5(3BA) states that a cryptocurrency is an excepted financial arrangement if the cryptocurrency does not meet the requirements of s EW 5(3BAB), which applies to cryptocurrency producing specified returns on the purchase price.

   (b) Section EW 5(3BAB) states that a cryptocurrency is not an excepted financial arrangement if a consequence of ownership of the cryptocurrency is that the owner receives or is entitled to receive, during the period of ownership, amounts that are determined:

      (i) By reference to the quantity or value of the cryptocurrency; and

      (ii) On a basis that is known by the owner in advance; and

      (iii) Not by reference to the profits of a business activity.

   (c) Section EW 5(13B) provides that an option to acquire or to dispose of cryptocurrency is an excepted financial arrangement.

7. Inland Revenue has stated that the purpose of the exclusion in s EW 5(3BAB) is to:

   (a) Ensure that cryptoassets that are economically equivalent to debt arrangements are still taxed under the financial arrangements rules;

   (b) Ensure that cryptoassets receive equivalent treatment to other types of investments;

   (c) Tax, on an accrual basis or, for a cash basis person, when the base price adjustment is performed, a fixed return on a cryptoasset.

8. While cryptoassets may not be taxable under the financial arrangements rules, Inland Revenue maintains that amounts received from selling , trading or exchanging cryptoassets could be taxable because:

   (a) The cryptoassets have been acquired for the purpose of disposal (for example, to sell or exchange);

   (b) Of trading in cryptoassets; or

   (c) Of using cryptroassets for a profit-making scheme.

9. These income tax implications of cryptoassets will be considered in next week's *Weekly Comment*.

10. For GST purposes, the following cryptoasset services are included within the definition of financial services in s 3, making them exempt or zero-rated for GST purposes:

   (a) The provision or assignment of a futures contract through a defined market or at arm's length if the contract provides for the delivery of cryptocurrency (s 3(1)(k)(iii));

   (b) The provision or transfer of ownership of an option over cryptocurrency (s 3(1)(kaab));

   (c) Arranging the provision, or transfer, of ownership of cryptocurrency (s 3(1)(lb)).

11. In addition, with retrospective effect from 1 April 2017, the meaning of "funding support services" in s 20H(1)(d) has been amended, so as to include the issue or allotment of an interest or right that is a cryptocurrency with similar features and function to a debt security, participatory security or an equity security. An input tax deduction has been available, from 1 April 2017, under s 20(3)(hd), for the cost of funding support services, such as legal or advisory services, made use of in the course of raising or replacing funds used in a taxable activity.

12. This allows GST-registered businesses that raise funds through issuing cryptoassets with features similar to debt or equity securities to claim input tax credits on their capital-raising costs. Examples could include legal fees, exchange listing fees, and costs associated with preparing a product disclosure statement (or whitepaper in the cryptoasset context).

Non-fungible tokens ("NFTs")

13. Inland Revenue notes that non-fungible tokens (NFTs) are like cryptoassets as they rely on the same programming technology and exist on distributed ledgers. However, they are not the same as cryptoassets. NFTs are unique and are not interchangeable.

14. A NFT is classified as a service for GST. Selling NFTs is subject to GST, therefore, a taxpayer needs to register for GST if they sell more than $60,000 worth of NFTs in a 12-month period. If the NFTs are sold to people outside of New Zealand the sales are zero-rated for GST purposes.

15. For income tax purposes, issuing NFTs will not be subject to the financial arrangements rules because that will not be within the definition of a financial arrangement as set out in s EW 3.

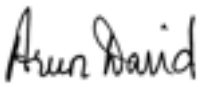
16. Unlike cryptoassets, some NFTs can be used and enjoyed by people. Where NFTs are acquired for personal use and enjoyment, there is no tax to pay on the subsequent sale of those NFTs.

17. However, as NFTs may also be acquired as a speculative investment, Inland Revenue notes that a taxpayer will need to provide clear and compelling evidence about their purpose for acquiring the NFTs at the time they were bought. Circumstances in which income tax may be payable on the profit from selling NFTs include:

    (a) Operating a business that involves creating, buying or selling NFTs; and

    (b) The sale of NFTs acquired for the purpose of disposal.

18. For example, creating and selling NFTs on a fairly continuous basis could be viewed as a profit-making scheme resulting in income tax obligations, and potentially GST obligations, if the activity meets the requirements to be a taxable activity and turnover exceeds $60,000 per annum. Sales of NFTs to non-residents can be zero-rated.



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