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AUSTRALIA + NEW ZEALAND

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## WEEKLY COMMENT: FRIDAY 2 SEPTEMBER 2022

1. This is week 4 of 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 income tax implications of airdrops and hard forks.

### Airdrops

2. Inland Revenue issued Question We've Been asked QB 21/06 "Income tax – tax treatment of cryptoassets received from an airdrop" published in *Tax Information Bulletin* Vol. 33, No. 7, August 2021.
3. As noted in *Weekly Comment* 12 August 2022, and in QB 21/06, airdrops are the distribution of tokens without compensation to:
  - (a) Increase supply of a cryptocurrency – for example, by airdropping cryptoassets to people who undertake minor tasks such as following the cryptoasset on social media, making referrals or signing up to an airdrop or newsletter (for example, Stellar Lumens (XLM) were airdropped to blockchain.com wallet holders who signed up to the airdrop and verified their identity, and ONT tokens were airdropped to people who signed up to a newsletter);
  - (b) Reward early users of a platform for previous use (for example, in the Uniswap airdrop, users of a decentralised exchange received airdrops of UNI tokens if they had provided liquidity or traded on the exchange before a specified date); or
  - (c) Raise awareness of a new cryptoasset - for example, people who hold one type of cryptoasset may receive airdrops of another type of cryptoasset (for example, in the Ontology airdrop, people who held NEO tokens at a specified date were airdropped ONT tokens).
4. Inland Revenue states that in most cases, the receipt of airdropped cryptoassets is unlikely to be taxable.
5. The receipt of airdropped cryptoassets is taxable where a person:
  - (a) Has a "cryptoasset business" – defined in QB 21/06 as "a business that uses cryptoassets as part of its day-to-day activities, such as an exchange, a cryptoasset dealing business or a mining business" - and the airdropped cryptoassets are received in the ordinary course, or as an ordinary incident, of the business:

- (i) The receipt of airdropped cryptoassets would be taxable if the receipt could be said to be part of the way in which the business earns its income;
  - (ii) Airdropped cryptoassets may form part of the trading stock of a cryptoasset business if they are held for sale or exchange in the ordinary course of the business;
- (b) Acquired the cryptoassets as part of a profit-making undertaking or scheme:
- (i) There needs to be a plan or purpose that is coherent and has some unity of conception, and the undertaking or scheme must be carried out for the dominant purpose of making a profit;
  - (ii) The receipt of airdropped cryptoassets could be income from a profit-making undertaking or scheme if the person has a plan directed at acquiring airdropped cryptoassets with the dominant purpose of making a profit;
- (c) Provided services to receive the airdrop (and the cryptoassets are payment for the services provided); or
- (d) Receives airdrops on a regular basis, and the receipt has hallmarks of income:
- (i) Factors relevant for deciding whether something is income include whether payments are regular or recurrent, the relationship between the payer and payee, and the purpose of the payment;
  - (ii) Where airdrops are not regular and where no relationship exists between the payer and recipient (for example, the recipient has not performed services to receive the airdropped cryptoassets), the receipts would not generally be ordinary income.
6. In other cases, the receipt is not taxable.
7. The disposal (defined in QB 21/06 as including selling cryptoassets for money, exchanging them for other cryptoassets or using them to acquire goods or services) of airdropped cryptoassets is taxable where a person:
- (a) Has a cryptoasset business:
- (i) Amounts received from disposing of airdropped cryptoassets will be taxable income of cryptoasset businesses (such as mining and dealing businesses) as the disposal will likely be the sale of their trading stock or otherwise income from a business;
  - (ii) The disposal of airdropped cryptoassets by other types of businesses is unlikely to be taxable under s CB 1, unless disposing of cryptoassets is something that occurs in the ordinary course of the business. However, the disposal may still be taxable under other provisions such as s CB 4;
- (b) Disposed of the cryptoassets as part of a profit-making undertaking or scheme Inland Revenue notes that this will be fact specific;
- (c) Provided services to receive the airdrop; or
- (d) Acquired the cryptoassets for the purpose of disposing of them:

- (i) An amount derived from disposing of personal property is income, under s CB 4, if the person acquired the property for the purpose of disposing of it - the decision in *Ruscoe v Cryptopia Ltd* (in liq) [2020] NZHC 728 (HC) clarified that cryptoassets can be property;
  - (ii) Disposal must be the dominant purpose for acquiring the property: *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA), however, the Commissioner's general position is that, in most cases, cryptoassets will be acquired for the purpose of disposal and a person will need to provide clear and compelling evidence to show otherwise;
  - (iii) Where a person passively acquires property, for example, by inheritance or gift, they generally do not have a purpose when acquiring that property, however, a person will not be regarded as a passive recipient where they have turned their mind to the acquisition or provided consideration;
  - (iv) A person acquires cryptoassets from an airdrop when the person has possession and control of the cryptoassets and can deal with them, which is when the person holds the private key (or otherwise holds the cryptoassets on an exchange), and all steps and actions of the person up until that time are relevant for determining what the person's purpose was when that cryptoasset was acquired - at that time, the person generally has had to turn their mind to completing an action to become entitled to receive an airdrop.
8. Inland Revenue distinguishes between situations where a person turns their mind to acquiring airdropped cryptoassets and situations where they have not turned their mind to claiming cryptoassets, as follows:
- (a) A purpose can be determined where the person has had to turn their mind to acquiring the cryptoassets in some way, and s CB 4 will apply where the person's purpose in acquiring the airdropped cryptoassets is to dispose of them. A person will be regarded as having turned their mind to acquiring cryptoassets where the person:
    - (i) Acquires cryptoassets in advance of an airdrop, in order to be entitled to the airdrop;
    - (ii) Uses a platform with the expectation or knowledge that they might receive an airdrop;
    - (iii) Transfers their cryptoassets to a supporting wallet to ensure they are eligible for an airdrop;
    - (iv) Signs up, opts in, joins a newsletter, mentions the cryptoasset on social media or does other minor tasks in order to be eligible to receive the airdrop;
  - (b) In contrast, Inland Revenue notes that a purpose may not be able to be determined "in some limited cases" such as when a person:
    - (i) Receives airdropped cryptoassets to their existing wallet simply because they already held that type of wallet, or a type of cryptoasset, and did not have to do anything to be entitled to them or claim them; or

- (ii) Had previously used a platform without any knowledge of an airdrop occurring, received an airdrop because of those previous actions, and only had minimal steps to claim the cryptoassets (such as clicking to claim the cryptoassets).
9. Whether a purpose can be established depends on the extent to which the person knew of an airdrop, and also whether they needed to do anything further to claim the cryptoassets (such as signing up or opting in, downloading new wallets or other tasks). If a person starts actively undertaking tasks (such as using platforms) hopeful for an airdrop, they have likely done enough for their acquisition to be considered active. In summary, Inland Revenue's view is clearly that in most cases, the disposal will be taxable.
10. Inland Revenue's views on the availability of tax deductions in relation to taxable airdrops are as follows:
- (a) Deductions are available under s DA 1 and DB 23 if the receipt is taxable;
  - (b) However, other than transaction fees, not other expenditure is incurred, therefore, no deduction, other than for transaction fees, will generally be available;
  - (c) Where a person is taxed on both receipt and disposal of a cryptoasset, a deduction for the cost of the cryptoasset, which tax was paid on, being the value at the time of receipt, would be available;
  - (d) Airdropped cryptoassets that form trading stock of a business may be taxable on receipt and on disposal – in this case, a deduction can be claimed in the year the receipt is returned as income (being the cost of purchases), however, cryptoassets held at year-end must be valued at cost under the trading stock rules because cryptoassets are excepted financial arrangements (as discussed in *Weekly Comment* 19 August 2022).

### **Hard forks**

11. Inland Revenue issued Question We've Been asked QB 21/07 "Income tax – tax treatment of cryptoassets received from a hard fork" published in *Tax Information Bulletin* Vol. 33, No. 7, August 2021.
12. A hard fork creates a new version of the blockchain alongside the old version, creating a new token, which operates under the rules of an amended protocol, while the original token continues to operate under the existing protocol (see *Weekly Comment* 12 August 2022).
13. How a person receives the new cryptoassets depends on whether the person holds their cryptoassets on an exchange that supports the hard fork, or on an exchange in a wallet that does not support the hard fork:
- (a) If the person holds their cryptoassets on an exchange that supports the hard fork before the 'snapshot' date, the person may receive the new cryptoassets by way of a credit to their account without doing anything, after the snapshot has occurred;
  - (b) Where a person holds their cryptoassets on an exchange, in a wallet that does not support the fork or in a cold wallet (that is, offline), they may not receive an entitlement to the new cryptoassets from the hard fork, and they will need to decide whether to undertake the necessary steps to be entitled to the new cryptoassets from the hard fork, or get possession and control of the new cryptoassets by:

- (i) Moving their original cryptoassets onto an exchange or wallet that supports the hard fork before the 'snapshot date', which may incur transaction fees or exchange fees;
- (ii) Downloading the new cryptoasset's wallet and syncing the new blockchain;
- (iii) Importing private keys; and
- (iv) Transferring cryptoassets between wallets at various stages (eg, for security reasons) - transaction fees are usually payable for such transfers.

14. On the question of whether the receipt of new cryptoassets from a hard fork will be taxable, Inland Revenue states that:

- (a) The receipt of new cryptoassets through a hard fork is unlikely to be taxable as business income unless received in the ordinary course, or an ordinary incident, of a cryptoasset business:
  - (i) The receipt of cryptoassets from a hard fork is likely to be in the ordinary course, or an ordinary incident, of cryptoasset businesses (such as mining or dealing businesses) but would not generally be an ordinary incident of other types of businesses;
  - (ii) A business that is not actively involved in cryptoassets as part of its day to day business may hold cryptoassets – for example, it may receive cryptoassets as a payment provided for goods (a barter transaction), and in such circumstances, a receipt of new cryptoassets from a hard fork is unlikely to be connected to the current operations or be an ordinary incident of a non-cryptoasset business, however, this will depend on the nature of the business and the extent to which the operations of the business involve receiving payments in cryptoassets;
- (b) The receipt of cryptoassets from a hard fork could be income from a profit-making undertaking or scheme if the person has a plan directed at acquiring cryptoassets that are undergoing a hard fork, with the dominant purpose of making a profit;
- (c) It is unlikely that the receipt of new cryptoassets from a hard fork would be income under ordinary concepts, as it would not be considered regular or recurrent, and there is generally no relationship between the "payer" (the blockchain) and recipients who may do nothing other than hold the original cryptoasset at the time of the fork; nor could there be said to be a particular purpose for making a payment of the new cryptoassets to the particular recipients.

15. Inland Revenue's views on whether the disposal of new cryptoassets acquired through a hard fork would be taxable are as follows:

- (a) Amounts received from disposing of cryptoassets that were received from a hard fork will be taxable income of cryptoasset businesses (such as mining and dealing businesses) as the disposal will likely be the sale of their trading stock or otherwise income from a business, but a disposal of cryptoassets received through a hard fork by other types of businesses is unlikely to be taxable as business income (although it may be taxed as a disposal of property acquired for the purpose of disposal);

- (b) There could be instances where the proceeds from the disposal of cryptoassets received through a hard fork could be taxed as part of a profit-making undertaking or scheme, but this will be fact specific;
  - (c) As in the case of airdrops discussed in paragraph 2 onwards above, whether a disposal of cryptoassets acquired through a hard fork will be taxable as personal property acquired for the purpose of disposal will depend on whether the person has turned their mind to acquiring the crypto assets:
    - (i) If the exchange or wallet did not support the hard fork, by acquiring cryptoassets to qualify for entitlement, or transferring cryptoassets to a supporting exchange or wallet, and regardless of whether or not a person held cryptoassets on an exchange or wallet that supported the hard fork at the snapshot, by deciding to claim the new cryptoassets and taking action such as downloading a new wallet and syncing the blockchain, transferring the original cryptoassets out of the original wallet for security (if desired) and paying transaction fees, and importing their private keys into the new wallet, in which case, the disposal will be taxable if the purpose in acquiring the cryptoassets is to dispose of them;
    - (ii) If a person has not specifically turned their mind to claiming cryptoassets from a hard fork because they already hold cryptoassets on an exchange that supports the fork, the question will be whether the original cryptoassets were acquired for the purpose of disposal because, as with share subdivisions and demergers, a hard fork could objectively be said to be an anticipated consequence and a normal feature of decentralised blockchains meaning that new cryptoassets would be acquired for the same purpose as the original cryptoassets.
16. Inland Revenue's comments regarding the availability of deductions and the application of the trading stock rules are the same as in the case of an airdrop, as set out in QB 21/06 and discussed in paragraph 2 onwards above.



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