28 November 2014

Committee Secretariat
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By Email: economics.sen@aph.gov.au

Submission to the Senate Standing Committees on Economics
Inquiry into Digital Currency

Dear Secretary

Thank you for the opportunity to make a submission to the Inquiry into Digital Currency. I attach a Submission prepared by me and Mr Joel Emery, research fellow with the Tax and Transfer Policy Institute. We would be happy to provide further information or explanation if needed.

Sincerely,

Miranda Stewart
Professor & Director
Summary and Recommendations

This Submission contends that regulating digital-currency intermediaries should be the focus of a regulatory model to address potential digital-currency-based tax evasion and other non-compliance issues, while supporting the development of the industry.

Australia should promote the development of Australian digital-currency intermediaries, both to enhance the growth of this industry and so that these intermediaries can form the basis of a taxation and regulatory framework. The current Goods and Services Tax (‘GST’) treatment of digital currencies is an obstacle to the establishment of Australian digital-currency intermediaries. Characterising digital currencies as money for GST purposes would result in a more neutral GST treatment. This is likely to promote the growth of the Australian bitcoin industry, and Australian bitcoin intermediaries. This submission therefore makes the following recommendations.

Recommendation One: Australia should develop regulations specific to the digital-currency industry. The most effective and efficient regulatory model for digital currencies is likely to be the regulation of digital-currency intermediaries.

Recommendation Two: To promote the development of the digital-currency industry, and to encourage the regulation of Australian digital-currency intermediaries, the Government should treat digital currencies as money under the GST Act.

Recommendation Three: The government should identify which existing intermediary regulations should be applied to digital-currency intermediaries and should continue to collate empirical evidence about use of digital currencies and evaluate policy approaches.

Objectives and Terms of Reference of Inquiry

The Inquiry’s objectives are to consider:

‘[H]ow to develop an effective regulatory system for digital currency, the potential impact of digital currency technology on the Australian economy, and how Australia can take advantage of digital currency technology.’

The terms of reference are:

(a) how to develop an effective regulatory system for digital currency that:
   (i) ascertains the most appropriate definition of digital currencies under Australian tax law,  
   (ii) promotes competition and growth of the digital currency industry,  
   (iii) ensures ongoing stability in the financial services industry,
(iv) secures protection of consumers and businesses against illegal activity,
(v) incorporates digital currencies into Australia's national security framework, and
(vi) ensures the financial stability of the industry;

(b) the potential impact of digital currency technology on the Australian economy,
   including the:
   (i) payments sector,
   (ii) retail sector, and
   (iii) banking sector;

(c) how Australia can take advantage of digital currency technology to establish itself as a market leader in this field; and

(d) any other related matters.
DETAILED SUBMISSION

A. Meaning of ‘Digital Currency’

This Submission recommends that the Inquiry focus predominantly on open-flow peer-to-peer digital currencies because this form of digital currency is most significant at present, and currently presents the main challenge to regulators.

As digital currency is a relatively new phenomenon, there remains some dispute about the appropriate definition of the concept and there are multiple forms or classes of digital currency. The US Government Accountability Office (GAO) provides a useful framework for defining digital currencies, which categorises digital currencies according to their level of integration with real-world activity.¹ According to the GAO framework, there are three categories of digital currency. The third category that the GAO identifies is that of ‘open flow’ digital currencies. This category involves the greatest degree of integration with real-world activity. In open-flow systems, real-world money can purchase digital currency, and digital currency can be readily exchanged as payment for real-world goods or services. Open-flow digital currencies that use peer-to-peer technology, rather than a single, defined administrator, are of most significance at the present time.

Bitcoin is the foremost example of an open-flow peer-to-peer type of digital currency. The application of peer-to-peer technology has led to the success of bitcoin, to date, and is recognised as a potentially revolutionary new approach that can lead to substantial growth in this industry.² Even if current market-leading peer-to-peer technologies fail, it is argued that the underlying technology is significant enough that peer-to-peer digital currencies are likely to persist.³ However, the use of peer-to-peer technology also causes significant difficulties in regulation, precisely because it enables anonymity and does not require a single hub, administrator or intermediary to validate transactions.

Given the speed with which this sphere of technology adapts and evolves, we suggest that it would be worth considering the defining features of digital currencies articulated by the GAO, in determining which classes of digital currencies should be regulated. While the current focus should be on open-flow peer-to-peer systems, the definition of digital currency should be broad and malleable, to ensure that the definition is not rendered obsolete as new forms of digital currency are developed. The GAO distinctions based on integration with real-world activity may also provide a useful platform for developing such a definition.

B. The Tax Challenges

Digital currencies present the following major challenges for taxation systems. In this Submission, we focus on the potential to regulate digital-currency intermediaries as providing a broad approach to address these challenges. We do not specifically address all of these challenges, and further analysis will be required in future.

1. Anonymity associated with many (particularly peer-to-peer) digital currencies makes it difficult to trace digital-currency transactions and relatively easy to under-report any tax due in connection with a transaction. This issue is similar in many ways to the problems traditionally associated with transactions using cash.

2. Digital currencies can be easily used to transfer money offshore to tax havens or other locations that are not subject to Australian tax jurisdiction or regulatory control. This reinforces their attractiveness for tax evasion such that some commentators claim that certain digital currencies are potential ‘super tax havens’.4

3. Digital currency transactions and services may lack a clear nexus to a particular jurisdiction for tax purposes. Most tax systems rely, to a certain extent, on principles of physical presence in defining source of profit, or place of delivery or consumption of services. This raises a number of challenges in terms of a practical and jurisdictional basis to obtain tax revenues from digital currencies. These are a subset of the broader challenges posed by the ‘digital economy’, currently being addressed by the OECD/G20 Base Erosion and Profit Shifting Project.5

C. Regulatory Approach

We outline four possible regulatory approaches that may be applied to digital currencies: (1) banning digital currencies; (2) relying on existing general regulatory systems to regulate digital currency; (3) regulating the users of digital currency directly; or (4) regulating digital-currency intermediaries. This submission concludes that the approach of regulating intermediaries is likely to be most effective.

1. Banning Digital Currencies

It would be theoretically possible to ban all, or some, forms of digital currency. For example, regulators may consider banning specific digital currencies that are most commonly applied to illicit purposes, fail to provide adequate consumer protection, or that present other legal or economic challenges.

---

5 OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 (16 September 2014).
Some governments, for example Russia, have taken this broad approach.\(^6\) In the context of copyright, the ability to regulate, and potentially outlaws certain peer-to-peer technologies has proved challenging, but ultimately possible.\(^7\) However, experience in the context of copyright suggests that outlawing certain technologies is likely to cause the market to produce subsequent technologies that are more difficult to regulate.\(^8\) This submission therefore concurs with the assertions of others that banning digital currencies such as bitcoin will serve only to ‘increase the cost of enforcement in the long run’.\(^9\)

More generally, this submission contends that outlawing digital currencies is unlikely to discourage digital-currency-based illicit activity. Those who are already engaged in illicit activities are unlikely to be dissuaded from using digital currencies merely because the use of digital currencies is also illegal, unless the rational criminal considers the penalties for using digital currencies to exceed the benefits of so doing.

We note that the terms of reference seek to promote the growth of the digital-currency industry and to establish Australia as a market leader in this field. Banning all, or even some, digital currencies obviously runs counter to this goal. This is particularly true given the ease with which digital currencies can relocate their business to rival jurisdictions that have already established a more favourable regulatory regime.

**2. Rely on general rules to regulate digital currencies**

At the other end of the regulatory spectrum, an alternative approach could rely on the application of tax and other laws surrounding traditional currency and financial transactions, to regulate digital-currency transactions.

The application of current financial services, banking, currency-trading and tax laws, is likely to have uncertain application to digital currencies. They often apply imperfectly because of the unique features of digital currencies.\(^10\) Many existing rules are designed to regulate large banks and financial services companies. However, as the digital currency industry is generally operated by small-to-medium enterprises (at this stage of its development), these rules may not be suitable, and may impose prohibitive compliance costs on digital currency businesses.\(^11\) Non-compliance with such regulations is likely. Either overly burdensome regulations, or insufficient regulations that lead to digital currency failures and lack of security in the market, may stifle the growth of the industry.

---


\(^7\) See eg Diane Rowland, Uta Kohl and Andrew Charlesworth, *Information Technology Law* (Routledge, 4\textsuperscript{th} Ed, 2012) 355-340.

\(^8\) Ibid 357-340.


There is some evidence that an absence of specific regulations, or unsuitability of existing regulations to address this new form of technology is causing difficulties for digital currency investors. For example, in Japan, the Mt Gox collapse may have been avoided if regulations ensured that it took adequate steps to secure customers’ accounts.\textsuperscript{12}

\section*{3. Regulate Individual Digital-Currency Users}

It would be theoretically possible to focus regulations on individual digital-currency users. However, commentators have long argued that it is impractical to regulate each individual user of modern technologies.\textsuperscript{13}

Direct regulation of each user’s digital currency transactions may be technologically and administratively difficult and may carry a high administrative, compliance and privacy cost. Ultimately, such a solution may require self-reporting or very large data analysis and potentially invasive tracing of individual digital currency transactions. In any event, this would not be adequate to address the application of digital currencies to illicit purposes. We therefore do not recommend a regulatory approach applied to individual users of digital currencies.

\section*{4. Regulate Digital-Currency Intermediaries}

We submit that it would be most effective to regulate digital-currency intermediaries, rather than ultimate users.

The regulation of corporate and financial intermediaries is a core element of existing tax and regulatory frameworks. In particular, it is a critical element in governments’ response to international tax evasion and avoidance, including rules for tax information exchange, application of withholding taxes and transaction reporting requirements.\textsuperscript{14}

A recent example is the US \textit{Foreign Account Tax Compliance Act} (FATCA), which Australia recently ratified, and which requires Australian banks to provide information about US customers to the Australian Taxation Office, which will pass that information on to US regulators.\textsuperscript{15} The Common Reporting Standard for Automatic Exchange of Information which has now been signed by more than fifty countries (to be implemented by 2017) will allow country regulators to share information on individual financial accounts collected from intermediaries.\textsuperscript{16} Requiring the reporting of residents’ offshore accounts helps to build a more accurate picture of a resident taxpayer’s true income and net worth. As much international tax evasion relies on financial intermediaries to transfer amounts out of a jurisdiction, this solution can be effective in curbing this method of tax evasion.

\begin{thebibliography}{99}
\bibitem{12} Ibid.
\bibitem{15} \textit{Tax Laws Amendment (Implementation of the FATCA Agreement) Act 2014} (Cth).
\end{thebibliography}
To ensure the applicability of these existing rules to users of digital currencies and to extend regulation and taxation more generally to the industry, it will be necessary to recognise digital-currency intermediaries and bring them into the regulatory net.

The major issue with relying on intermediaries to form the basis of regulations is that, in principle, the underlying peer-to-peer technology does not need an intermediary. All digital-currency users will, of course, require access to the internet, and so one approach could be to regulate the Internet Service Provider (ISP) who provides digital currency users’ internet access. However, the ISP is quite remote from the underlying digital currency transaction. This remoteness is likely to make regulation at this level both less practical and more costly. It may also be difficult to justify as a matter of law. For example, given the tenuous connection between the ISP and any peer-to-peer-based illicit activity, Australian courts have shown reluctance to find intermediaries liable for facilitating copyright infringement.  

It would be better for regulations to focus on intermediaries that are closely connected to, and part of, the actual digital-currency transfer or digital-currency industry. This is likely to be more cost effective, as there is a clearer nexus between a digital-currency intermediary’s business, and the activity they may be required to report on.

We suggest that the use of peer-to-peer technologies does not prevent a regulatory approach that focuses on intermediaries. Digital-currency intermediaries are already established in the market, involved in a high proportion of transactions, and are part of the industry that regulations are designed to address. Some intermediaries are based in Australia. Digital-currency intermediaries are therefore likely to provide a convenient and effective basis for a regulatory system. Indeed, it is asserted that, despite the fact that bitcoin and other digital currencies apply peer-to-peer technologies that do not require validation by an administrator or third party, a high proportion of digital-currency transactions do actually occur through an intermediary. These digital-currency intermediaries effectively provide traditional banking, currency exchange, and transaction services to the digital-currency market. For example, reportedly over 80 per cent of transactions were through intermediaries during the peak of operations of the Mt Gox bitcoin exchange.

Because a high proportion of transactions already occur through intermediaries, regulations that govern intermediary behaviour, or that rely on intermediaries to govern individuals’ behaviour, are likely to encompass indirectly the activities of most digital-

---

18 *Roadshow Films Pty Ltd v iiNet Ltd (No 3)* [2010] FCA 24 [430]-[442].
20 Wong, above n 11, 126.
currency users. Further, they are unlikely to be disruptive to the growth of the digital-currency industry. This approach is further justified on the grounds that, where digital currencies are used for illicit purposes, intermediaries are more clearly contributory wrongdoers.\textsuperscript{23} Moreover, such regulations would bring the requirements for digital currency intermediaries in line with their traditional, financial-intermediary counterparts.

A possible argument against this approach is that users may cease to use digital-currency intermediaries if they become subject to regulations. However, we suggest that anonymity or avoiding regulation is not, in fact, a primary attraction for digital-currency users. We note that the major digital currency, bitcoin, is recognised as offering only pseudo-anonymity.\textsuperscript{24} Regulators can, and do in some cases, trace bitcoin users.\textsuperscript{25} There are digital currencies (such as DarkCoin) that could provide greater privacy from regulators, avoiding the applicability of regulations. While there is no substantive research on this point, reports suggest that digital currencies tailored to avoiding regulations have gained significantly less traction than those that offer only pseudo-anonymity.\textsuperscript{26}

This Submission therefore contends that regulating intermediaries should not dissuade most (or even many) digital currency users. The use of intermediaries regulated in an appropriate manner would be made more attractive, if the costs and impacts of such regulations were offset by introducing a more favourable regulatory environment for the industry. A potential avenue for initiating this approach is outlined below.

**Recommendation One:** Australia should develop regulations specific to the digital-currency industry. The most effective and efficient regulatory model for digital currencies is likely to be the regulation of digital-currency intermediaries.

**Encouraging and regulating digital-currency intermediaries in Australia**

If Australia wants to establish digital-currency intermediaries to form the basis of regulation and taxation of users, and to establish itself as ‘a market leader in the field’, then we suggest that Australia must attract and promote intermediaries to locate within the Australian jurisdiction. If Australia’s regulatory environment is unfavourable, it is likely that digital-currency intermediaries will not operate directly in Australia. Without Australian-based intermediaries, it may be difficult for a regulatory model to enforce tax law (or other areas of law) on digital-currency intermediaries.

When designing regulations for intermediaries, it is important to consider the inherent mobility of the industry. As highlighted by the OECD, many forms of digital commerce can occur across jurisdictions; thus, intermediaries may relocate to avoid regulations, whilst

\textsuperscript{23} For discussion of ‘contributory wrongdoing’, see for example Rowland et al, above n 7, 72.

\textsuperscript{24} Marian, above n 4, 117.

\textsuperscript{25} Doguet, above n 19, 1153.

retaining a commercial interest in a jurisdiction.\textsuperscript{27} If intermediaries operate outside the confines of Australian jurisdiction, it may prove difficult to effectively regulate them. Commentators have contended that strict regulations, such as New York State’s bitcoin licenses, are likely to prohibit the growth of an industry founded on small, modestly resourced businesses.\textsuperscript{28} At the other extreme, a lack of regulatory certainty for digital-currency intermediaries has reportedly caused difficulties in obtaining the financial backing required to expand.\textsuperscript{29}

1. Australian GST Treatment of Digital Currencies

The ATO recently released draft GST rulings about bitcoin and similar digital currencies.\textsuperscript{30} These were met with widespread disquiet amongst the digital-currency community.\textsuperscript{31} The crux of the issue is that digital currencies operate as money, but are taxed as commodities under the GST Act. Under the proposed ATO approach, business-to-business transactions are therefore taxed as barter transactions, rather than as input-taxed financial supplies. This means that the supply of digital currency is taxable.

This submission contends that from a policy perspective, it would be more appropriate to characterise digital currencies as money under section 9-10(4) of the \textit{A New Tax System (Goods and Services Tax) Act 1999} (Cth) (‘GST Act’). This would better reflect the practical use of digital currencies.

There are three aspects of the proposed GST treatment of digital currencies as commodities that may produce an uncommercial or undesirable outcome.

\textit{Case 1}

Treatment of digital currency as a commodity may cause double GST reporting where two GST registered businesses transact. Because digital currency is treated as a commodity, a barter transaction is recorded, which may require two sets of GST input tax credits and two sets of GST remittances. In contrast, had Australian dollars (or recognised foreign currency) been used, then only one remittance and set of GST input credits would be required.

This is illustrated below.

\textsuperscript{28} See eg Wong, above n 11, 126.
\textsuperscript{29} See eg Matthew Sparkes, ‘Convincing Banks about Bicoin is Challenging’ \textsl{Daily Telegraph} (London, 21 October 2014).
Case 2

The treatment of digital currency as a commodity may in some circumstances result in double taxation under the GST. Where a business receives digital currency for a sale and exchanges it for Australian dollars at a digital-currency exchange, two separate transactions occur. As with a normal sale, the business is liable for the collection and remittance of GST at the point of sale to the customer. However, because the digital currency is treated as a commodity, the business may also be liable to pay GST at the point of disposing of the digital currency when it exchanges it with the digital-currency exchange.

This second situation is illustrated below.
Case 3

By requiring exchanges to collect GST, rather than treat digital currencies as money, and an input taxed financial supply, the cost of using an Australian-based intermediary may be inflated compared to the price at overseas exchanges that are not required to collect tax on the exchange. This price inflation may dissuade users from purchasing digital currencies at Australian exchanges. Users may instead choose to purchase digital currency from overseas exchanges to avoid paying the GST.

As digital currencies are internet based, it is relatively easy for users to purchase digital currency from overseas. Thus, this aspect of the GST treatment may put Australian intermediaries at a competitive disadvantage.

This effect of charging GST on digital currencies such as bitcoin, compared with the GST treatment of financial supplies, is illustrated below.

The current GST treatment of digital currencies is therefore unfavourable for the digital currency industry, and poorly reflects digital currencies’ practical purpose. This results in an unfavourable regulatory environment, which may dissuade users from operating in
Australia. Defining digital currencies as a form of money under the GST exemption\textsuperscript{32} is likely to overcome the problems arising from the current GST treatment.

\textbf{Recommendation Two:} To promote the development of the digital-currency industry, and to encourage the regulation of Australian digital-currency intermediaries, the Government should treat digital currencies as money under the GST Act.

2. UK Value Added Tax on Digital Currencies

The UK recently announced that bitcoin and similar digital currencies would be treated as exempt from Value Added Tax (VAT).\textsuperscript{33} This affords digital currencies broadly similar VAT treatment to traditional money. It means that where a digital currency is used to purchase goods or services, VAT is payable on the supply of the good or service but not on the supply of the digital currency.

Adopting a similar approach to that taken in the UK would address the three cases of different treatment under Australia’s GST outlined above. It would promote simplicity and neutrality, as it treats sales using digital currency as payment largely the same as sales using traditional cash.

Anecdotal reports suggest that this treatment has been effective in attracting the digital currency industry to the UK.\textsuperscript{34} This suggests that VAT/GST exemption to ensure similar treatment to money may be effective in promoting a jurisdiction to digital-currency intermediaries. We note that as a result of this UK action, there is now a jurisdiction with a relatively favourable tax regime to which intermediaries may relocate if the Australian regulatory framework is considered unfavourable.

3. Digital Currencies are likely to be defined as commodities under current law

The ATO takes the approach in GST Ruling 2014/D3 that digital currencies are best defined as commodities under the current law rather than money, leading to the ‘barter’ analysis discussed in the Cases above. The ATO observes that the matter is arguable, but that digital currencies are most likely to satisfy the legal definition of property, even though peer-to-peer currencies are unlikely to afford users legally enforceable rights against a third party.\textsuperscript{35} If digital currencies were treated as money, they would qualify for treatment under section 9-10(4) of the GST Act, and may also constitute input taxed financial supplies.

On balance, the ATO is likely to be correct about interpretation of the current law. However, there are some sound legal and policy arguments for defining digital currencies

\textsuperscript{32} A New Tax System (Goods and Services Tax) Act 1999 (Cth), section 9-10(4).
\textsuperscript{33} Her Majesty’s Revenue and Customs, Brief 9: Bitcoin and other Cryptocurrencies, 3 March 2014, (‘HMRC Brief 09/14’).
\textsuperscript{34} See e.g. Stephanie Johnson, ‘A Many-Sided Coin: The Tax Implications of Bitcoin’ (17 March 2014) Tax Note International 971; Mathew Sparkes, ‘Creating a Bitcoin Island off the English Coast’ Daily Telegraph (London, 20 September 2014).
\textsuperscript{35} Nicholas Mirzai, and Johanan Ottensooser, ‘The Bitcoin is Property’ (June 2014) Australian Property Law Bulletin 94.
as money under the current GST regime. Given this uncertainty, we recommend that a specific legislative reform is needed to the GST law.

*Does digital currency satisfy the definition of ‘money’ under current law?*

The primary definition of money at law relies on a concept of ‘sovereignty’; that is, money must be authorised by an act of sovereignty, or exercise of sovereign power.\(^{36}\) As digital currencies are not authorised or established by an act of sovereignty, they are not money according to the sovereignty definition in Australia. However, the sovereignty definition of money may be less appropriate in the modern economy.

A second definition of money at law is ‘functional’; defining money based on its use, and its social and economic characteristics. This definition has three elements: money must function as a ‘unit of account’, a ‘medium of exchange’ and a ‘store of value’. Some Australian courts, most notably the Federal Court in *Travelex*\(^{37}\) and *Messenger Press*\(^{38}\) have applied the functional definition in the context of defining money under the GST Act, although not in the context of digital currencies. However, some digital currencies, particularly more widely adopted digital currencies such as bitcoin, arguably could satisfy this definition of money.

The functional definition of money was conceived when bank notes first came into fruition, and courts were required to adapt existing legal concepts to this new form of practical money.\(^{39}\) One may contend that the same phenomenon should occur here; as new forms of money are developed, the legal definition of money should be broadened to include them.

*The GST statutory rule*

There is also an argument based on statutory interpretation that would support a more expansive definition of money under the GST Act. The definition of money under the GST Act is expansive, as it lists a relatively wide range of items that may be considered money under the Act.\(^{40}\) Money is defined to ‘include:

- (a) currency (whether of Australia or of any other country); and
- (b) promissory notes and bills of exchange; and
- (c) any negotiable instrument used or circulated, or intended for use or circulation, as currency (whether of Australia or of any other country); and
- (d) postal notes and money orders; and

---

39 *Miller v Race* [1758] 97 ER 398 401 [40].
(e) whatever is supplied as payment by way of:

(i) credit card or debit card; or

(ii) crediting or debiting an account; or

(iii) creation or transfer of a debt.’

One could argue this broad definition may extend to a digital currency, and that the GST consequences of treating digital currencies in the Cases above amount to absurdity: they reflect the fact that something functions as money but is not taxed as such, resulting in arguably unfair or unintended consequences of the GST regime.

Some commentators have expressed concern at affording bitcoin and other digital currencies an exemption from GST, suggesting that ‘the price of any pragmatic convenience... comes at the cost of a conceptual anomaly, and presents a piecemeal rather than principled response to the bitcoin concept.’ However, where digital currency is increasingly used as money, an exemption or a broader definition of money under the GST Act better reflects the practical purpose of this new form of money. As established in the Model Law on Electronic Commerce, new digital interpretations of traditional assets should be afforded similar legal treatment to their traditional counterparts.

4. No change recommended for income tax treatment of digital currencies

The ATO also takes the approach in its draft rulings on income tax and Fringe Benefits Tax, of treating digital currencies as property or a commodity.

It is unlikely that characterising digital currencies as money under the income tax regime would be particularly beneficial for users in respect of the application of ordinary income, capital gains tax and foreign currency rules. Indeed, treating digital currencies as foreign money under the income tax regime may add unnecessary complexity, with no gain for the ATO and digital currency users. This because foreign currency is generally treated as a form of capital asset leading to CGT or income tax consequences in any event under the income tax law. The consequences of disposing of digital currency for foreign currency, and disposing of a commodity, are broadly similar.

We therefore consider that at this stage, there is no obvious policy basis for characterising digital currencies as money for income tax purposes and that further research and analysis is required before making any amendments to the income tax law in this regard. In this submission, we therefore recommend that digital currencies are subject only to a GST-specific exemption, or treated as money only for the purposes of GST.

41 Mirzai, Ottensooser, above n 35, 96.
44 Division 775, Income Tax Assessment Act 1997 (Cth).
Regulation of digital-currency intermediaries

If the Committee accepts our recommendation that regulation of digital-currency intermediaries is the best approach, a number of consequences follow. We suggest the following possible requirements to be applied to digital-currency intermediaries, with the ultimate objective of reducing the anonymity of digital currencies. Regulations should have the purpose of minimising the opportunities for tax avoidance or tax evasion while facilitating ordinary dealings, with minimal impact of digital currency intermediaries and ultimate users who comply with regulatory requirements. We note that these are initial suggestions, and implementation would require further analysis and research.

1. Tax File Numbers and Australian Business Numbers

All individual Australian taxpayers must have a tax file number. We recommend that digital-currency intermediaries be required to register for a TFN and ABN, and may also be required to register under financial institutional rules, acknowledging that digital-currency intermediaries may often be small-to-medium enterprises. This brings the requirements for digital currency intermediaries in line with regulation of traditional financial institutions.

2. Collect and report details of Australian resident digital currency accounts

This promotes transparency within various digital currency systems. Many common peer-to-peer systems such as bitcoin rely on a publically accessible and maintained account ledger to record ownership of digital currencies. A number of commentators have indicated that the more details which authorities gain as to the identity of compliant users, the easier it becomes to ascertain the identity of non-compliant users, and non-compliant transactions. This is necessary information for ATO audits or other regulatory enquiries.

3. Withholding taxes on digital currency transfers

A requirement for digital-currency intermediaries to withhold tax on digital currency transfers to offshore account holders could support a system of information disclosure and reporting. A withholding tax could be required, in particular if information is not submitted on the identification of the ultimate user.

This could be treated as a kind of ‘elective anonymity tax’, to regulate transactions where a user fails to provide identification, or, if possible for transactions that do not involve an intermediary. Such an ‘anonymity tax’ was recently proposed by a US commentator. It is designed to increase transparency of the digital currency ecosystem, by taxing anonymity, enabling regulation transactions and promote transparency where no intermediary is present. The solution could be considered as a way to supplement intermediary regulations.

---

45 Doguet, above n 19, 1153.
**Recommendation Three:** The government should identify which existing intermediary regulations should be applied to digital-currency intermediaries and should continue to collate empirical evidence about use of digital currencies and evaluate policy approaches.

4. Tax Jurisdiction and international cooperation

There are two major facets to the taxation of digital currencies that will require international co-operation with other jurisdictions in future.

First, as Australia currently occupies and is likely to continue to be a relatively small section of the digital currency market, any large-scale attempt to trace or regulate accounts may require some form of international tax administrative data exchange, in order to build a more complete picture of digital-currency account users, and transactions.

Secondly, it will be a challenge to determine a fair apportionment of jurisdictional rights to tax a digital currency transaction in some cases. Relying on Australian-based digital-currency intermediaries may support the assertion of taxing jurisdiction over a particular transaction. For example, regulations could designate Australia as the jurisdiction for transactions involving Australian intermediaries; thus, affording Australia jurisdiction to tax. The ongoing OECD BEPS project may generate some proposals for further solutions to the problem of defining jurisdictional nexus of digital currencies.47

Miranda Stewart
Joel Emery

28 November 2014

---