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Graeme is executive manager, SMSF technical and private wealth, SuperConcepts. He is a well-known figure in the SMSF community with a long-standing reputation as an accomplished educator, technical expert and advocate for the sector. Graeme has held senior roles at the Australian Tax Office, worked as assistant commissioner for the Insurance and Superannuation Commission, and most recently held the role of director, technical and professional standards at the SMSF Association.

# Cryptic with cryptocurrency

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**C**ryptocurrency is a virtual or digital currency which allows people to pay for goods and services directly through an online system. It has no legislated or intrinsic value and it is simply worth what people are willing to pay for it on the open market.

There are many types of cryptocurrency, with the most well-known being Bitcoin, but others include Litecoin, Peercoin and Dogecoin. In contrast, official currencies of a country, such as the Australian or US dollar, derive their value from being legislated as legal tender of that country.

So, is it possible for an SMSF to acquire cryptocurrency and comply with the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations)?

Here are 10 things to know about cryptocurrency and SMSFs.

## 1. Is cryptocurrency considered to be currency or money?

In Australia, cryptocurrency is not legal tender nor is it a 'foreign currency' for the purpose of the Australian taxation law as per Taxation Determination TD 2014/25 *Income tax: is bitcoin a 'foreign currency' for the purposes of Division 775 of the Income Tax Assessment Act 1997?*

Under the *Currency Act 1965*, the currency unit is the Australian dollar and is the only recognised form of payment.

On 7 September 2021, cryptocurrency was recognised as legal ten-

der in El Salvador alongside the US dollar, which is its other official currency. It remains to be seen whether other countries will recognise as the decision in El Salvador to be considered as a currency of a 'foreign country'.

## 2. How is cryptocurrency treated for capital gains tax purposes?

Since cryptocurrency is not a currency for Australian taxation purposes, it is treated like any other type of asset. That is, losses or gains on the disposal of cryptocurrency are treated as the disposal of an asset for capital gains tax (CGT) purposes as per Taxation Determination TD 2014/26 *Income tax: is bitcoin a 'CGT asset' for the purposes of subsection 108-5(1) of the Income Tax Assessment Act 1997?*

However, in some situations where the buying and selling of cryptocurrency is considered to be the carrying on of a business, any gains or losses will be treated as being on revenue account rather than capital account.

Under the capital gains tax provisions, the buying or selling of cryptocurrency will determine the capital gain or loss from its disposal for the financial year. A capital gain arises where the proceeds from the disposal of the cryptocurrency is greater than its cost base, and a capital loss will arise where the proceeds from the disposal of the cryptocurrency is less than its cost base. Any capital gains will be added to any other capital gains or offset against any capital losses, including carry forward capital losses.

The proceeds from the disposal of cryptocurrency will consist of what is given in exchange from the disposal. This may include cash

and the value of any goods, services or other property given to the seller in exchange for the disposal. The cost base of the cryptocurrency is the amount paid to acquire it and includes the value of any goods, services or other property given as part of the acquisition.

If the cryptocurrency has been held for up to 12 months, the whole capital gain is assessable income. However, when it has been held for at least 12 months, any capital gain may receive a discount on the gain. In the case of an SMSF there is a one-third discount on the taxable capital gain which is taxed at 15% if the fund is in accumulation phase.

### 3. How is cryptocurrency treated if it is considered that a business is in existence?

There is no single factor that determines whether a business of buying and selling cryptocurrency is in existence. What may start out as a casual hobby may grow and end up as a business. However, for a business to be recognised the activity must operate in a businesslike manner. This can include some of the following:

- registration of the business
- intention to make a profit at some stage
- the size and scale of the activity is similar to other businesses in the industry
- there is repetition of the activities
- the activities are planned and organised, such as establishing accounts and keeping records.

If a business of buying and selling cryptocurrency, including mining, is in existence then any profit and loss is determined in the same way as any business. The sale price of the cryptocurrency less the cost of its purchase and other associated costs will determine whether a profit or loss has been made. At the end of the financial year any taxable income that has been earned by the business will be taxed, and if there is a loss it will be offset against any other income earned in the financial year.

One misconception is that if the gains from buying and selling cryptocurrency is below a certain amount any profits are tax free. If a person is considered to be carrying on a business of cryptocurrency any profit is taxable just like any other business income. However, if the scale of the activity is no more than a casual hobby then things may be different. A ruling from the Australian Taxation Office (ATO) could be helpful to overcome any uncertainty.

### 4. Can an SMSF acquire cryptocurrency?

It is possible for an SMSF to acquire cryptocurrency from unrelated third parties providing the acquisition is on an arm's length basis. However, acquisition is prohibited from a 'related party' such as a member, trustee, relative of a member or trustee, or any company or unit trust that they control.

The reason for the prohibition is that section 66 of the SIS Act prevents a superannuation fund from acquiring

assets from related parties. There are exceptions to the general rule which include listed shares, commercial property and in-house assets, however cryptocurrency does not fall within any of the exceptions.

### 5. What SIS legislation applies to cryptocurrency?

The same provisions of the SIS Act and SIS Regulations apply to cryptocurrency as they do to the fund's investments. Some of the relevant provisions that apply are:

- the covenants in the SIS Act require the trustee to act in the interests of the members and other beneficiaries
- the investment strategy must be formulated and give effect to the whole circumstances of the fund including the investment risks involved, cash flows, diversification and liquidity
- money and other assets of the fund are kept separate from a trustee's personal assets
- the prohibition of acquiring cryptocurrency from a related party
- restrictions on placing charges over the fund's assets
- ensuring cashing requirements are met when pensions are paid from the fund
- ensuring cryptocurrency is acquired and maintained on an arm's length basis
- complying with the lending and borrowing rules.

### 6. How are acquisitions or disposals of cryptocurrency treated in an SMSF?

Given cryptocurrency is not currency for Australian taxation purposes, it will always be treated as a CGT asset where an SMSF is the owner.

It is not possible to have the acquisition and disposal of cryptocurrency by an SMSF treated as being as ordinary income. The reason is that the CGT provisions of the income tax law are the primary code for calculating gains and losses for superannuation fund investments. While there are some exceptions to this general rule, they do not apply to cryptocurrency.

### 7. How does an SMSF acquire cryptocurrency?

Before acquiring cryptocurrency, the trustees should review the investment provisions of the SMSF's trust deed to ensure it is an approved investment. This may not require the trust deed to be amended if the investment in cryptocurrency is possible. In addition, the investment strategy of the fund should include a statement to indicate that the trustees will be investing in cryptocurrency and the range of the fund assets that will be used.

If an SMSF is to acquire cryptocurrency, a trading account or exchange account with an exchange will need to be established in the name of the SMSF. This is not the same as opening a bank account as the trustees are left to their own devices to get things going or may need to rely on someone with experience who has established



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a trading account in the past. Therefore, a due diligence review of the exchange is required to ensure the account has been opened in the correct name and that the trustees understand the reports that are to be provided.

Cryptocurrency is identified by wallets which do not store the cryptocurrency. However, it includes a public key also known as an address, very similar to a bank account number, which receives the cryptocurrency. The wallet also includes a private key which verifies the owner of the cryptocurrency that is being used for payment. Details of the private key need to be stored securely otherwise a loss will mean the address is unrecoverable.

### 8. Record keeping and cryptocurrency

Like all things to do with SMSFs it is necessary to keep accurate records to assist with account preparation and for compliance purposes. With cryptocurrency investments records should be kept for up to five years of all transactions associated in acquiring, holding and disposing of cryptocurrency. This should include information about:

- the cryptocurrency and its purchase or sale price in Australian dollars
- when the transaction occurred including the date and time of acquisition or disposal
- fees and costs associated with the acquisition or disposal
- the exchange record concerning the transaction.

While cryptocurrency continues to be held by the SMSF, records should be made concerning any software costs, the details of the digital wallet as well as the public and private keys, and the quantity of cryptocurrency received.

### 9. What are auditors interested in with cryptocurrency?

In view of the added complexity in auditing cryptocurrency, SMSF auditors are in search of appropriate audit evidence in support that the SMSF is the legal owner of the cryptocurrency and that it actually exists. The trustee will need to show that the cryptocurrency is held in a secure manner at a public address.

Audit evidence will include:

- account verification including the account transactions, wallet address and that it has been used wholly and exclusively by the SMSF
- the balance of the cryptocurrency account as at the end of the financial year
- confirmation of purchases and sales including confirmation of the transaction in the fund's bank account.

Where the valuation of the cryptocurrency is not in Australian dollars, this will require a conversion as at the end of the financial year determined by the last traded price prior to the end of that financial year.

### 10. ATO monitoring of cryptocurrency

While some consider that cryptocurrency lives in an anonymous world surrounded by a digital cloud, the

perception is that it is impossible to identify. However, things such as data matching and international sharing of tax information assists in identifying disclosure of the required information.

Recent statements from the ATO have announced that cryptocurrency will be included in its data matching program for 2020/21.

From a compliance point of view, cryptocurrency is an asset that is gaining popularity in a high risk and volatile environment. The issues for trustees, members and SMSF professionals provides a huge challenge and will depend exclusively on each fund's situation. **FS**