

Individual Income Tax Treatment of Digital Tokens

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BACKGROUND

Since Bitcoin was first released to the public in 2009, cryptocurrencies and digital tokens have taken off in the last decade. To date, there are over 2000 digital currencies available in the cryptocurrency market and it is continually expanding. With the widespread creation and trading of digital tokens and cryptocurrencies, their tax treatment has become a grey area in tax legislations as most of them do not explicitly provide for the complexities around digital tokens and cryptocurrencies.

In view of this, the Inland Revenue Authority of Singapore ("IRAS") released a tax guide on 17 April 2020 on the income tax treatment of digital tokens. The guide helps to streamline and provide more clarity to the issues relating to tax treatment of transactions involving digital tokens. It covers three types of digital tokens – payment token, utilities token and security token.

In general, the IRAS' view on the tax treatment of digital tokens revolves around the nature (ie. capital or revenue) and usage of these virtual assets. However, as technology is constantly evolving, the

nature of these tokens may vary over time. Adding on to such complexities, questions relating to the source and valuation of these intangible assets may arise. For example, if an individual is being remunerated with payment tokens for his service, how do we determine the value of the token since it is not actual money and is not legal tender? Also, when would the income be accrued to the individual?

This tax alert attempts to summarise the individual tax implications of transactions involving digital tokens, including businesses carried on by individuals (eg. self-employed or sole proprietorship).

INDIVIDUAL INCOME TAX TREATMENT OF RECEIPT OF PAYMENT TOKENS

Income received from trade or businesses carried on by individuals

Where an individual carries on a trade or business and receives payment tokens in exchange for provision of goods or services, the transaction is regarded as a barter trade. The taxable



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value of the income received would be the value of the underlying goods or services performed. IRAS does not prescribe any methodology to value the payment tokens and the individual can also use an exchange rate that is reasonable and verifiable.

In this respect, the contractual terms and value of the transaction should reflect the open market value of the goods or services. For example, if the individual is contractually due to receive an agreed amount of fiat currency in payment tokens eg. S\$100 worth of bitcoins, the taxable income is S\$100. If the individual is contractually due to receive an agreed number of unit of payment tokens e.g. 1 unit of Bitcoin, the taxable income is the value of the 1 unit of payment token at the time income accrues to the business.

Income received from employment

In cases where employees are being remunerated for employment services in the form of payment tokens, this is taxable in the hands of the employee based on value of employment services performed by the employee. Similarly, the value of the taxable amount is determined based on employment contract and taxation point would be when the income accrues to the employee. As such, if there is a moratorium attached to the payment token, the payments will be taxable when the moratorium is lifted.

Income received through mining

Unlike physical currencies that are regulated by the Monetary Authority of Singapore, digital tokens like Bitcoin are decentralized and are backed by a network of independent computers. The digital information ("block") relating to transactions using Bitcoin are stored in a public database ("blockchain"). To put

it simply, the process of adding blocks to the blockchain is mining. In the process of mining, these digital token transactions are being verified, making the payment network secure. On top of that, new digital tokens are released and these are rewarded to the miners.

The taxability of the profits from mining is dependent on the intention of the miner (i.e. whether the mining activity is for a long-term investment or for trading purpose). If it is evident that the individual is engaging in mining activities as a hobby, the gain from sale of the mined payment tokens are treated as capital and not taxable in Singapore. Conversely, if the individual shows a habitual and systematic effort to profit from mining, he may be regarded as trading and thus, the sale of mined tokens will be subject to tax.

The taxation point would be at the point of disposal of the payment token and not at the point when the payment token is successfully mined. This is because at the point where the tokens are mined, the miner derived a right to own the tokens as a reward from mining but no income is derived merely by holding on to the payment token.

Income received through airdrop or hard fork

With regards to receipt of payment tokens through airdrop, if the payment token received is not in return for any goods or services performed, it would not be regarded as income to the individual and hence, not taxable.

For hard fork (i.e. splitting of existing token), it is not regarded as an income if the recipient had received the additional token without doing anything in return. Thus, it is not taxable on the individual at the point of receipt.

INDIVIDUAL INCOME TAX TREATMENT OF DISPOSAL OF PAYMENT TOKENS

Expenses in respect of trade or businesses carried on by individuals

Where payment tokens are used for purchase of goods or services for the business, a deduction is allowable based on the value of the underlying goods purchased or services received. This is similar to income received in the form of payment tokens. There is a need to look at the contractual agreement to determine the allowable expense. In terms of timing of recognition, the deduction is allowed when the person providing the goods or services becomes entitled to the tokens.

Taxability/deductibility of the gain/loss on disposal of the payment token

As for the taxability/deductibility of the gain/loss on disposal of the payment token, we look at the nature of these payment token. If the gain on disposal is due to the individual's trading activities or individual carrying on a trade, it will be assessed as revenue in nature and hence, taxable in the hands of the individual. In this case, to determine whether the individual is carrying on a trade, we look at the factors to be considered under the "badges of trade". If the individual is not regarded as performing trading activities, the payment tokens are capital in nature and not taxable. Where taxable, the timing of taxation is when income is realised and accrued to the individual disposing the payment tokens.

Furthermore, if the payment tokens are disposed and exchanged for another payment token, the same taxation principle applies (i.e. the gains from disposal will be taxable if the payment token is considered revenue in nature).



OTHER CONSIDERATIONS

Valuation

As mentioned, the value of the payment token depends on the underlying goods or services that the token is used to make payment for. Currently, IRAS does not prescribe any methodology to value these payment tokens but retains the right to enquire the valuation method used by taxpayers. In situation where the gains on disposal of payment tokens are taxable (i.e. revenue in nature), IRAS accepts the first-in-first-out ("FIFO") method or weighted average costs method in valuing the payment tokens disposed.

Source

When the gains on disposal of payment tokens are revenue in nature and taxable, questions regarding the source of this income will arise. IRAS has clarified that they will consider the whole operation of the taxpayer's trade or business when determining what the taxpayer has done to derive the income in question, and where those activities are performed. If the bulk of the business operations are performed in Singapore, then the income from such activities would likely be regarded as sourced in Singapore and hence taxable in Singapore.

OUR COMMENTS

In summary, the taxability of payment tokens is determined by whether they are revenue in nature. The intention of the individual, whether they are transacting for trading or long-term investment is considered. For businesses, "badges of trade" (e.g. holding period and frequency of transactions) are usually used to determine the nature of these transactions and it can be used as a guide on the

individual basis as well.

While it is good that IRAS has provided more clarity to the taxable/deductible value of the underlying goods or services performed, IRAS still does not prescribe any methodology to value the payment tokens. There are numerous cryptocurrencies exchanges for these payment tokens and their value are known to experience more volatility compared to traditional financial instruments. Hence, more specific guidelines would ensure consistency and fairness in their tax treatment.

Currently, we noted that it is still not common for employment contracts to provide remuneration in payment tokens, but this could be a trend in the future. Companies should consider the implications in using payment tokens for remuneration purposes. For example, if there is a moratorium attached to the remuneration in the form of payment tokens, under current tax legislation, it will be taxable when the moratorium is lifted. However, the value of these payment tokens might have change significantly between the date of remuneration and the date the moratorium is lifted. This may cause discrepancies between the intended and actual remuneration.

On a business basis, the source of income for payment token transactions is determined by the location of business operations. This may also be applied on an individual basis as well as it is a challenge to determine the business location of cryptocurrency networks. As such, in cases where the individual is physically present in Singapore, we are of the view that the source of income can be regarded as in Singapore.

Technology and systems for cryptocurrencies and payment tokens are

continually evolving. IRAS has currently addressed taxability when they are earned through mining. However, new ways of earning these payment tokens are continually emerging (e.g. staking) and their tax implications will have to be considered as well.

NEXT STEPS

As cryptocurrencies and payment tokens become more widespread in their adoption, individuals and employers have to ensure that they consider the tax implications that can come with their usage. Some of the issues to consider are:

- ▶ ***How are the value of payment tokens being tracked? IRAS allow for the value to the determined using FIFO or weighted average methods, are portfolio management systems robust enough to track this?***
- ▶ ***How are transactions involving payment tokens being structured to make tax position more certain? For example, should transactions be valued in dollar terms or in units of payment tokens.***

Cryptocurrencies and payment tokens will be more widely accepted and transacted in the future and it is important for individuals and businesses to start planning for them so as to be able to account for them and their tax implications in near future. As such digital tokens are constantly changing in forms and dealings, the IRAS will have to keep pace to update the tax positions stated in this guidelines although the guidelines stated therein are mainly the general principles of taxation applicable in Singapore and can be applied even if the forms are somewhat different.

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