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Public Rulings
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Public Rulings Unit Issues Paper No 11:
Whether remuneration paid to an employee in cryptocurrency is subject to PAYE or FBT

Introduction

1. The New Zealand Law Society welcomes the opportunity to comment on Public Rulings Unit Issues Paper no 11: *Whether Remuneration Paid to an Employee in cryptocurrency is subject to PAYE or FBT* (Issues Paper). All statutory references are to the Income Tax Act 2007 (ITA), unless otherwise specified.

Overview

2. The appropriate treatment of cryptocurrencies in the New Zealand tax system is a current and pertinent issue for both the domestic and international tax base. Establishing clear guidance for cryptocurrency transactions is a valuable exercise, but one which is likely to raise unique challenges because of the challenging task of classifying cryptocurrencies within existing tax law.
3. The Law Society considers there is value in ensuring the approach to cryptocurrency taxation is comprehensive and considered from the beginning, to avoid a patchwork outcome as issues are addressed independently of one another. This review is comprehensive and presents an admirably broad approach to interpretation of statute, in keeping with the Interpretation Act 1999.
4. However, we note that Inland Revenue has considered whether a payment in cryptocurrency can qualify as “salary and wages”. The Law Society recommends that periodic remuneration in cryptocurrency should not be subjected to the PAYE regime through the definition of “salary and wages”. Such an approach risks confusing cryptocurrency with ordinary currency.
5. Treatment of cryptocurrency should be consistent with existing Inland Revenue guidance. This indicates that, for tax purposes, cryptocurrency is property.¹ Property is not traditionally caught by the PAYE regime under the definition of “salary and wages”.

¹ <http://www.ird.govt.nz/income-tax-individual/cryptocurrency-ga.html> Accessed 1 August 2018 at Q1.

6. While this might suggest that the FBT regime is more appropriate, as this is usually applied to non-cash remuneration benefits, FBT does not adequately deal with the periodic nature of the remuneration considered by the Issues Paper.
7. For this reason, we suggest that consideration be given to expanding the recently reviewed Employee Share Scheme (ESS) rules to apply certain sections to cryptocurrency remuneration. This would address the unique issues presented by cryptocurrency remuneration, such as the timing for valuation purposes, the difficulty of tracing cryptocurrency transactions, the reporting requirements, and the costs incurred by the employer.

Periodic Remuneration in cryptocurrency should not be subject to the PAYE regime

8. Cryptocurrencies have numerous characteristics analogous to shares and personal property. Both shares and cryptocurrency are similarly fungible – each ‘coin’ and stock has a unique identifier. The sale of a ‘coin’ or stock must clearly identify which ‘coin’ or stock has been sold (or first in, first out presumptions will apply to share sales).² Through the blockchain mechanism, a public ledger of all coin trades is recorded and used to confirm the validity of all future trades – by confirming ownership and recording the movement and details of each purchase for each unique coin. The purpose of this is roughly analogous to a regulatory body for a stock exchange, although arguably more thorough.
9. The existing guidance states “[f]or tax purposes, cryptocurrency is property, not currency. This means foreign currency gain or loss provisions do not apply.”³ Treating cryptocurrency as property aligns with the Australian approach of considering disposals of cryptocurrency to be a capital gains tax event.⁴ There is political and economic value in a simple and consistent tax recognition of cryptocurrencies in both Australia and New Zealand, however the tax rules which apply will need to recognise New Zealand’s tax treatment of capital.
10. For these reasons, we consider that the treatment of cryptocurrency as property for tax purposes has merit. Applying this treatment consistently prevents the taxpayer from engineering how cryptocurrency is acquired to effectively choose which tax treatment will apply. This is consistent with creating a tax system which encourages the most economically efficient behaviour, rather than the most tax efficient. It also reduces compliance costs and increases the tax system’s simplicity.
11. It is inappropriate to subject remuneration in cryptocurrency to the PAYE regime if it is property, as this would not align with the usual treatment of payment in property.
12. The application of FBT may therefore be appropriate. FBT usually applies when an employee receives a non-cash benefit. However, the Issues Paper is exclusively interested in payments in cryptocurrency which have the periodicity and regularity of salary or wages. When property is subject to FBT, it is usually in the context of one-off benefits which lack the periodicity and regularity of salary or wages (apart from specific instances, such as the provision of motor vehicles). While the FBT regime may be widened to encompass remuneration in

² Joni Larson “Implications of Bitcoin not being actual currency: the Espinoza case” (2016) 36(1) *ABA Tax Times* 12 at 12.

³ <http://www.ird.govt.nz/income-tax-individual/cryptocurrency-ga.html> Accessed 1 August 2018 at Q1.

⁴ Australian Taxation Office “Tax treatment of crypto-currencies in Australia - specifically bitcoin” QC 42159 at 2, available at <https://www.ato.gov.au/misc/downloads/pdf/qc42159.pdf> Accessed 23 July 2018.

cryptocurrency, we suggest that this is not the best treatment available under existing tax law and Inland Revenue guidance.

The unique nature of cryptocurrency justifies expanding the Employee Share Scheme Rules

13. If cryptocurrency is to be treated consistently as property for tax purposes, we suggest that the correct treatment is to apply selected ESS rules in the ITA, as amended by the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 (TA 2018): specifically, we refer to the timing rules in new section CE 7B and the employer/employee deductions in new section DV 27. This would treat cryptocurrency like property, and thus be a less disruptive application of existing tax law and guidance to payments in cryptocurrency, rather than widening the interpretation of “salary and wages”. The logistics of applying these sections is explored below.
14. A benefit derived in connection with a person’s employment can include a benefit derived under an employee share scheme.⁵ For the purposes of section CE 1(1)(d) a person receives a benefit from a share scheme if the person is or has been an employee of the company or group of companies which issued the shares.⁶ The ITA (as amended by the TA 2018) limits ESS benefits to employees receiving shares of the company or a company in the same group of companies.⁷
15. While Inland Revenue has indicated a preference for applying existing law, rather than creating new law aimed at cryptocurrencies,⁸ we consider that the ESS rules could apply broadly with only minor amendment. This would allow the comprehensive and current approach in the TA 2018 to encompass cryptocurrency payments with the addition of an amendment to section CE 7 allowing for the inclusion of “cryptocurrency acquired, through purchase, mining or issue, by company A” to be considered part of an ESS. It is unclear if an initial coin offering – the creation of a new cryptocurrency usually issued to raise capital by a new company – would already fall under the definition in section CE 7, as it is issued by the company.
16. The existing Inland Revenue guidance is unclear as to when cryptocurrencies must be valued by referring only to the “relevant date” (emphasis added):⁹

*If your cryptocurrency receipt is not converted into New Zealand dollars (NZD) straight away by a cryptocurrency merchant processor, **you’ll need to convert it to the NZD equivalent on the relevant date.***

Conversion rates used must be from a reputable exchange with a reasonable trading volume.

For some ‘alt coins’ (cryptocurrency other than Bitcoin) it may be necessary to convert into US dollars, or any other fiat currency, and then convert into NZD. Rates can vary significantly between different exchanges and currencies. You must use a consistent exchange and conversion approach.

17. This could force the conversion of cryptocurrency to fiat currency upon receipt. If payment in cryptocurrency results in an obligation to convert, this would be an inappropriate imposition

⁵ See section CE 1(1)(d).

⁶ See section CE 2(1).

⁷ See section CE 7.

⁸ <http://www.ird.govt.nz/campaigns/2018/cryptocurrency-tax.html> Accessed 23 July 2018 “There are no special tax rules for cryptocurrencies – ordinary tax rules apply.”

⁹ <http://www.ird.govt.nz/income-tax-individual/cryptocurrency-ga.html> Accessed 1 August 2018 at Q3.

of tax rules, as it risks directly affecting taxpayer behaviour in priority over economic considerations and reasonable business practices. It will be important, regardless of the treatment of cryptocurrency payments, that the necessity of conversion and the timing of the “relevant date” is made clear. Using established cryptocurrency exchanges to value cryptocurrency is useful for well-established cryptocurrencies but poses problems for alt-coins and initial coin offerings where the value is not objectively quantifiable.

18. A detailed review of how the ESS rules could be expanded to encompass cryptocurrency remuneration is set out in Appendix A.

Concluding comments

19. Paragraph 4.16 of the Issues Paper notes that Inland Revenue does not consider cryptocurrency to be legal tender anywhere. We would suggest that this downplays the fact that bitcoin is recognised as having many of the same characteristics as currency in some countries. For example, bitcoin in Japan has been recognised as a "means of payment that is not a legal currency" since April 2017.¹⁰ Further, we note the European Union decision that bitcoin is currency for the purposes of VAT.¹¹ Similar treatment is seen in Australia for GST purposes.¹²
20. Should Inland Revenue choose to treat all cryptocurrencies as currency, we would propose that this be done comprehensively, since a piecemeal approach to cryptocurrencies, dependent on how they are transferred or spent, could undermine the simplicity of the tax system, result in higher compliance costs and greater inadvertent non-compliance.
21. However, recognition as currency (not legal tender) may only be appropriate for more established cryptocurrencies such as bitcoin, rather than fringe cryptocurrencies or new Initial Coin Offerings, which are better treated as property and an appropriate relevant date for valuation set.
22. Therefore, we consider it appropriate to treat cryptocurrency as property in all situations and suggest that the correct tax treatment for payments in cryptocurrency to employees could best be found in an expanded application of section CE 7B and section DV 27 of the amended Income Tax Act 2007, as outlined above.
23. The benefits of expanding the ESS rules include:
 - a. clear timing rules;
 - b. availability of limited employer deductions targeting cryptocurrency and share specific costs; and
 - c. employer reporting of an asset which is difficult to trace.
24. These benefits are potentially more readily gained from the modernised ESS rules than from expanding the existing FBT regime.

¹⁰ Article 2-5 of Japan’s Payment Services Act (PSA) 25 May 2016.

¹¹ <https://curia.europa.eu/jcms/upload/docs/application/pdf/2015-10/cp150128en.pdf> Accessed 23 July 2018.

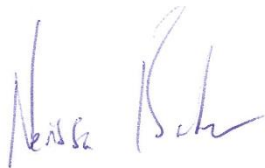
¹² <https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Financial-services-and-insurance/GST-and-digital-currency/> Accessed 23 July 2018.

25. While the existing PAYE regime may offer some of these benefits, we suggest that the ESS rules better address the unique challenges posed by remuneration in cryptocurrency. By applying the PAYE regime without recognising that cryptocurrency is property, Inland Revenue risks introducing inconsistent treatment of cryptocurrencies which may create opportunity for aggressive tax planning. By expanding the ESS rules, employees and employers can still opt into the PAYE regime, but with certainty regarding valuation and timing and thus tax compliance. If compliance is uncertain or inconsistent, there is a risk that tax treatment could discourage remuneration in cryptocurrencies.
26. As concerns the logistics of withholding PAYE on remuneration in cryptocurrencies through an ESS, this is arguably simpler than doing the same for payment in shares. For example, Bitcoin is highly divisible. Each bitcoin can be split into one hundred million independent and uniquely recognisable units. One of the next most prevalent and valuable cryptocurrencies, Ethereum, is divisible to 18 decimal places.¹³ Therefore, when transferring Bitcoin to an employee, an appropriate percentage for PAYE purposes could literally be retained and exchanged for NZD to be held on trust for the Commissioner. If sufficiently fine-scale divisibility was not possible, then it could be appropriate for the equivalent in NZD to meet the PAYE obligations to be set aside.

Further information

27. This submission was prepared with assistance of the Law Society's Tax Law Committee. If you wish to discuss any aspect of this submission further, please contact the committee's convenor Neil Russ, via the committee secretary, Jo Holland at jo.holland@lawsociety.org.nz, (04) 463 2967.

Yours faithfully



Nerissa Barber
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Appendix A: Application in detail of the ESS rules to cryptocurrency remuneration

¹³ <https://cryptonewsreview.com/an-introduction-to-cryptocurrency-coins/> Accessed 23 July 2018.

Appendix A: Application in detail of the ESS rules to cryptocurrency remuneration

1. The same timing rules in section CE 7B(1) could apply to cryptocurrency payments. The effect of the new timing rules for an ESS are summarised here by Inland Revenue:¹⁴

Unless an employee first transfers its share scheme benefits to a non-associate, or the company cancels them, the share scheme taxing date is when:

- *there is no real risk that beneficial ownership of the shares will change, or that the shares will be required to be transferred or cancelled;*
- *the employee is not compensated for a fall in the value of the shares; and*
- *there is no real risk that there will be a change in the terms of the shares affecting their value.*

If the benefits are cancelled or transferred to a non-associate before these events occur, then the share scheme taxing date is at the time of the cancellation or transfer.

In determining whether there is a risk of a change of ownership, transfer or cancellation, certain rights and requirements do not affect the employee's status as the economic owner of the shares under the scheme (proposed section CE 7B(2)) and are ignored. They are rights or requirements:

- *for transfer for market value;*
- *not contemplated by the employee share scheme;*
- *that have no real risk of occurring;*
- *that are of no real commercial significance; or*
- *that also apply to shares not subject to the employee share scheme.*

2. This would result in a simple and comprehensive solution to the correct timing of tax on cryptocurrency payments, without needing to broadly interpret existing law or widen the scope of "salary and wages".
3. We note that an ESS offers employees and employers the option to opt into the PAYE regime. Therefore, in this respect, this proposed approach appears to reach the same conclusion as the Issues Paper. However, by taking the ESS route rather than widening the interpretation of "salary and wages", we suggest that the differences are more than superficial because the ESS rules:
 - Clearly identify the taxing date. This is not necessarily as clear under the PAYE regime if a "salary and wages" approach is taken.
 - Allow for appropriate employer deductions for costs. An analogous approach under the PAYE regime could result in inappropriate deductions being claimed for the cost of acquiring cryptocurrency, or insufficient deductions being available for management costs of a share-like asset.
 - Impose employer reporting requirements which are more thorough than PAYE reporting requirements. This accounts for the classification of cryptocurrency as property, and accounts for the difficulties Inland Revenue would face monitoring cryptocurrency transactions.

¹⁴ <http://taxpolicy.ird.govt.nz/publications/2017-commentary-areiirm-bill/employee-share-schemes>
Accessed 23 July 2018.

4. By expanding the taxing date rules in TA 2018, tax would be imposed on the employee and the employer on the date that the cryptocurrency transfers to the employee. Additionally, symmetry of the tax system would be maintained, as the volatile value of cryptocurrencies would be set at a single instance in time.
5. New section DV 27 allows for limited deductions for employers. This includes deductions for administrative and management services related to an ESS, as well as a deduction for an amount equal to the employee's income. The deductibility of these expenses is subject to the usual capital/revenue tests. This is designed to ensure that the tax position of both the employer and the employee is identical whether an employee is paid in cash or shares. This ensures economic efficiency guides business decisions. Were this expanded to include payments in cryptocurrency, it would allow for appropriate deductions for the cost of an employee's salary without allowing for the cost of acquiring cryptocurrency to be deductible.
6. Initial coin offerings would not present opportunities to artificially engineer deductions, on the condition that section CE 7B and section DV 27 were both expanded to work in tandem for cryptocurrency payments. It would need to be clearly identified that payments of cryptocurrency would not affect an employer's available subscribed capital.
7. The reporting rules which applied to an ESS from 1 April 2017, could apply to payments in cryptocurrency. This would give employers the choice of deducting tax under the PAYE regime on an employee by employee basis or on a benefit basis for each employee. Employers would still be required to include the taxable value of the cryptocurrency benefit on the employment information or employer monthly schedule supplied to Inland Revenue. Were PAYE not withheld, the taxpayer would still be liable for tax on the income in accordance with the information supplied to Inland Revenue by the employer.
8. This approach would allow employees to have student loan deductions, child support payments and Working for Families Tax Credits withheld by agreement with the employer. In this way payment in cryptocurrency would create a neutral outcome as compared to payment in shares or money for both the employer and the employee. Compliance costs would not be substantially increased, as existing ESS arrangements could be repurposed for accounting purposes.