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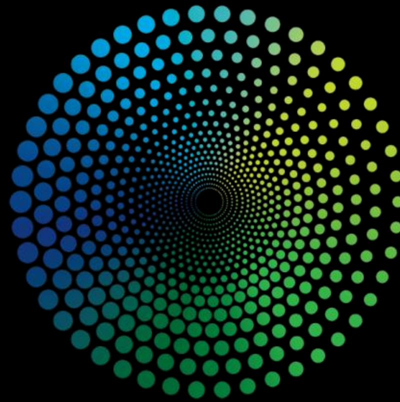

Singapore Tax & Legal developments

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We are pleased to share the following with you.

Organisation for Economic Co-operation and Development (OECD) publishes report on "Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues"

On 12 October 2020, the OECD published a report prepared for and endorsed by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (the "**Inclusive Framework**"), entitled "*Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues*" (the "**Report**").

The Report focuses specifically upon the taxation of virtual currencies (and not other types of digital assets), and was prepared for presentation to the meeting of G20 Finance Ministers and Central Bank Governors in October 2020. It does not make recommendations, and sets forth a "*framework to analyse the tax treatment of different events in the lifecycle of a unit of virtual currency*".

The Report notes at the outset that the OECD's Base Erosion and Profits Shifting (BEPS) Action 1 Final Report published in 2015 identified virtual currencies as being amongst the developments contributing to the digitalisation of the economy, and it is implicit in the introduction and from the timing of the publication (which coincides with the publication of further BEPS Action 1 documents) that the Report is delivered in furtherance of the Inclusive Framework's BEPS Action 1 discussions.

The Report comprises three main parts followed by a series of policy considerations that policymakers may wish to consider with a view to strengthening their legal and regulatory frameworks for taxing virtual currencies.

- Part one of the Report contains an overview of the development of virtual currencies to date, and discusses some key distributed ledger technology (DLT) concepts and virtual currency lifetime events (e.g., creation, transfer, and disposal). It provides a good summary of relevant background and concepts *vis-à-vis* virtual currencies and DLT upon which they are based.
- Part two discusses approaches to various aspects of the taxation of virtual currencies adopted by a number of countries; with the underlying data-set comprising questionnaire responses received from 53 jurisdictions between 2018 and early 2020, which are supplemented by other publicly-available guidance and material (countries considered for the purposes of the Report are referred to herein as the "**Survey Group**").
- Part three of the Report discusses a number of tax policy challenges and emerging issues as of the present date, and provides a good overview of developing areas.

This alert provides an overview of key comments and conclusions discussed in Parts two and three of the Report.

It is important to note that this alert principally summarises key comments and conclusions of the OECD from a tax policy perspective, and that the comments herein should not be construed as being specifically applicable within any particular jurisdiction. We offer a perspective from a Singapore point of view in our concluding thoughts; and we also highlight some current and emerging issues which, if addressed proactively, could contribute to Singapore's competitive advantage in the DLT and related investment spaces.

What follows will be of interest to stakeholders interested in understanding the current state-of-play regarding virtual currencies taxation and likely developments.

Prevailing international tax treatments

Issues	OECD comments
Income taxation	The OECD found that almost all countries amongst the Survey Group which had issued guidance regarding the nature of virtual currencies had declared them to comprise property for tax purposes; most commonly an intangible asset other than goodwill, a financial asset, or a commodity. On that basis, the Report states that virtual currencies are most often considered to generate either capital gains, or business or miscellaneous income. Most taxable events relevant to virtual currencies were found to arise in connection with disposals of for consideration. The Report notes that, amongst the Survey Group: (i) almost all countries presently consider exchanges between virtual currencies and fiat currency to comprise a taxable event; and (ii) whilst there were found to be a small number of exceptions, the same countries tended to consider exchanges of one virtual currency for another virtual currency to also comprise a

	taxable event. It is also noted that exchanges of virtual currencies for goods and/or services, or as salary/wages, most often comprise barter or reciprocal transaction for tax purposes, and that the tax treatment of underlying transactions is typically not changed. In terms of the creation of virtual currencies, the OECD found that mining has received the most tax attention and guidance from policymakers to date. The Report states that 33 Survey Group countries presently consider the receipt of a mined unit of a virtual currency to be a taxable event (giving rise to a taxable gain/income), albeit that nine of those countries generally consider no tax to actually be payable until disposal of the asset. It also highlights that a further nine countries consider the tax treatment of mining rewards to depend upon the identity and activities of the taxpayers, and most notably with reference to whether the taxpayer is engaged in business. The OECD has also concluded that guidance issued by the Survey Group rarely addresses the tax treatment of disposals of virtual currencies for no consideration, including by way of gifting, theft and loss. It reports that the small number of countries that have provided guidance regarding the former tend to treat such disposals as taxable events subject to tax rules concerning gifts/donations; and that countries that have issued guidance concerning theft or loss tend to either permit the recognition of a capital loss or, where no disposal is prima facie considered to occur, to permit the taxpayer to make an application to the relevant tax authority for derecognition of the asset.
Value-added/goods and services taxation	The Report highlights that the definition of virtual currencies as property or otherwise is also important to determining their value-added tax or goods and services tax (together "**indirect tax**") treatments. The OECD found that, for indirect tax purposes, Survey Group countries mostly tend to treat virtual currencies as akin to fiat currencies rather than as property. It opines that this is mostly the result of pragmatism (at least outside of European Union countries subject to the European Court of Justice's judgment in the case of *Skatteverket* v *Hedqvist* Case C-264/14), given the technical and administrative complexities of such assets as giving rise to barter transactions. The OECD found that, because of this, the indirect tax treatment of virtual currencies is more consistent across countries than the income tax treatment (in that in almost all countries the exchange of virtual currencies is not subject to indirect tax). Furthermore, the OECD notes that use of virtual currencies to acquire goods or services is typically not subject to indirect tax; and that, subject to a few exceptions, a receipt of new tokens through mining is also not subject to indirect tax.

	Treating transactions as being outside of scope of indirect tax rules was also found to be partly motivated by simplifying administrative and record keeping requirements. The OECD found that the indirect tax treatment of virtual currency exchange support services is generally more varied across the survey group, and that whilst indirect tax is not chargeable in connection with such services in the large majority of countries (often due to the application of financial services exemptions), in some countries—particularly outside the European Union—such services are treated as taxable supplies and are subject to indirect tax under normal rules. The Report notes that this inevitably *inter alia* gives rise to practical variations between jurisdictions with regards to different registration, record-keeping, and valuation requirements.
Property taxes	The OECD reports that as virtual currencies are typically considered to be property for tax purposes (with the possible exception for indirect tax purposes), transactions in virtual currencies are also likely to be subject to property taxation in countries that levy inheritance, gift, wealth, and/or transfer taxes; though it found that guidance issued by the Survey Group rarely explains how such taxes should apply to virtual currencies. Property tax-related conclusions reached in the Report include: • Countries with inheritance or estate taxes tend to consider virtual currencies as relevant assets for the purposes of such rules. • Virtual currencies tend to comprise relevant assets within the definition of wealth taxes in the small number of countries which impose such taxes. • Transfer taxes (e.g., stamp duties) do not typically apply to virtual currencies, often because virtual currencies do not fall within the definition of asset in respect of which such taxes/duties apply. • Whilst the application of gift taxes in relevant countries is rarely addressed in published guidance, it is likely that virtual currencies will be subject to gift taxes if they exceed relevant exemption thresholds.

Observed tax policy challenges and emerging issues

Valuation

Valuation is a key challenge to taxation of virtual currencies identified by the OECD in the Report. There is often a high degree of volatility, which makes valuation both difficult and complex. However, valuation of the virtual currencies is of critical importance for the computation of tax basis, tax liabilities, etc.

Key difficulties relating to valuation identified by the OECD include:

- High value volatility, even over short timeframes.
- Difficulties in compiling and maintaining records with the necessary degree of precision, particularly given that exchange platform may at any given time offer different prices for the same virtual currency.
- Tax basis tracking, particularly given the fungible nature of virtual currencies of the same type, the potential for acquisition at different prices and mixing within a single wallet.

The OECD found that where guidance concerning valuation for tax purposes exists amongst the Survey group, such guidance tends to vary based on the nature of the transaction; e.g., with a value being identifiable with reference that indicated on a relevant exchange platform, the value of fiat currency consideration, the fair market value of the goods and services paid for, etc.

To minimise practical difficulties, the Report notes that some countries provide taxpayers with some discretion as regards how to identify an acquisition or disposal value. In terms of disposal computations, countries tend to permit computation based on basis tracking of specified units, deemed chronological order based on the first-in-first-out (FIFO) accounting principle, or based on pooling/averaging.

The Report acknowledges that valuation can be particularly difficult in the context of mining, albeit guidance amongst the Survey Group tended to point to such valuation being most commonly determinable with reference to the corresponding fiat currency value where a market already exists for the relevant virtual currency (guidance in other cases can be inferred to most commonly be lacking). There is often also some provision for deduction of relevant expenses.

Hard forks

The OECD has determined that guidance regarding the taxation of hard forks is limited, albeit that three alternative treatments are observable across the Survey Group:

- No taxable event upon receipt, but taxation under capital gains rules upon disposal (with this being the most common approach).
- Taxable event upon receipt, with income received at the time of the hard fork (with the value of the new tokens received treated at the taxable receipt, and base cost being either nil or an apportionment of the basis in the original tokens).
- Different treatment depending upon whether the relevant virtual currencies are held for business purposes or as an investment.

The Report also acknowledges difficulties experienced by taxpayers who hold virtual currencies in custodied wallets on exchanges, which do not recognise the new tokens (where a tax liability may technically arise due to the new tokens being received by the taxpayer as a result of their entry onto the relevant distributed ledger, but may not be accessible by the taxpayer due to exchange listing limitations). To address such issues, the OECD suggests that policymakers could consider virtual currencies as only being received by a taxpayer when they exercise "*dominion and control*" over the new tokens "*for example by changing the wallet in which the tokens are stored, or by disposing of the assets.*"

Yield/returns

The OECD notes that some virtual currencies may generate yield from first creation or receipt, with taxpayers potentially being deemed to receive income from the time at which such yield (usually realised as further virtual currency) is recorded to the distributed ledger. The OECD notes that this can give rise to dry tax charges due to the fact that yield tokens might need to be disposed of to fund tax liabilities (potentially notwithstanding a lack of liquidity at the relevant time).

Stablecoins

Whilst the OECD notes that tax implications for stablecoins could in principle be materially the same as for other virtual currencies, it also notes that there is currently no international consensus regarding the tax treatment of stablecoins. It also notes that there is presently only very limited country guidance concerning classification of stablecoins from amongst the Survey Group, and that the nature of stablecoins also give rise to further specific challenges.

One such challenge is whether or not asset-backing should give rise to a differential tax treatment (as compared with non-asset backing; for example as compared with an algorithm-based stablecoin). The OECD advances this as a question (though our own practical experience of this issue is that asset-backing and the nature of the underlying is typically a relevant factor for both regulatory and tax purposes).

A second challenge highlighted in the Report relates to the fact that "*stablecoins are increasingly high on the political agenda, in particular of the G20 and the G27*"; including for fiscal sovereignty and monetary policy reasons.

Central Bank Digital Currencies

The Report notes that "*growing interest in (Central Bank Digital Currencies [CBDCs]) is primarily due to the changing nature of money and payments*" and that "*the [International Monetary Fund] has looked at the trend and forecasts of cash payments up to 2026, showing that the use of cash is declining and that in turn the relevance of digital means of payments and or CBDCs will continue to increase.*"

Furthermore, it is reported that *"[a]nother reason for the interest in CBDCs is the role they could play in implementing monetary policy. The [Bank of International Settlements] notes that while a CBDC would not alter the basic mechanics of monetary policy implementation, it could enrich a central bank's monetary policy toolkit."*

So far as the taxation of CBDCs is concerned, the OECD suggests that policymakers may wish to consider CBDCs as fiat currencies for tax purposes. It also notes that to date no country has provided guidance regarding the tax treatment of CBDCs.

Decentralised finance

Decentralised finance (DeFi) has grown rapidly throughout 2020, and has also attracted the attention of policymakers globally due to the potential for it to improve financial inclusion.

The OECD reports that the tax implications of DeFi have not commonly been addressed by regulators amongst the Survey Group.

The main tax implication flagged in the Report as being of relevance to DeFi relates to the characterisation of the lender's return (commonly received in the

form of a virtual currency) as interest for tax purposes, and the corresponding treatment. Such characterisation is relevant to both taxation and the time at which any tax liability crystallises.

Proliferation of proof of stake consensus

A material observation of the OECD in respect of proof of stake consensus is that much tax guidance on the taxation of virtual currencies to date is based on DLT and protocols, which utilise proof of work consensus; and that as proof of work and proof of stake consensus function very differently, a tax outcome under the former may not be the same under the latter. (For example, the OECD notes that proof of stake challenges many Survey Group countries' present indirect tax treatments of mining virtual currencies, because forged tokens are intrinsically linked to existing token holdings, and that is inconsistent with many countries indirect tax determinations that mining and gas-payers are not sufficient proximate to justify the imposition of indirect tax on block reward received by miners in a proof of work context.) Furthermore, it notes that "*[t]he linkage to existing holdings raises the possibility that the return is more akin to a return on the assets held..., and therefore closer in concept to investment income.*"

The OECD concludes that the proliferation of proof of stake consensus suggests that countries should reassess whether their published guidance is appropriate on an ongoing basis; and that the impact of proof of stake could be particularly clear in the indirect tax space. These are important points, particular given that some prominent DLT platforms (e.g., Ethereum) are expected to transition from proof of work consensus to proof of stake.

The OECD's conclusions and considerations for policymakers

The Report concludes with the OECD listing several "*general insights that policymakers may wish to consider in the taxation of virtual currencies*".

Broadly, the proposed considerations for policymakers comprise the following:

- A clear legislative framework and publication of clear guidance. Specific considerations include the provision of guidance on how virtual currencies fit within existing tax frameworks, addressing the treatment of major taxable events and income forms associated with virtual currencies, and how other forms of crypto-assets (including security and utility tokens) are to be treated for tax purposes. Reviewing and adapting guidance frequently may also be of value.
- Communicating the rationale behind adopted tax treatments.
- Whether the tax treatment of virtual currencies should be consistent with the tax treatment of other assets.
- Whether the tax treatment of virtual currencies is coherent with the broader regulatory framework.
- Supporting improved compliance. The OECD specifically references difficulties associated with high volatility, differing exchange rates for the same virtual currency, illiquidity, and the need to keep complex records of transactions. It also notes that excluding exchanges between different virtual currencies from income tax rules could ease compliance requirements.
- Providing simplified tax treatment for occasional or small traders.
- How the tax treatment of virtual currencies could align with or undermine other policy objectives.

Deloitte Singapore's views

The tax implications of virtual currencies and other digital assets/crypto-assets are inherently complex. DLT remains nascent, but the pace of development is very fast. Tax policy and legislation inherently require time to develop, and the pace of DLT developments to date has meant that tax administrations have typically had to adopt a reactive approach, often when approached with specific queries and tax positions by affected taxpayers.

The OECD's Report is an excellent introduction to material issues affecting the taxation of the virtual currencies, and an excellent summary of international approaches to such issues to date.

Whilst the Report highlights varied treatment *vis-à-vis* certain matters across the Survey Group, it also highlights a number of commonalities and prevailing international treatments that may provide a strong basis from which broad international consensus to certain issues may be developed.

The Report also emphasises the importance of the developing nature of DLT and the critical need for guidance issued by tax authorities to remain both cognisant of, and agile to, DLT developments. Moreover, it draws attention to issues of significance to material stakeholders in a way that should help further educate policymakers about market developments and concerns.

From a narrow perspective, we consider the publication of the Report to be a welcome and significant development in respect of the taxation of virtual currencies. Given the OECD's work in this area, further work in this area could be expected to focus on issues relevant to other crypto-assets like utility tokens, security tokens, stablecoins (including algorithm-based coins), non-fungible tokens, etc.

Considering the Report more broadly, we consider it an interesting and timely addition to the BEPS Action 1 debate, and a good introduction to issues and measures countries should be considering to respond to the fast-paced further development of the digital economy.

From a Singapore perspective, it is interesting to note that the tax treatment of virtual currencies in Singapore is referenced at a number of points throughout the Report. Furthermore, whilst there are some small differences between tax treatments in Singapore and elsewhere, those differences—which mostly to income tax—are mostly connected with Singapore's quasi-territorial approach to taxation and its lack of capital gains taxation. On the whole, treatments in Singapore (as outlined in the Inland Revenue Authority of Singapore's [IRAS] income tax and goods and services tax e-Tax Guides) are broadly consistent with the most common tax treatments identified in the Report. Consequently, there is nothing in the Report to suggest that approaches in Singapore are inconsistent with international practice, or could be subject to material change. It is also apparent from its published guidance that IRAS is aware of the some of the challenges identified by the OECD, and it is reasonable to assume that it will publish further guidance regarding emerging issues at an appropriate time.

In our recent experience, issues in point locally and warranting consideration include:

a. The potential for inclusion of virtual currencies (along with other categories of crypto-assets) within the definition of Designated Investments for purposes of the fund exemptions (*viz*. under sections

13CA, 13R, 13X, and 13Y of the Income Tax Act), to help ensure that the exemptions remain technology agnostic, and take account of DLT developments and evolving investment strategies; and

b. the benefits of further guidance from IRAS concerning the tax treatment of staking activities and DeFi, particularly given, respectively: the potential for stakeholder confusion due to current guidance being principally relevant to proof of work; and the regional proliferation of platforms through which alternative debt finance is being made available through DeFi applications.

Contact

For more information on the above or any other matters, please contact either the listed contacts below, or any member of the Singapore Tax & Legal team.

Low Hwee Chua
Tax & Legal Leader
Deloitte Singapore

+65 6216 3290
hwlow@deloitte.com

Daniel Ho
Tax Partner
Deloitte Singapore

+65 6216 3189
danho@deloitte.com

Michael Velten
Tax Partner
Deloitte Singapore

+65 6531 5039
mvelten@deloitte.com

Matthew Lovatt
Tax Director (subject matter expert)
Deloitte Singapore

+65 6800 4591
mlovatt@deloitte.com

Richard Mackender
Tax Partner
Deloitte Singapore

+65 6216 3270
rimackender@deloitte.com

Yeoh Lian Chuan
Managing Director
Sabara Law LLC (a member of Deloitte Legal)

+65 6800 2253
lcyeoh@sabaralaw.com.sg

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