GST Treatment of Digital Payment Tokens

Practical Implications For Businesses

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There was a time when taxation of exchange of goods and services would depend only on the location where the title to the goods was transferred or where services were performed. The subsequent arrival of e-commerce then prompted lawmakers to put in place new Goods and Services Tax (GST) legislation to try and tax online shopping activity because of the disincentive to transact locally when transacting internationally could be done without being subject to tax. Further technological breakthroughs powering new digital products (such as cloud computing and software as a service) continued to add on new layers of complexities to the GST system.

Blockchain is the latest digital technology to enter the fray. The revolutionary technology has opened up a new realm of opportunities for businesses and individuals. Decentralised finance (DeFi), for example, is a blockchain-based form of finance utilising smart contracts and is poised to take on traditional financial intermediaries around the world.

To help tax professionals navigate the novelty of the digital currency landscape, Accredited Tax Advisor (GST) Richard Mackender, Indirect Tax Leader, Deloitte Southeast Asia and Singapore, and Accredited Tax Advisor (Income Tax) Kwan Chang Yew, shed light on IRAS' GST guidance on Digital Payment Tokens (DPTs) and the practical implications for businesses in a recent webinar organised by the Singapore Chartered Tax Professionals.

Blockchain and Cryptocurrency

Blockchain

The concept of blockchain is inherently captured within its name – each record of a digital transaction referred to as a "block" is maintained as a growing list of data records known as a "chain". Essentially, blockchain is a ledger of digital transactions with data recorded and structured in blocks and chained together in chronological order, and is duplicated and distributed across the entire network of computer systems on the blockchain.

Crytocurrency

Cryptocurrency is a digital or virtual currency that enables anyone anywhere to send and receive payment securely through a peer-to-peer system based on blockchain technology. Examples of cryptocurrencies include Bitcoin and Ether.

How crytocurrency is revolutionising the financial sector

In a traditional financial system, multiple intermediaries would generally be involved to effect a single payment. Each intermediary would validate and maintain its own data records separately to ensure that the financial transaction is secured and accurate. This would inevitably lead to slower payments and added fees, not to mention exposures to foreign exchange risks for overseas payments.

In contrast, cryptocurrencies (like Bitcoin) are built on public blockchains that allow anyone to send and receive payments, cutting down the need for trusted third parties to verify transactions and giving people around the world access to fast, cheap and borderless payments.

IRAS' Guidance: GST Treatment of Transactions Involving Digital Payment Tokens

On 19 November 2019, Inland Revenue Authority of Singapore (IRAS) published a e-Tax guide on "Digital Payment Tokens" to set out the GST treatment of transactions involving digital tokens or cryptocurrencies that function or are intended to function as a medium of exchange with effect from 1 January 2020.

It is important to note that the GST treatment stipulated in the e-Tax Guide is specifically carved out for DPTs. The GST treatment for digital tokens that do not qualify as DPTs is not covered by the e-Tax Guide; supplies of such digital tokens will continue to be regarded as taxable supplies of services (unless they fall under the prescribed list of exempt financial services under Part I of the Fourth Schedule to the GST Act).

DEFINITION OF DPT

A digital token refers to any cryptographically-secured digital representation of value that can be transferred, stored, or traded electronically, while a DPT is defined as a digital token that has the following characteristics:

(a) it is expressed as a unit;

(b) it is designed to be fungible (such that the digital token can be used interchangeably as consideration);

(c) it is not denominated in any currency, and is not pegged by its issuer to any currency;

(d) it can be transferred, stored, or traded electronically;

(e) it is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, without substantial restrictions on its use as consideration; but does not include:

(f) money;

(g) anything which, if supplied, would be an exempt supply under Part I of Fourth Schedule to the GST Act (for example, cryptocurrencies that are backed by gold or pegged to fiat currencies);

(h) anything which gives an entitlement to receive or to direct the supply of goods or services from a specific person or persons and ceases to function as a medium of exchange after the entitlement has been used (for example, loyalty points issued by retailers, or game credits that cannot be used outside of the online game).

SUPPLY OF DPTS

Prior to 1 January 2020, IRAS considered the supply of virtual currencies as a taxable supply of services. Accordingly, 7% GST applied to these transactions unless the zero-rating provision is applicable under Section 21(3) of the GST Act.

IRAS has since reviewed its position and revised the GST treatment for DPTs with effect from 1 January 2020 to better reflect the characteristics of DPTs.

Specifically, the use of DPTs as payment in respect of any transaction (other than a transaction for a supply of fiat currency or other DPTs) is now disregarded as a supply for GST purposes under the GST (Excluded Transactions) Order. In other words, if a company is using DPTs to pay for goods or services, it is not a supply for GST purposes.

On the other hand, supplies of DPTs by way of exchange of DPTs for fiat currency or other DPTs, or the provision of any loan, advance or credit of DPTs, constitute an exempt supply. Consequently, businesses that trade in DPTs are no longer liable for GST registration even if the annual turnover from the trade exceeds $1 million, as the supplies of the tokens are exempt supplies.

GST-registered businesses that are making both taxable supplies and exempt supplies of DPTs are partially exempt, and accordingly may have to apportion their input tax and be subject to reverse charge.

VALUE OF SUPPLY

Depending on the type of transaction, the value of supply to be reported in the GST return would depend on different criteria.

- When receiving DPTs as consideration for the supply of goods or services, the value of supply is the open market value of the goods and services supplied.
- When exchanging DPTs for fiat currency or other DPTs, the value of supply is either the realised gain/loss from the exchange, or the proceeds received.
- When making loans of DPTs, the value of supply is the interest income received.

TIME OF SUPPLY

The general time of supply rule based on the earlier of the date of invoice or date of receipt of consideration also applies to DPT transactions. Suppliers of goods or services in return for DPTs may regard the date of receipt of consideration as the date when the payment is validated on the blockchain.

BELONGING STATUS OF CUSTOMERS

The belonging status of customers is relevant as while the supply of DPTs is an exempt supply, the business can zero-rate the supply (and hence claim the input tax that is otherwise not allowed) if the supply is:

- contractually made to a person who belongs in a country outside Singapore, and
- directly benefits a person belonging outside Singapore or a GST-registered person in Singapore.

The current GST rules on determining belonging status of customers will continue to apply for issuers, transferors, and sellers of DPTs. The use of proxy indicators is also allowed in instances where the supplier is unable to reasonably verify the belonging status of the customer. Specifically, the supplier is required to obtain and maintain at least two pieces of non-conflicting evidence out of three proxy categories (that is, payment proxy, residence proxy, and access proxy).

Practical Considerations for Businesses

Businesses intending to introduce cryptocurrencies or integrate cryptocurrencies into their existing model should consider the following:

(a) Is the business supplying DPTs, digital tokens other than DPTs, or a mixture of both?

- The characterisation of the digital tokens would determine if the supply were a taxable supply of services, disregarded under the the GST (Excluded Transactions) Order, or exempt under the Fourth Schedule of the GST Act.

(b) Where and how would the business maintain the required information to support the belonging status of customers?

- The business should ensure that its systems are capable of maintaining the information and supporting documents required to substantiate its input tax claims.

(c) Would the business' intended activities make it a partially exempt trader?

- The business should evaluate the nature of the supplies it makes or is intending to make to see if the supplies comprise both taxable and exempt supplies, making it a partially exempt trader.

(d) Has the business considered reverse charge and GST input tax apportionment?
If the business is a partially exempt trader, it should assess whether the value of its exempt supplies of DPTs exceeds the threshold under the De Minimis Rule. If so, GST input tax apportionment and reverse charge on services acquired from overseas suppliers may apply.

Blurred Lines and Grey Areas

While the GST treatment for DPTs is clearly stipulated in the IRAS e-Tax Guide, one practical challenge is that the digital token may not fall squarely under the definition of a DPT or otherwise. A DPT, based on IRAS' definition, is not denominated in any currency, and is not pegged by its issuer to any currency. In practice, a digital token may be pegged to another digital token or DPT (instead of a fiat currency). It is unclear whether in such cases, the digital token would still qualify as a DPT for GST purposes.

As businesses and financial institutions explore the emerging digital space of blockchain and cryptocurrencies, the lines will be blurred, the boundaries will be pushed, and the existing GST rules will be challenged.

In this regard, tax advisors and taxpayers would be wise to keep abreast of the latest tax updates as blockchain and cryptocurrencies continue to evolve. Where the tax position is unclear, businesses moving into the brave new world of blockchain and cryptocurrencies may consider an advance ruling to manage their tax exposure.

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