Digital Tokens

Knowing Their Income Tax Treatment

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Facilitated by:
Accredited Tax Advisor (Income Tax) Mr Sivakumar Saravan,
Ms Tan You Bao and
Accredited Tax Advisor (Income Tax) Ms Karen Goh Sher Chin

Blockchain is one of the emerging technologies that has the potential to disrupt the world.

A blockchain is essentially a digital ledger of transactions that is duplicated and distributed across a decentralised network of computer systems that makes the data on the blockchain almost impossible to be modified. Each transaction or record on the ledger is stored in a "block", with each block linked to the information in a previous block, forming a chronological "chain" of transactions.

The advent of blockchain technology has led to the emergence of the token economy where the need for intermediaries and third parties to authenticate and verify transactions is eliminated, and the exchange of goods and services can be made faster and cheaper without compromising trust and security.

Against this evolution, Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Senior Partner at Crowe Singapore, and officers from Inland Revenue Authority of Singapore (IRAS), in a webinar organised by the Singapore Chartered Tax Professionals, shared their insights on the token economy arising from blockchain technology and accordingly, the income tax treatment of digital tokens in Singapore.

Unlike the current platform economy, where goods and services are sold via intermediaries on an e-commerce platform, the token economy does not require an intermediary. In the token economy, tokens can come in various forms – they can be designed to act as currency (payment tokens), offer the right to a service or product (utility tokens), or represent any underlying asset (security tokens).

IRAS' Guidance: Income Tax Treatment of Transactions Involving Digital Tokens

Based on IRAS' e-Tax Guide on "Income Tax Treatment of Digital Tokens", a digital token is referred to as a digital representation of a token holder's right to receive a benefit or to perform specified functions.

The tax treatment for digital tokens is based on the application of existing income tax provisions. Where the digital token falls outside of payment tokens, utility tokens and security tokens as described by IRAS, the nature and use of such tokens would have to be examined to determine the appropriate income tax treatment.

Payment Tokens

A payment token represents a digital right that can be used or is intended to be used as a means of payment for goods and/or services. It has no further function apart from being used as a mode of payment. Common examples of payment tokens include Bitcoin and Ether.

Payment tokens are regarded as intangible properties for tax purposes as they do not have physical forms and are not recognised as fiat currency since they are not legal tender. Transactions involving the use of payment tokens as payment for goods and services are therefore viewed as barter trade.

TAX TREATMENT

Where a business receives payment tokens for the goods or services it has provided, it would be taxed on the value of the underlying goods provided or services performed. Likewise, a business that pays for the goods and services using payment tokens can claim a deduction based on the value of the underlying goods purchased or services received, subject to general tax deduction rules. The value of the goods or services transferred is to be determined at the point of transaction and depending on the contractual terms of the agreement.

On disposal of the payment tokens, the gain or loss from the disposal would be taxable or deductible if they were assessed to be revenue in nature. Conversely, if the tokens were held as capital assets, the gain or loss from the disposal would not be taxable or deductible.

It is useful to note that the purchase of a payment token itself is not a taxable event, although the intention at the point of purchase would have to be considered (through the application of the badges of trade) to determine if subsequent disposal of the payment token is a trading activity and accordingly, whether the resulting gains or losses are revenue in nature.

MINING PROFITS

Mining is the process by which digital token transactions are verified and added to the blockchain, and the means through which new digital tokens are released. When a miner successfully mines for payment tokens, he is rewarded with payment tokens from the system which he may subsequently dispose of or exchange for goods or services.

Upon disposal of the payment tokens, the miner would be taxed on the profits from the disposal and the tax treatment would depend on whether the miner performed the mining as a hobby or with the intention to profit. If it was the former, the disposal gains or losses of the payment tokens would not be taxable or deductible. However, if the mining activity was carried out as a trade or business, the gains or losses from the disposal would be taxable or deductible.

Utility Tokens

Utility tokens give the token holder a right (usually a future right) to a good or service. They are typically issued in an Initial Coin Offering (ICO) and come in different forms – akin to a voucher (to entitle the holder to future services from the ICO company), or a key (to entitle the holder to access the ICO company’s platform).

TAX TREATMENT

From a token holder’s perspective, when a utility token is acquired, it is treated as a prepayment for goods or services to be provided in future. Therefore, a tax deduction will be allowed to the token holder, subject to general tax deduction rules, when the token is used to exchange for the goods or services.

Security Tokens

Security tokens give the token holder a stake or rights to an underlying asset, generally with a degree of control or economic entitlements. Common types of security tokens that have been issued are typically accounted for as a form of debt or equity.

It should also be noted that security tokens may also be a tokenised form of traditional securities and as such, they can also take the form of any other security or investment assets or instruments.

Tax Treatment

IRAS would examine the legal form of the security token, the rights and obligations tied to the security token, and the nature of the underlying asset to determine the nature of the security token (for example, whether it is debt or equity). This, in turn, determines the nature of the returns derived by the security token holder from the security token (for example, whether it is interest or dividend) and how it should be taxed.

Where the security token is disposed of by the holder, the tax treatment of the gain or loss on disposal would depend on whether the security token is a capital or revenue asset to the token holder and accordingly, determine whether the gain or loss is capital or revenue in nature.

ICO

ICO refers to the first issue of a digital token to the public. It is commonly used as a method to raise funds for new projects or to make available the means of access to an existing or future specific good or service.

Tax Treatment

The taxability of ICO proceeds in the hands of the token issuer depends on the rights and functions of the tokens issued to the investors.

Payment Tokens

The issuance of payment tokens may be taxable depending on its specific facts and circumstances. Generally, an ICO company is treated as carrying on a trade of trading in payment tokens and the tokens are treated as its trading stock. Accordingly, the proceeds from the issuance of payment tokens are taxable at the point of issuance.

Utility Tokens

The issuance of a utility token comes with an obligation for the issuer to provide a service in the future. In this regard, the proceeds from the issuance are generally regarded as deferred revenue and are taxable at the point when the performance obligation is fulfilled (for example, when the services are performed or the goods delivered).

Security Tokens

Proceeds from the issuance of security tokens are akin to those from the issuance of securities or other investment assets and are thus capital in nature and not taxable. The ICO company would not be taxed on the proceeds at the point of issuance.

General income tax rules and withholding tax obligations apply to the dividend, interest and other distributions derived by the investor or token holder.

Founder's tokens

Founder's tokens refer to ICO tokens set aside by the ICO company to be awarded to the founding developers of the ICO in recognition of their hard work in creating and implementing the tokens.

Founder's tokens issued as remuneration are regarded as revenue in nature and taxable on the founder. However, if the tokens were not given as remuneration for services provided (for example, if the founder has contributed capital towards the formation of the company and the tokens were issued to him to confer an ownership right), the founder would not be taxed on the tokens as they will be regarded as his capital assets.

If there is a lock-in period or moratorium, the tokens would be regarded as being accrued to the founder only when the lock-in period ends or when the moratorium is lifted and be taxable then. The amount to be taxed is the value of the tokens when the moratorium ends.

What's the Future Like?

Blockchain technology, with its interoperability with different technologies (such as artificial intelligence) is revolutionising the way goods and services are provided and opening a whole new world of possibilities.

With blockchain technology and digital assets evolving at a rapid pace, tax advisors and taxpayers would need to first understand the underlying technologies used in these transactions before they can reconcile them with the prevailing tax legislations to determine the tax implications.
While there is currently no specific provision in the Income Tax Act for digital tokens, IRAS is monitoring developments in this area and would continually review the tax rules to ensure they are relevant and robust.

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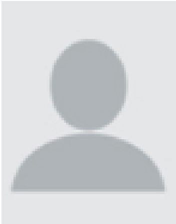

Ms Tan You Bao
Principal Tax Policy & Ruling Officer
Tax Policy and Ruling Branch
Inland Revenue Authority of Singapore

Ms Karen Goh Sher Chin
Group Tax Specialist
Tax Policy and Ruling Branch
Inland Revenue Authority of Singapore
Accredited Tax Advisor (Income Tax)

Mr Sivakumar Saravan
Senior Partner, Head of Tax
Crowe Singapore
Accredited Tax Advisor (Income Tax)
E: siva.saravan@crowe.sg

Angelina Tan is Technical Specialist, Singapore Chartered Tax Professionals.

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