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New Zealand tax treatment of crypto-assets for investors

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While this article covers taxation of crypto generally it principally focuses on tax issues facing crypto investors. It should be read in conjunction with our companion articles regarding crypto business tax article and tax residency article.

Until recently, cryptocurrency, digital assets, or crypto-assets ('**crypto**'), have generally only been discussed in small, niche circles – heard of by few and understood by even fewer. However, since the first 'genesis block' was mined by Bitcoin's pseudonymous creator, Satoshi Nakamoto, more than 12 years ago, crypto have risen to values and multiplied in numbers few would have predicted.

As crypto rapidly grows and establishes itself as a genuine asset class, now with a combined market cap of over 2.3 trillion - yes, more than the market cap of global giant Apple (APPL) with 2.2 trillion – governments worldwide are wrestling with how to deal with it in its various forms. As a comprehensive report by the OECD Centre for Tax Policy and Administration has observed:

> "Crypto-assets, for which no uniform definition exists, and which span a vast spectrum of heterogeneous forms and purposes, have a number of inherent and unique characteristics that pose challenges for policymakers. These challenges arise due to their lack of centralised control, (pseudo-) anonymity, valuation difficulties, hybrid characteristics including both aspects of financial instruments and intangible assets, and the rapid evolution of the underpinning technology as well as the form of these assets."

As New Zealand's Inland Revenue ('**IRD**') has noted, crypto have no special tax rules. Therefore, it is necessary to apply existing legislation. As the technology is both novel and rapidly evolving, this application can be difficult, and so the IRD is considering whether the current law taxes crypto transactions appropriately.

Authors

James Cochrane **Partner**
DDI: 09 886 1439
Email: jamesc@shlaw.co.nz
Website: View Profile
LinkedIn: View Profile

Olga Garin **Solicitor**
DDI: 09 306 6870
Email: olgag@shlaw.co.nz
Website: View Profile
LinkedIn: View Profile

Thankfully for those interested, the IRD has provided guidance on the tax treatment of these assets. Despite the Government's claim that one of the key attractions of our tax system is that there is "no general capital gains tax", the IRD's crypto guidance makes it clear that the default position is that this is not the case for crypto. Similar to our cousins across the Tasman, but quite unlike more progressive jurisdictions like Wyoming and Portugal which provide a comprehensive, welcoming legal framework, New Zealand's approach to taxing crypto is unquestionably aggressive.

If you were one of the brave early adopters who made it through 'crypto winter', then in the last year you have been treated to quite the ride on a raging bull. It is said that with great risk comes great reward, but, as we discuss, great reward can also be partnered with wild volatility and equally raging tax liabilities.

Crypto is property

As we discussed in an earlier article, the New Zealand High Court in *Ruscoe & Moore v Cryptopia Limited 2020 (in liquidation)* [2020] NZHC 728 rejected the argument that crypto was mere information and, instead determined that crypto met all four classic characteristics of property.

The first line of the IRD's crypto guidance page states that "cryptoassets are treated as a form of property for tax purposes". However, it goes on to say that the "tax treatment depends on the characteristic and use of the assets, not what they are called". Crypto are not legal tender. If they were, instead, treated as a financial arrangement, akin to currency, then depending on the value held, it could mean unrealised gains are taxable.

The IRD's treatment of crypto as property is in line with that of the United States, where the IRS has released guidance that cryptocurrency is property, and gains are subject to capital gains tax. Australia and the United Kingdom also tax gains from the sale of crypto under their capital gains tax rules.

If you follow the markets, you will have noticed a recent sell-off in both crypto and equities. This was in part due to fears of US President Joe Biden's proposal to double capital gains taxes, and tax deadlines in the USA.[1][2] Unless you held on with 'diamond hands', if you sold your crypto back into 'fiat' currency (e.g. NZ dollars), or converted e.g. your bitcoin (BTC) into a 'stablecoin' e.g. tether (USDT) in a panic, there's a very good chance you may have tax to pay or could be able to claim a tax loss.

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[1] Massive Bitcoin Pullback Explained by CryptoQuant CEO, Here's What He Says (cryptonews.net)

[2] https://finance.yahoo.com/news/bitcoin-price-plunge-feels-capitulation-155602652.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAItsMSiU8rxGx0xZJ4hEJsQQR3SzmT43N1E-9dCmdQ7YWoI0TrwG_bMAQcC8JUGu9jAfBSHmtvDLiP8qMghPijyx_aDuXyoZ1gjSFXaHpGmm3pXi5tRIkRv_q5uqhU9Ki6bbtRi6bKh25Oau10m-F-3so3Z8ACCsuz-wp5nKsWNk

Buying and selling crypto

Unfortunately for both crypto traders and 'hodlers' alike, it is safe to assume that the IRD will likely assess profits from both activities (trading and investing) as taxable.

As the IRD notes, purpose matters:

- "If your purpose for getting cryptoassets is to sell or exchange them, you'll need to pay income tax when you do."
- "If you make a loss when you sell your cryptoassets you may be able to claim this loss."

What many may retail investors may not have appreciated is that according to the IRD: "Tax is also applied when one cryptocurrency is swapped for another. You don't need to cash out to dollars to create a tax obligation."

The latter is likely to capture those who have acquired, e.g. bitcoin (BTC) as an 'on-ramp' crypto, in order to buy other altcoins (e.g. purchasing bitcoin via Apple Pay in an Exodus wallet and then transferring the BTC to another crypto within the Exodus wallet platform).

Dominant purpose test

Because crypto is property, section CB 4 of the Income Tax Act 2007 ('**ITA**') applies. Section CB 4 states: "An amount that a person derives from disposing of personal property is income of the person if they acquired the property for the purpose of disposing of it."

The important factor is **purpose**, which plays a pivotal role as to whether your proceeds will be subject to income tax. The purchaser's state of mind must be considered at the time of acquisition (not at the time of disposal) and purpose of disposal must be the **dominant purpose**. The test is subjective. If you are using another legal entity as a vehicle to buy your crypto, e.g. a company or trust, it is the collective purpose in the minds of those in control of the entity or entities making those decisions which is determinative. If you had more than one purpose, taxability turns on whether the dominant purpose was for sale or disposition. If it was, then it will be taxable.

> **Example:** Let's say you recently bought a bunch of dogecoin (DOGE) with the intention of selling and making a quick buck because you had heard it was up 12,000% since the start of the year. You heard that Elon was going to be on Saturday Night Live and expected the price would 'moon' further if he 'shilled' it. When you convert the DOGE back into NZ dollars or into some other crypto, then the gains (or losses) on the DOGE will be assessable (or claimable) because your dominant purpose in acquiring the DOGE was sale or disposal. If you bought, e.g. $1,000 NZD of DOGE and sold or transferred it for $1,800 NZD, then you would pay tax on the $800 profit.

The IRD's crypto guidance appears to have been lifted from *CIR v National Distributors,*[3] the leading case on CB 4's predecessor. In that case the Court was asked to determine whether certain gains on sales of shares were assessable income. Except for two allocations of shares which were held to have been purchased for a specific reason other than resale (the gains on which were not assessable income), the Court found that all other shares were purchased for the dominant purpose of sale or disposal and therefore the gains on them were assessable.

According to the evidence of the taxpayer (the director of National Distributors that had purchased the shares) the reasons for acquiring the shares were that "the shares were attractive investments and that long term the taxpayer could foresee some growth and the making of some capital for the shareholding family in investing shares". The Court at first instance was satisfied that the taxpayer's purpose was not for resale but for "the management of a portfolio in such a way as to keep pace with inflation". On appeal, the Court rejected this, drawing a distinction between motive and intention:

> "If the taxpayer's dominant purpose in acquiring the property is to sell it in the future at a price which, allowing for inflation, corresponds with or is better than its price at the time of purchase, his statutory purpose is to sell the property even though his motive is to protect his savings from inflation."

National Distributors considered two cases which discuss the distinction between motive and purpose.[4] Both concerned whether gains were assessable in circumstances where stock had been purchased in England for sterling and immediately sold in New Zealand for dollars, rather than the funds being transferred to New Zealand through banking channels. While the motive for the taxpayers was to remit funds from England to New Zealand, the dominant purpose for purchasing the stock was to sell it. While these cases are unique in terms of their facts, they are a convenient comparison for the IRD's presumption of purpose of disposal where one crypto is exchanged for another, e.g. ethereum (ETH) is acquired and then sold (or sold in part) to buy, say, polkadot (DOT).

When considering the purpose of an investment, Justice Richardson's following observations in *National Distributors* are particularly noteworthy:[5]

> "[A] person buying such an asset does so either with a view to investment for the income it will return, or with a view to realising a profit on disposal sooner or later - and while logically these "purposes" of retention or resale are not mutually exclusive, it will generally be possible to say that the one or the other is predominant at the time when the purchase is made. There may be other cases where the dominant purpose is retention of the asset not for the intermediate income it will afford, but for reasons such as the obtaining of a director's qualification or the building up of a large estate or simply to secure the real value of the taxpayer's money in the long term; and acquisitions may be made for reasons of an essentially personal nature or in response to extraneous family considerations. But generally speaking, if the taxpayer is in pursuit of economic gain and is not acquiring an asset for private use or

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[3] *Commissioner of Inland Revenue (CIR) v National Distributors Ltd [1989] 3 NZLR 661*

[4] *Commissioner of Inland Revenue v Hunter [1970] NZLR 116; Holden v Commissioner of Inland Revenue [1974] 2 NZLR 52.*

[5] *National Distributors* at 668

enjoyment or other extraneous reasons, the economic rewards, which are the recognised goals of most investments, are ordinarily obtained either through periodic receipts such as dividends or through the gains derived on sale or through a combination of the two.
The mere fact that at time of purchase of the property the taxpayer did not expect to hold the property for ever and contemplated the possibility of sale, does not attract the application of the second limb. That follows from the requirement that to come within its provisions the dominant purpose of the purchaser must have been the resale of the property. If the investment policy is to provide and enlarge the dividend income and to buy (and sell) with that as the dominant consideration, there can be no basis for invoking the second limb. It is proper then to distinguish between sales made in the course of the review of an investment portfolio held primarily for its potential income yield on the one hand, and sales of shares acquired primarily with the object of eventually realising gains on resale on the other. Many ordinary investors acquire shares for the purpose of securing not only income from dividends, but also growth in the value of the shares. In those cases where there is not a clear dominant purpose of resale at the time of purchase, any profits on the ultimate sale of the shares are not within the second limb."

Put another way, the dominant purpose test focuses on: "what was truly important to the taxpayer at the time of acquisition".

Comparison with gold

As the IRD has noted, because bitcoin and similar cryptos generally don't produce an income stream or any other benefits while you hold them, except when sold or exchanged, the IRD presumes that they are acquired for the purpose of disposal. In this regard the IRD compares the tax treatment of crypto to that of gold. Because gold is not capable in and of itself of producing income, it is presumed to be acquired for sale.
Interestingly, the New Zealand Law Society robustly challenged this presumption of disposal in relation to gold and silver bullion in this 2016 letter. It noted that Australian case law regarding gold and silver investments indicates that, in some circumstances, non-income producing assets can be acquired without a dominant purpose of disposal, but that each case will ultimately depend on its facts. Two cases are noteworthy as examples:

- In one, the evidence showed that it was the taxpayers' intention to pass the silver to their children on death or when their children reached maturity and not for any other purpose, including profit-making by sale.
- In the other, the evidence showed that the gold was purchased by the taxpayer on the recommendation of his stockbroker as part of a diverse investment portfolio without a specific purpose in mind.

The importance of surrounding circumstances when assessing purpose

A person's dominant purpose in acquiring crypto must be supported by the person's actions and the surrounding circumstances. Because of the IRD's default position, the onus will be on the taxpayer to rebut the presumption. The surrounding circumstances, as indicated by IRD, can be:

- the circumstances surrounding the acquisition of the crypto, its use, and its disposal;
- the nature of the crypto (whether it provides an income stream or any other benefits while held);
- the number of similar transactions; and
- the length of time the crypto is held.

In relation to the latter, the Court in *National Distributors* noted:[6]

> "Ordinarily, too, the length of time the shares are held before being sold is regarded as of particular importance. If shares are held for a matter of months only, then in the absence of special reasons occasioning an earlier than contemplated sale, it is difficult to escape the conclusion that they were purchased with a view to the gain likely to arise on resale rather than with a view to reliance on the dividend income. If they are held for a period of years during which time the market has moved upwards and downwards, that is a factor tending to displace the proposition that the shares were acquired for the purpose of sale."

These comments will without doubt shine a ray of light for the hodlers.

What about CeFi and DeFi?

You shouldn't assume that because you acquired crypto for staking or to lend and earn interest on 'CeFi' platforms like Blockfi or Celcius or 'DeFi' platforms like Aave and Compound, that the IRD won't assess your dominant purpose as being other than disposal.[7] Very compelling evidence will be required to support the claim that the crypto in question was not acquired for the purpose of disposal. In short, you should prepare for an uphill battle.

However, the fact that it is possible to hold crypto in a non-custodial way, generate income from it, and also borrow fiat against it using the crypto as security, mean that CeFi and DeFi provide taxpayers with a legitimate means of generating a return while never intending or needing to sell or dispose of their crypto. This is where crypto clearly differs and has advantages over gold and silver.

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[6] *National Distributors* at 668

[7] For the difference between CeFi and DeFi see this article: How The Ethereum, EOS, And PolkadotCommunities Got Divided Into Two: CeFi Vs. DeFi (forbes.com)

If the taxpayer acquired the crypto with such a purpose in mind and the facts showed that the plan was implemented, in those circumstances we would think that the taxpayer would at least have an arguable case that the presumption of acquisition for sale is displaced. While the IRD is likely to take the position that the 'fruit of the tree' (i.e. the staking or interest returns) is revenue and should be taxed as a profit-making scheme or income under ordinary concepts (discussed below), the taxpayer might be able to sidestep further tax on the growth of the tree itself.

Further guidance required

With that said, it would be helpful to have further guidance from the IRD on the following matters.

- If a taxpayer 'deposits' their crypto to a CeFi or DeFi platform to earn interest, will the transfer be a disposal for tax purposes? Not all such platforms are non-custodial.
- Similarly, if they transfer some of their crypto from one platform, e.g. a non-custodial wallet like a Ledger Nano X, to a custodial wallet with an exchange, e.g. Gemini, as part of a risk mitigation strategy to avoid a total loss from a hack, will this constitute a disposal for tax purposes?
- What if a taxpayer is dollar cost averaging a crypto in one wallet with the intention of holding indefinitely, then at a later point purchases some further crypto of the same kind in order to acquire a different crypto on the same platform. Will the IRD look at the purpose for which that specific later allocation was acquired (i.e. to be converted) only? Or will the IRD apply a first in first out, weighted average cost, or last in first out assessment in relation to the entire stack?

In the first two cases, the taxpayer probably intends to retain ownership and control of the crypto, but the crypto will likely lose its identifiability when moved. Depending on whether it is custodial or non-custodial and other terms of use, a CeFi or DeFi deposit could arguably be viewed:

- as a loan in return for a debt (i.e. a debtor creditor relationship) akin to a general banker / customer relationship, in which case the IRD could well view it as a disposal; or
- more like a principal / agent or trustee banker relationship, whereby e.g. platform acts more like a bailee of valuables or the crypto is offered as security by the customer to the platform, rather than ownership being transferred, in which case there is arguably no disposal or sale at all.

The focus should still be on the taxpayer's purpose when they acquired the crypto. But it would not be a surprise if in some cases the Commissioner took the view that apples have been 'disposed' of for oranges – as opposed to transferred to a different apple cart. This would be unfortunate and, according to this article at least, out of step with other jurisdictions such as the US.

How will the IRD know?

It is safe to assume that, like the Australian Taxation Office or the US Internal Revenue Service, the IRD is keeping a watching brief. Both overseas tax authorities have established specialised investigation teams.

In the US, as this article notes, the IRS is actively "hunting for tax cheats" by demanding exchanges release customer information via 'John Doe' summons. On 5 May 2021, a federal court in the Northern District of California entered an order authorising the IRS to serve a John Doe summons on one of the US's largest exchanges, Kraken. According to the summons filed with the petition, the IRS directed Kraken to produce records identifying the U.S. taxpayers described, along with other documents relating to their crypto transactions.

The IRS is reported to also be probing the dark web to look for crypto and NFT tax evasion. It also requires tax payers to declare on their tax returns whether they received, sold, sent, exchanged or otherwise acquired any financial interest in any virtual currency.

In Australia, as this press release discusses, the ATO has been collecting bulk records as part of a data matching program to monitor tax compliance. In 2019 the ATO expected to collect $3 billion in tax fines from Australian crypto traders. This article suggests that they will be seeking information about, e.g. taxpayers' social media accounts, and using algorithms to cross check data against tax returns.

This video interview of the founder of New Zealand exchange, Easy Crypto, confirms the IRD is adopting a similar approach and that, despite their concerns about privacy rights, Easy Crypto feelspowerless to object.

Practical guidance

Plan, and document

All of the above emphasises the importance of structuring. Before you purchase, it is worth considering and seeking professional advice about whether you should purchase in your own name, on behalf of a company, trust or other entity and how you go about setting that up.

Unless you are actively trading, to give yourself or the entity you represent the best shot at rebutting the presumption of disposal, you should be clearly documenting what you are doing and keep those documents safe. At some point in the future you may need to rely on the documentation if the IRD challenges your position to whether gains are assessable or not.

Be conscious that transferring your crypto to family or friends, even if by way of gift, could be considered a disposal and therefore a taxable event.

If you are transferring, selling, or disposing, make notes as you go.

If you are considering crypto as a business, or to use in business, be mindful of the various tax rules. If in doubt seek advice.

Keep your 'stacks' separate

If you are trading, keep the trading crypto separate from your long term holds by using different exchanges or hardware wallets.

If you want to spread your risk, be conscious that transferring to a different wallet or platform may be considered a disposal. Transferring to non-custodial wallets which you own and control should reduce the chances of IRD finding that the transfer amounted to a disposal.

Crypto tax software and other online resources can assist

Platforms like taxoshi and koinly cater directly to the New Zealand market and can dramatically reduce time and cost completing returns.

In addition to the IRD's guidance regarding completion of tax returns, there are plenty of other great resources available online from crypto tax specialists, such as this crypto tax checklist, or New Zealand exchanges, such as this tax guide.

However, it is important to remember that the circumstances of every taxpayer are different. If in doubt seek specific advice for your situation.

What if I think I have a tax liability?

Seek professional advice and assistance as soon as possible to limit the risk of penalties. Our cryptocurrency / crypto assets, dispute resolution and tax teams understand crypto and have particular expertise dealing with the IRD (e.g. negotiating payment arrangements and reductions in penalties).

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