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Tax on cryptocurrency transactions

South African income tax returns contain questions about a taxpayer's transactions in cryptocurrencies. This suggests that SARS has a specific interest in these type of transactions. Transactions that involve cryptocurrencies give rise to various tax issues. This article provides a brief overview of some of the more common issues that taxpayers need to be aware of when taking a position on the tax implications of such transactions.

Cryptocurrencies present lucrative trading as their short-term values fluctuate wildly. They may however also prove to be good longer term investments if the value ultimately grows substantially when held over a longer period of time. Over the past few months, the value of many cryptocurrencies have risen rapidly until about the end of April 2021. This was followed by a sharp fall since then. Many South Africans participate in this market and made handsome profits. Some of those who entered late in the cycle however suffered significant losses. These gains or losses must be accounted for income tax purposes. This article briefly considers some key principles of the South African income tax implications of transactions that involve cryptocurrencies.

Some of the issues

As one delves deeper into transactions or possible transactions that involve cryptocurrencies, you are likely to encounter many intricate tax issues. The main issues that most taxpayers however grapple with relate to, firstly, the nature of the gains or losses (i.e. whether these are capital or revenue in nature) and, secondly, the timing of the tax events. I limit this short article to these aspects.

Nature of the gains or losses

There are no specific rules in the Income Tax Act that govern or prescribe the nature of transactions that involve cryptocurrencies. This means that one has to consider the principles laid down by the courts over the years to determine whether these assets are held as capital assets or not. If they are held as capital assets, the transactions would be subject to capital gains tax ('CGT'). Alternatively, if they are not held as capital assets, it would be subject to normal income tax. There is not yet any reported cases in South Africa that specifically consider the taxation of cryptocurrencies. One therefore needs to look at case law dealing with other type of assets for guidance. It is a well established principle that amounts realised in the course of a scheme of profit-making are considered revenue in nature. On the other side of the equation, the courts have held, in the context of shares, that where a taxpayer acquires and holds an asset for keeps in the long-term it may be held on capital account. It is a question of fact and degree where on the scale a person's activities fall. It is important to bear in mind that where a taxpayer takes a position that an amount is taxable at a specific rate (in the case of transactions involving cryptocurrencies, at CGT rates), he/she bears the burden of proving this on a balance of probabilities in the case of a dispute. SARS states in its CGT Guide that: "Given their extreme volatility, Cryptocurrencies are likely to be held as a speculative asset of a revenue nature". They do however indicate in their FAQs on crypto assets that the treatment depends on the facts and circumstances of each case.

Timing of the tax event

Many taxpayers are under the impression that a tax event only occurs when a cryptocurrency is converted into a fiat currency or when the funds are ultimately returned back to South African Rands on a local exchange. This is not correct. Taxpayers must account for any amounts that they receive or that accrues to them. The term *amount* includes items other than cash. It includes cryptocurrencies. When one cryptocurrency is exchanged for another, the taxpayer receives an amount and a taxable event occurs. Similarly, when a taxpayer conducts crypto-mining activities or renders services and receives cryptocurrency as compensation, an amount that must be accounted for accrues to the taxpayer.

Cryptocurrencies are not considered foreign currencies (although this may become debatable as countries adopt it legal tender). In principle, unrealised gains are therefore not taxable. Traders who carry cryptocurrency as trading stock are not allowed to write these items down for tax purposes when the value decreases below the cost. There are further restrictions that prevent persons who pay tax at the maximum marginal tax rate from offsetting losses from trading cryptocurrency against income that they derive from other trades that they carry on.

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