ISSUES PAPER – TAX COUNSEL OFFICE

# Income tax – tax treatment of cryptoassets received from blockchain forks and airdrops

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Issues paper #14

The use of cryptoassets and distributed ledger technology (e.g. blockchain) is becoming increasingly common. As a result, Inland Revenue is being asked to clarify the tax treatment of various types of cryptoasset transactions and arrangements. This issues paper addresses the income tax consequences of receiving cryptoassets in two situations: a blockchain hard fork and an airdrop.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

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# About this document

Inland Revenue's Tax Counsel Office (Public Advice and Guidance) develops and publishes public statements interpreting the tax laws.

Where there are significant uncertainties, it helps for us to hear from interested parties before we progress to preparing a public statement. This helps generate discussion so we can gain a better understanding of the issues, including any practical concerns. An issues paper sets out our initial views on how the relevant tax laws may apply. If it results in the issue of a draft public statement, public consultation will still occur in the usual manner.

Given that issues papers produced by the Tax Counsel Office represent our initial views only, taxation officers, taxpayers and practitioners may not rely on them. Only finalised public statements represent authoritative statements by Inland Revenue on its stance on the issues covered.

**Views presented in an issues paper do not change the Commissioner's current position or practices.**

**LET US KNOW WHAT YOU THINK**

We want to know what you think about our initial views presented in this issues paper.

Do you:

- think our initial interpretation of the relevant tax law is correct;
- have any practical concerns about the interpretation reached;
- think the result is correct from a tax policy perspective (i.e. does the tax law need changing or clarifying); or
- have ideas on how to administer the tax laws in this context?

Email your thoughts to Public.Consultation@ird.govt.nz

Deadline for comment: **1 February 2021**

Please quote reference: **IRRUIP14**

# Introduction

1. Cryptoassets 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. Inland Revenue is working on advice for applying the law to cryptoassets. As part of that work, we are also considering whether the current law taxes cryptoasset transactions appropriately.

2. General advice on the taxation of cryptoassets can be found on our website at https://www.ird.govt.nz/cryptoassets. This issues paper addresses the possible income tax consequences of receiving cryptoassets in two somewhat more novel situations: a blockchain hard fork and an airdrop.

## Blockchain hard forks

3. In simple terms, a blockchain is a type of distributed ledger technology, providing a digital record of transactions that is shared and maintained by users across the network.

4. This issues paper considers the tax consequences that arise where a person receives new cryptoassets from a blockchain hard fork.[1] A hard fork has been described as follows:[2]

> As the rules relating to the functioning of each type of virtual currency are established by the underlying protocol that is shared by all of the users of that token, most changes to how the token functions requires a change to that protocol. These might be for example changes that would improve the speed at which transactions can be processed by changing how much information can be included in each block on the chain.
>
> These changes are known as forks in the chain and require users to update the protocol software they are running. In order to implement a fork, a majority of users running the protocol must agree to the change. There are two main types of fork:
>
> - **A hard fork** (sometimes also referred to as a "chain split") changes the protocol code to create a new version of the blockchain alongside the old version, thus creating a new token which operates under the rules of the amended protocol while the original token continues to operate under the existing protocol. One

1 This issues paper does not consider other types of blockchain forks that may occur (such as a soft fork) where no new cryptoasset is created.

2 OECD (2020), *Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues* (OECD, Paris) at 1.2.2 http://www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.pdf

example of this was the July 2017 hard fork of Bitcoin that saw the creation of the Bitcoin Cash token alongside Bitcoin).

- **A soft fork** also updates the protocol, however, it is intended to be adopted by all users on the network and thus no new coin is expected to be created (e.g. the August 2017 Segwit fork to the Bitcoin protocol).

5. A person who holds the original cryptoassets at the time the hard fork occurs will have an equivalent value of new cryptoassets on the new blockchain. Whether and how a person receives the new cryptoassets may depend on the way in which the person holds the original cryptoassets:

   - A person who holds their cryptoassets in a wallet they control will often need to undertake steps in order to get possession of the new cryptoassets. These steps may include downloading a new wallet, importing private keys and syncing the new blockchain (and transaction fees may be applicable).
   - A person who holds their cryptoassets on an exchange will only receive new cryptoassets if the exchange supports the fork. In that case, holders may receive a credit to their account of the new cryptoassets. However, where an exchange does not support the fork, holders may not receive the new cryptoassets unless they take the original cryptoassets off that exchange before the snapshot date.

## Airdrops

6. Airdrops are distributions of cryptoassets for no payment. They have been described as follows:[3]

> **Airdrops:** an airdrop is the distribution of tokens without compensation (i.e. for free), generally undertaken with a view to increasing awareness of a new token, particularly amongst "influencers", and to increase liquidity in the early stages of a new token project.

7. For example, airdrops may occur to:

   - raise awareness of a new cryptoasset by distributing to holders of other cryptoassets;
   - increase the supply of a cryptoasset on the market; or
   - reward early investors or users.

[3] OECD (2020), *Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues* (OECD, Paris) at 1.2.2.

8. The ways in which people become entitled to airdrops differ. Some examples include:

   - holders of one type of cryptoasset received airdrops of a different cryptoasset as a form of marketing.[4]
   - users of a decentralised exchange received airdrops of a new cryptoasset where users had previously provided liquidity or traded on the exchange.[5]
   - people may also undertake minor tasks, such as signing up to an airdrop online, following the cryptoasset on social media or making referrals.[6]

9. The difficulty in claiming the airdrop once a person is entitled to it depends on the circumstances. In some cases, new wallets need to be downloaded in order to claim the new cryptoassets and transaction fees may be applicable.

# Issues

10. This issues paper addresses the possible income tax consequences that arise where a person receives cryptoassets from a blockchain hard fork or an airdrop. The issues addressed in this issues paper are:

    - the tax consequences of receiving cryptoassets from a blockchain hard fork or airdrop;
    - the tax consequences of disposing of cryptoassets received from a hard fork or airdrop; and
    - the cost of the cryptoassets for deductibility purposes.

## Summary of initial conclusions

11. The receipt of new cryptoassets from a hard fork or airdrop will not be income to the recipient in many cases. However, the receipt of new cryptoassets may be income of the recipient if they:

    - have a cryptoasset business (such as a dealing or mining business);

[4] See for example the Ontology airdrops to Neo holders https://www.coindesk.com/10-million-crypto-tokens-are-now-being-airdropped-to-neo-investors.

[5] This occurred where the Uniswap decentralised exchange airdropped its new governance tokens to people who had been using the exchange prior to a certain date https://www.coindesk.com/uniswap-defi-buzz-uni-token-airdrop.

[6] For example Ontology had previously distributed airdrops to people who signed up for its newsletter and to people who attended a conference.

- have a profit-making undertaking or scheme involving acquisitions of airdropped or forked cryptoassets;
- receive airdropped cryptoassets as payment for services provided; or
- receive airdropped cryptoassets on a regular basis such that the receipts have the hallmarks of income.

12. Whether amounts received from disposing of these cryptoassets are taxable depends on the person's circumstances.

13. Cryptoassets received from a hard fork or airdrop by a cryptoasset business (such as a cryptoasset dealing or mining business) will likely be trading stock of the business and subject to the trading stock rules. Disposals of trading stock are taxable as business income.

14. It is possible that s CB 3 may apply if the person has a relevant profit making undertaking or scheme. In most other cases, if a disposal is taxable, this will be under s CB 4. Where a person received new cryptoassets from a hard fork, competing arguments can be made regarding the application of s CB 4:

    - One argument is that the person's purpose for acquiring the new cryptoassets takes on the same purpose as the original cryptoassets. This is due to the relationship between the two blockchains, both carrying the same transactional history. This is similar to the tax treatment of a share subdivision and the treatment of shares under some demergers. Section CB 4 would apply to a disposal if it would apply to a disposal of the original cryptoassets.
    - An alternative argument is that where the person has to undertake steps to take possession of the new cryptoassets, the person has turned their mind to the acquisition. Generally, these steps may include downloading the new wallet, importing private keys and syncing the blockchain. A purpose on acquisition can be separately established for these cryptoassets, so s CB 4 could apply to a disposal.
    - Another alternative argument is that the person has done nothing to receive the new cryptoassets, and so the receipt is passive. A purpose on acquisition may not be able to be established, so s CB 4 would not apply to a disposal. This is similar to case law on gifts, inheritances and share rights issues.

15. We consider that the more compelling argument is the first argument set out above. That is, a person's purpose for acquiring the new cryptoassets from a fork is the same as their purpose for acquiring the original cryptoassets. This is due to the relationship between the two blockchains, sharing the same transactional history up until the

snapshot date. Also, a fork could be said to be a normal and anticipated consequence of holding cryptoassets.

16. For disposals of airdropped cryptoassets, it is likely that in many cases the person had done something to become entitled to receive or take possession of the airdropped cryptoassets (for example, the person may have signed up online to receive an airdrop). In those cases, the acquisition of the cryptoassets could not be argued to be passive as the person has turned their mind to acquiring the cryptoassets. This means that s CB 4 could apply to disposals of these cryptoassets if the person acquired them for the purpose of disposal.

17. However, where the person has not done anything to acquire airdropped cryptoassets and has not had to turn their mind to the acquisition or to taking possession of them, then it is arguable that s CB 4 may not apply to a disposal as the acquisition is merely passive.

18. As can be seen, the application of s CB 4 to disposals of cryptoassets received from a hard fork or airdrop can be subject to debate. Hence, we seek feedback on this issue.

19. No deductions are generally available for the cost of the cryptoassets received from a hard fork or an airdrop, as the person has not incurred any expenditure in acquiring them. However, transaction fees incurred may be included as part of the cost of acquiring such cryptoassets.

20. In some instances, a person may be taxed on the receipt of cryptoassets and again on disposal. In this instance, a cost should be attributed to the cryptoassets at the time of their disposal. The attributed cost of the cryptoassets should be equal to the value of the cryptoassets at the time of their receipt (in respect of which tax has already been paid).

# Receipt of cryptoassets from a hard fork

21. This section considers whether the receipt of cryptoassets from a hard fork could be taxable income under:

- s CB 1 – business income
- s CB 3 – profit-making undertaking or scheme; or
- s CA 1(2) – income under ordinary concepts.

22. The tax consequences of receiving new cryptoassets from a hard fork will depend on the recipient's individual circumstances. This issues paper concludes that generally, the

receipt is not taxable income. However, the receipt may be taxable income where a person has a:

- cryptoasset business (such as a mining or dealing business) and receives new cryptoassets as an ordinary incident of that business; or
- profit-making scheme and receives new cryptoassets as part of that scheme.

## Section CB 1 – business income

23. An amount that a person derives from a business is income of the person, unless the amount is of a capital nature (s CB 1).

24. An "amount" includes money's worth. Cryptoassets, while not "money", are money's worth, so cryptoassets received from a hard fork could be an "amount" derived from a business.

25. In *CIR v City Motor Service Ltd; CIR v Napier Motors Ltd* [1969] NZLR 1,010 (CA) Turner J said at 1,017:

> … in my opinion in the words "from the business" of the company something more is meant than merely "as a result of the fact that the company was carrying on this business". I think that from the business must mean from the current operations of the business. The distinction between capital accretions and revenue operations runs all through the law of income tax.

26. The question is whether the amount is derived from the current operations of the business or is merely connected to the fact that the business exists. This depends on the nature of the business and its relationship with the cryptoassets.

27. An amount that is not derived from the current operations of a business may still be of an income nature if it is a gain made in the ordinary course of the business. In *AA Finance Ltd v CIR* (1994) 16 NZTC 11,383 (CA), Richardson J stated at 11,391:

> A transaction may be part of the ordinary business of the taxpayer or, short of that, an ordinary incident of the business activity of the taxpayer although not its main activity. A gain made in the ordinary course of carrying on the business is thus stamped with an income character.

28. Similarly, the Court of Appeal in *Rangatira Ltd v CIR* (1995) 17 NZTC 12,182 referred to Richardson J's above statement and explained what an ordinary incident of a business activity might be. The court stated at 12,185:

> One must ask what is meant by an "ordinary incident of the business activity of the taxpayer". A manufacturing business requires to have premises, and at some time may need to move to larger or more suitable premises. The need to change is in that sense an incident of the business, since it is dictated by the needs of the business. Any profit on the sale would normally be capital, however, except to the extent of previous depreciation recovered. This is because selling premises is not **an activity which the company engages in in the hope of making a profit from the sale**. It is related to providing the capital assets needed for carrying on the company's business, but is not **a part of or an ordinary incident of the income producing process.** [Emphasis added]

29. For the receipt of cryptoassets to be derived "from" the business, they must be derived from the current operations of the business or be an ordinary incident of the income producing process. The receipt must be a gain made in the ordinary course of the business.

## Cryptoasset businesses

30. References in this issues paper to "cryptoasset businesses" are to businesses that use cryptoassets as part of their day-to-day activities, such as an exchange, a cryptoasset dealing or trading business or a mining business.

31. For cryptoasset businesses, the receipt of cryptoassets from a hard fork may be business income if the cryptoassets are an amount derived "from the business". This means that the receipt of the new cryptoassets needs to be connected to the current operations or be an ordinary incident of that business.

32. The receipt of cryptoassets from a hard fork could be argued to be an ordinary incident of a business where the scope of that business includes receiving and holding cryptoassets for disposal.

33. In a mining business, the amounts derived from the current operations of the business would generally be mining rewards and transaction fees. Mining rewards and transaction fees are received for providing the mining service (maintaining the blockchain digital ledger and verifying transactions). The receipt of cryptoassets from a hard fork could be said to be an ordinary incident of a mining business, as hard forks are part of a decentralised blockchain operating effectively, so that they could be considered to be a normal and anticipated consequence of holding such cryptoassets. Accordingly, new cryptoassets received from a hard fork may be income derived from a mining business.

34. In a dealing business, the amounts derived from the current operations of the business would be the amounts received from disposals or exchanges of cryptoassets. In addition, an ordinary incident of such a business would be the receipt of amounts from

holding cryptoassets (for example, if the business derives income from the cryptoassets prior to sale). The receipt of cryptoassets from a hard fork could be argued to be similar to this type of income derived from holding cryptoassets prior to disposal, and could be considered an ordinary incident of a business that acquires and holds cryptoassets for disposal. Accordingly, new cryptoassets received from a hard fork may be an ordinary incident of, and so income derived from, a dealing business.

35. Where the receipt of new cryptoassets from hard forks is taxable, valuation and timing issues may arise. Timing issues are addressed in more detail from [134] below and relate to when the person is considered to have acquired cryptoassets (when the right to acquire them is available, or when possession is taken). We are interested in your feedback on timing and valuation issues if receipts of cryptoassets from a hard fork are taxable.

36. New cryptoassets received from a hard fork are likely to be trading stock of the cryptoasset business under subpart EB. Trading stock is property that a person has for the purpose of selling or exchanging in the ordinary course of their business. A person who is in a business of mining or dealing in cryptoassets would generally have their cryptoassets for the purpose of selling them in the ordinary course of that business.

37. The detailed application of the trading stock rules in subpart EB is outside the scope of this issues paper. In summary, any cryptoassets that remain as stock on hand at the end of the year (i.e. because they have not been sold or traded) is closing stock and forms part of the business income for that year. Generally, this value becomes deductible as opening stock in the next income year. Whether this would result in any income in a particular year may depend on the valuation method used. A recent policy discussion document proposed that cryptoassets will be included as excepted financial arrangements, which means that (if this proposal goes ahead) cryptoassets will be valued at cost under subpart ED.

## Other businesses

38. A business that is not a cryptoasset business and is not involved in dealing or mining cryptoassets may hold cryptoassets for various reasons. For instance, it may receive cryptoassets as a payment provided as part of a barter transaction. Where such a business holds cryptoassets and has not cashed out, it may receive new cryptoassets when a hard fork occurs.

39. In these circumstances, whether the receipt of new cryptoassets from a hard fork is business income under s CB 1 will depend on the circumstances. The new cryptoassets are unlikely to be connected to the current operations or be an ordinary incident of many non-cryptoasset businesses. However, this may depend on the nature of the

business and the extent to which the operations of the business involve receiving payments in cryptoassets. It is also acknowledged that the use of cryptoassets by businesses over time may change.

40. Where a business does not hold cryptoassets as trading stock, for the purpose of selling them in the ordinary course of the business, new cryptoassets received from a fork are also not likely to be trading stock of such a business.

### Summary

41. Section CB 1 may apply to treat the receipt of new cryptoassets from a hard fork as being income of a cryptoasset business. If the receipt is taxable, issues may arise as to how to value the cryptoassets and the timing of receipt. Accordingly, we seek your feedback on this issue.

## Section CB 3 – profit-making undertaking or scheme

42. The receipt of new cryptoassets from a hard fork may be taxable where the person is carrying on an undertaking or scheme with the dominant purpose of making a profit (s CB 3).

43. An undertaking or scheme is a series of steps directed to an end result. There needs to be a plan or purpose that is coherent and has some unity of conception (*Investment & Merchant Finance v FCT* (1970) CLR 177 (HCA) at 189, *Vuleta v CIR* [1962] NZLR 325 (SC) at 329, *Duff v CIR* (1982) 5 NZTC 61,131 (CA) at 61,141, and *Case S86* (1996) 17 NZTC 7,538 (TRA) at 7,548). The undertaking or scheme must be carried out for the dominant purpose of making a profit.

44. The receipt of cryptoassets from a hard fork may be taxable if they are received as part of a profit-making undertaking or scheme. An example is where a person may have a well developed plan that involves acquiring cryptoassets that are undergoing a hard fork for the purpose of profiting from the receipt and disposal of the new cryptoassets.

## Section CA 1(2) – income under ordinary concepts

45. Another situation where receipts may be taxable is where the receipt of new cryptoassets is income under ordinary concepts. Section CA 1(2) provides that an amount is income of a person if it is their income under ordinary concepts.

46. Income is commonly described as something that "comes in" to a person (*Tennant v Smith* (1892) 3 TC 158 (HL) and *CIR v Grover* (1988) 10 NZTC 5,012 (CA)). However, not

all amounts that "come in" are income. In *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA) Richardson J described "income" as follows (at 13,355):

> Thus income is perceived as a gain derived from property which leaves the property intact - a fruit of the tree as distinct from the tree itself, a crop as distinct from the land. Again, income is a flow of money or money's worth, a series of periodic receipts arising from the ownership of property or capital, or from labour, or a combination, eg rent, interest and dividends, salary and other personal exertion receipts, annuities and business receipts. And the source of the transaction which produces the dollar may be relevant in determining assessability as well as being relevant geographically in international tax matters.

47. In *Reid v CIR* (1985) 7 NZTC 5,176 (CA) Richardson J said at 5,183:

> There may be difficulty in marginal cases in determining what are the ordinary concepts and usages of mankind in this regard and to assist in that determination there has been much discussion in the cases of criteria which bear on the characterisation of receipts as income in particular classes of case. The major determinant in many cases is the periodic nature of a payment (*FC of T v Dixon* (1952) 86 CLR 540; and *Asher v London Film Productions* [1944] 1 All ER 77). If it has that quality of regularity or recurrence then the payments become part of the receipts upon which the recipient may depend for his living expenses, just as in the case of a salary or wage earner, annuitant or welfare beneficiary. But that in itself is not enough and consideration must be given to the relationship between payer and payee and to the purpose of the payment, in order to determine the quality of the payment in the hands of the payee.

48. According to the above, the major determinant in many cases is the periodic nature of a payment. If payments have that quality of regularity or recurrence, then they become part of the receipts upon which the recipient may depend for their living expenses. Consideration must also be given to the relationship between payer and payee, and to the purpose of the payment. It is the quality of the payment in the hands of the recipient which is important.

49. It is unlikely that the receipt of new cryptoassets from a hard fork would occur often enough to be considered periodic, regular or recurrent, or part of the receipts on which the recipient may depend for living expenses. In addition, determining whether something is income under ordinary concepts requires considering the relationship between payer and payee. Where a hard fork occurs, there is arguably no relationship between the payer (the blockchain) and recipients who may do nothing other than hold the original cryptoasset at the time of the fork; nor could there be said to be a particular purpose for making a payment of the new cryptoassets to the particular recipients.

50. Some people may describe the receipt of new cryptoassets from a hard fork as a windfall gain. However, a windfall gain is something unexpected or unanticipated. New cryptoassets received from a hard fork are not unexpected, and so are not a "windfall gain". However, regardless of whether the receipt is a windfall gain or not, a receipt will only be income if it has the hallmarks of income (as described above).

51. Accordingly, the receipt of new cryptoassets from a hard fork does not appear to be income under ordinary concepts.

### Initial conclusions

52. In many cases, the receipt of new cryptoassets from a hard fork will not be income of the recipient.

53. For cryptoasset businesses such as dealing and mining businesses, the new cryptoassets may be taxable on receipt if they could be said to be received as an ordinary incident of that business. In addition, they are likely to form part of the trading stock of that business.

54. The receipt of new cryptoassets from a hard fork may also be income if they are received as part of a person's profit-making undertaking or scheme.

## Receipt of cryptoassets from an airdrop

55. This section considers whether the receipt of cryptoassets from an airdrop could be taxable income under:

- s CB 1 – business income;
- s CB 3 – profit-making undertaking or scheme; or
- s CA 1(2) – income under ordinary concepts.

56. The tax consequences of receiving airdropped cryptoassets will depend on the recipient's individual circumstances.

57. This issues paper concludes that receipts of airdropped cryptoassets are generally not likely to be a person's taxable income. However, receipts will be taxable income where they are an ordinary incident of a business, where a person earns airdropped cryptoassets from providing services, or where airdrops are received on a regular basis.

## Section CB 1 – business income

58. The previous section explained from [23] that an amount will be income of a business if it is earned in the ordinary operations of that business or is otherwise an ordinary incident of that business.

59. It will be fact specific as to whether the receipt of airdropped cryptoassets is part of the ordinary operations, or an ordinary incident of a business. It appears that the receipt of airdrops could be an ordinary incident of cryptoasset businesses, depending on how the airdrop is received. It appears that the receipt of an airdrop would not be an ordinary incident of other non-cryptoasset businesses. The receipt of airdropped cryptoassets could be taxable if the receipt could be said to be part of the way in which the business earns its income.

60. Airdropped cryptoassets may form part of the trading stock of a cryptoasset business (such as a mining or dealing business) if they are held for sale in the ordinary course of the business. Airdropped cryptoassets held by a business that is not a cryptoasset business are not likely to be trading stock of such a business. This is because the business is unlikely to have its cryptoassets for the purpose of selling or exchanging them in the ordinary course of that business.

61. Accordingly, the receipt of airdropped cryptoassets may be income under s CB 1 in some cases. However, such receipts appear unlikely to be connected to the current operations (or be an ordinary incident) of most businesses. As with the receipt of cryptoassets from hard forks, valuation and timing issues may arise if the receipt of airdropped cryptoassets is taxable.

## Section CB 3 - profit-making undertaking or scheme

62. The previous section explained from [42] what a profit making undertaking or scheme is.

63. As with receipts from hard forks, the receipt of airdropped cryptoassets could be income from a profit-making undertaking or scheme if the recipient has a well-developed plan directed at the acquisition of airdropped cryptoassets with the dominant purpose of making a profit.

## Section CA 1(2) - income under ordinary concepts

64. The previous section explained from [45] what income under ordinary concepts is.

65. In summary, whether a receipt is ordinary income depends on the nature of the receipt in the hands of the recipient. This may be based on the relationship between the payer and recipient, and whether there is any regularity to the payments.

66. Where airdrops are not regular, and where there is no relationship between the payer and recipient (e.g. the recipient has not performed services to receive the airdrop), the receipts would not generally be ordinary income of the recipient.

67. For example, some airdrops are received by people who undertake minor tasks such as subscribing for a newsletter. This type of activity would not appear to be sufficient to make the receipt of the airdropped cryptoassets their income. Other airdrops may be made to reward early investors or users of a platform. Where the users have no knowledge that an airdrop is likely (that is, they are not providing services in order to receive the airdrops) and there is no regularity to the receipts, then the receipt of airdrops would not appear to be ordinary income.

68. In cases where a person receives regular airdrops of cryptoassets or performs services to receive airdropped cryptoassets, the cryptoassets received could be income. Where airdrops are received for providing a service, this is considered a payment by way of a barter transaction. Receipts from a barter transaction would be income under ordinary concepts.

## Initial conclusions

69. Generally, receipts of airdropped cryptoassets are unlikely to be income of the recipient. Airdropped cryptoassets may be taxable on receipt where they are received by:

- some cryptoasset businesses (if received as an ordinary incident of the way in which the business earns its income);
- a person who has an undertaking or scheme to profit from the receipt of airdropped cryptoassets;
- a person who has provided services and receives airdropped cryptoassets as payment for those services; or
- a person who receives airdrops on a regular basis, such that they have the hallmarks of income.

70. As with the previous issue, if airdropped cryptoassets are taxable on receipt, valuation and timing issues may arise.

# Disposals of cryptoassets received from a hard fork

71. This section considers whether amounts received from disposing of cryptoassets that were received from a hard fork could be taxable under:

- ss CB 1 or CB 5 – business income;
- s CB 3 – profit making undertaking or scheme; or
- s CB 4 – purpose of disposal.

72. A disposal of cryptoassets includes selling them for fiat, exchanging them for other cryptoassets or using them to acquire goods. An "amount" can include an amount in money's worth so the above provisions could apply whether the person receives money, other cryptoassets, or goods (for example in a barter transaction).

73. The tax consequences of disposing of cryptoassets that were received from a hard fork will depend on the recipient's circumstances.

74. Generally, disposals of cryptoassets are taxable under s CB 4 if the person acquired the cryptoassets for the purpose of disposing of them. However, where cryptoassets were received from a hard fork, issues can arise when applying s CB 4 to their disposal.

75. This issues paper seeks feedback on the application of s CB 4.

## Sections CB 1 or CB 5 – business income

76. As discussed at [33], new cryptoassets received from a hard fork by a cryptoasset business (for example a mining or dealing business) will likely be trading stock of the business. Mining and dealing businesses generally involve the acquisition and holding of cryptoassets (through mining, buying or trading) for the ultimate disposal of them.

77. Amounts derived from the disposal of cryptoassets that were received from a hard fork are taxable income of these businesses, as the disposal is the sale of trading stock in the ordinary course of the business, or the amount may otherwise be income from the business under s CB 1.

78. Section CB 5 could alternatively apply in relation to a dealer or trader's disposal of cryptoassets. Section CB 5 includes as income amounts that a person derives from disposing of personal property if their business is to deal in property of that kind.

79. Gendall J clarified that cryptoassets are a form of property in *Ruscoe v Cryptopia Ltd (in liq)* [2020] NZHC 728. As cryptoassets are not land (real property), they are personal property.

80. Other businesses are unlikely to have taxable income under ss CB 1 or CB 5, unless disposing of cryptoassets is something that occurs in the ordinary course of those businesses.

## Section CB 3 – profit-making undertaking or scheme

81. The previous section explained from [43] what a profit making undertaking or scheme is.

82. There may be instances where a disposal of cryptoassets received from a hard fork are part of a person's profit-making undertaking or scheme. For example, this could be the case where a person has a plan that involves acquiring cryptoassets that are undergoing a fork for the purpose of profiting from those new cryptoassets. In that event, the disposals could be taxable (as well as the receipt) under s CB 3 (as all amounts derived from the profit making scheme may be taxable income).

## Section CB 4 – purpose of disposal

83. The most common provision to apply in this context is s CB 4, which provides:

> **CB 4 Personal property acquired for purpose of disposal**
>
> 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.

84. Section CB 4 applies where:

- a person derives an amount from disposing of personal property; and
- they acquired the property for the purpose of disposing of it.

### A person derives an amount from disposing of personal property

85. The decision in *Ruscoe* clarified that cryptoassets can be property. Personal property is property that is not land.

86. An "amount" can include an amount in money's worth. Section CB 4 could apply whether the person receives money, other cryptoassets or goods (i.e. in a barter transaction) in exchange for disposing of their cryptoassets.

87. A "disposal" is a broad concept. In the context of s CB 4, "disposal" means to get rid of something. In the context of cryptoassets, a disposal could be a sale, an exchange for other cryptoassets, a barter transaction to pay for goods or services, or gifting. Disposal does not include the transfer of cryptoassets between wallet addresses or accounts that belong to the same person.

## Property acquired for the purpose of disposal

88. Section CB 4 applies if the property (the cryptoasset) was acquired for the purpose of disposing of it.

89. In *CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA) Richardson J considered that for s CB 4 to apply, the purpose of disposal must be the taxpayer's dominant purpose for acquiring the property.

90. Ascertaining what a person's dominant purpose was at the time they acquired property is fact specific. Merely describing property, or the reason for which it was acquired in a particular way, will not answer the question of whether there was a dominant purpose of disposal. For example, describing cryptoassets as being acquired as a long-term investment is not enough to negate a dominant purpose of disposal. The person's underlying motive should not be confused with their purpose.

91. The main question is whether the person's objectives in acquiring the cryptoassets are to be achieved through a course of action that will involve disposal at some point. If so, then s CB 4 will apply to that disposal.

92. The Commissioner's general position is that most cryptoassets are acquired for the purpose of disposal, unless a person can show otherwise. This is particularly the case for cryptoassets that do not provide income streams or other benefits. We acknowledge that the industry is evolving and there are types of cryptoassets that provide income streams, but in many cases the person's dominant purpose for acquiring them is still for disposal (either speculative or as an investment that involves realisation). This position is set out on our website, and is consistent with the position taken on gold bullion in QB 17/08: *Are proceeds from the sale of gold bullion income?* (Question We've Been Asked, 20 September 2017).

93. However, determining a person's purpose in the context of cryptoassets received from a hard fork is not clear. This is because, to have a purpose when acquiring something, a person must have turned their mind to the acquisition.

## Property acquired passively

94. It is possible to passively acquire something (for example, by inheritance or gift). This was discussed in the Privy Council decision in *McClelland v FCT* (1970) 120 CLR 487.

95. In *McClelland*, the taxpayer and her brother inherited land under a will. The taxpayer was granted an option to buy her brother's share of the land, and she exercised that option and acquired the land. The taxpayer had to sell part of the land to pay her brother. The Privy Council held that a taxpayer who had acquired property under a will had not acquired the property for the purpose of profit making by sale. Lord Donovan accepted that the taxpayer had merely acquired the land through the bounty of the testator (as had been held initially by Windeyer J in *McClelland v FCT* (1967) 14 ATD 529)).

96. *McClelland* (PC) was followed in *FCT v NF Williams* (1972) 3 ATR 283 (HCA). The taxpayer was gifted land from her husband, and later subdivided and sold the land under her husband's direction. The High Court of Australia held that the equivalent to s CB 4 could not apply where property was obtained as an unsolicited gift. Barwick CJ commented at 285:

> The acceptance of the gift was not, in my opinion, an acquisition of the interest in the land with the purpose of profit-making. I find it difficult to conceive of the unsolicited receipt of a gift as purposive in any relevant sense on the part of the beneficiary.

97. Gibbs J stated at 290 - 291:

> It is not a natural use of language to say that a person who becomes the owner of property as the result of an unsolicited and unconditional gift has acquired that property for the purpose of profit-making by sale, even if he intends to sell the property after he gets it.... If a donee who passively receives property the subject of a gift can be said to acquire that property within section 26(a) (which is doubtful), the main or dominant purpose with which he acquires that property (as distinct from any purpose for which he may later hold it) is simply to accept the bounty of the donor.

98. Gibbs J considered that if a person could passively acquire property, the recipient of such a gift could not have a purpose of profit making by sale when the gift was acquired. Rather, the recipient's dominant purpose was simply to accept the "bounty of the donor" (at 291).

99. In *McClelland* and *Williams*, taxpayers who passively acquired property were considered to acquire it for no purpose other than accepting the bounty of the donor. If a person has no purpose, they cannot have acquired property for the purpose of disposal.

100. However, a taxpayer will not be regarded as a mere passive recipient where they provide consideration for the property received (*Tikva Investments Pty Ltd v FCT* 72 ATC 4231 (HCA)).

### Whether recipients have a purpose on acquisition

101. Three alternative views could be taken on whether a purpose can be attributed to the acquisition of new cryptoassets from a hard fork:

- **Continuation of purpose:** It could be argued that the person's purpose for acquiring the new cryptoassets takes on the same purpose as for acquiring the original cryptoassets. This is due to the relationship between the two blockchains, both carrying the same transactional history. Also, a fork is an integral part of the effective operation of a decentralised blockchain and something that could be anticipated to occur. This is similar to the tax treatment of a share subdivision. Under this view, the new cryptoassets will be acquired for the same purpose as the original cryptoassets and s CB 4 could apply to a disposal if it would apply to a disposal of the original cryptoassets.
- **Active acquisition:** It could be argued that where a person has to undertake steps to take possession of the new cryptoassets, the person has turned their mind to acquiring the new cryptoassets. This is because the recipient does not immediately have access to (or possession and control over) the new cryptoassets. The recipient needs to take various steps in order to gain access to the cryptoasset (and some people may never take steps to get them). Under this view, a purpose on acquisition can be separately established at the time steps are taken so s CB 4 could apply to a disposal.
- **Passive acquisition:** It could be argued that the person has done nothing to receive the new cryptoassets, and so the receipt is passive (as in *McClelland* and *Williams*). This is because the recipient does not need to do anything to become entitled to the new cryptoassets (other than hold the original cryptoassets at the snapshot date). Under this view, if a purpose on acquisition cannot be established then s CB 4 would not apply to a disposal.

102. This issue of whether a person can have a purpose in acquiring new cryptoassets from a hard fork is crucial for the application of s CB 4. If no purpose can be ascertained (because it is a passive acquisition), then s CB 4 cannot apply to a disposal.

103. The application of s CB 4 to comparable situations (albeit in the context of distributions from a company) may assist in determining whether a purpose can be attributed to the acquisition of new cryptoassets from a hard fork. The comparable situations are:

- share rights issues;
- share subdivisions; or
- demergers.

104. Any specific provisions in the Act that apply to the above situations (such as dividend provisions) would not apply to hard forks as there is no distribution from a company.

### *Comparisons with other situations*

#### *Share rights issues*

105. The receipt of new cryptoassets from a hard fork could be compared with share rights issues. A share rights issue is where a person holds shares in a company and, because of that shareholding, receives a right to take up more shares. The rights can often be separately traded.

106. In *Case F41* 74 ATC 227 the taxpayer acquired 2,000 shares in a company and a one-for-one rights issue was announced. The taxpayer sold these rights and sold the original shares. The Board of Review held that the profit from the sale of the rights was not subject to a former equivalent of s CB 4, at [13] and [14]:

> We accept the evidence of the taxpayer that at the time when he acquired the Murchison shares **he had no inkling of a prospective issue of rights**. He purchased the shares in October 1969, and the rights issue was announced about three months later. He did not avail himself of the right to take up further shares on a one for one basis, but instead he sold the rights. …
>
> The difficulty confronting the Commissioner lies in the fact that in this case, as in most cases, **shareholders of Murchison played a completely passive role in the acquisition of the rights. The taxpayer did not have to exercise his mind in any way to acquire rights. They simply came to him because he was a shareholder**. **Certainly he could have renounced them after he had acquired them, but that is not the point. If he had exercised his right to take up the shares offered it may have been possible to spell out some purpose of acquisition of such shares, but he did not do so.** This appears to us to be one of the unusual cases where no purpose of any kind can be spelt out, and unless an acquisition of property is as a result of an affirmative profit making purpose an assessment under sec. 26(a) of profit gained as a result of such acquisition simply cannot be sustained. [Emphasis added]

107. The Board of Review found that where a shareholder did not “exercise his mind in any way to acquire rights”, then the shareholder could not have acquired those rights for the purpose of profit making by sale.

108. The Board of Review indicated that if the rights to take up shares had been exercised, then a purpose might be able to be ascertained. However, the rights were not exercised.

109. In *FCT v Miranda* 76 ATC 4180 the taxpayer acquired shares in a company, some of which were acquired pursuant to a rights issue. The company made a further rights issue on a one for one basis, so the taxpayer held 2,100 shares and 2,100 rights. The taxpayer sold shares both before and after that rights issue. All the remaining shares and the rights were subsequently sold. The court concluded that the sale of rights was not taxable as no purpose in acquiring those rights could be ascertained.

110. In the court below, *Case G30* 75 ATC 170, the Board of Review held that all share sales were taxable, as they had been acquired for the purpose of profit making by sale. This part of the decision was not appealed. The share sales included sales of shares that had been acquired from a previous rights issue. This indicates that a purpose for acquiring shares can be ascertained when rights issues are exercised and shares acquired (that is, when steps are taken). CF Fairleigh QC (in a dissenting judgement regarding the sale of the rights) said as follows:

> 15. There was an issue of rights (2 for 5) by Barrier Exploration N.L. in April 1969 and these were taken up by the taxpayer and the new shares were sold by him in the year ended 30 June 1970. If the original shares were acquired by a speculator and he takes up the new shares upon a rights issue he is not necessarily taking up the new shares with a view to profitmaking by sale. Similarly it does not follow inevitably that if the original shares are taken up as an investment that new issues are taken up as an investment. The question is to be decided on the evidence. In the present case the taxpayer has failed to discharge the onus of proof in respect of the purpose of acquisition of the new shares.

111. This comment indicates that while the new shares do not take the same purpose as the original shares, a purpose is still ascertainable when the rights are exercised and shares obtained. Arguably, a purpose can be established at this time as the person would need to take steps to exercise the rights and pay consideration for the shares.

112. This conclusion was not appealed in *Miranda*, which concerned the sale of the rights (not the shares acquired by the exercise of the previous rights issue). Nevertheless, Rath J commented that shares that are acquired from exercising rights could be attributed a purpose, but this did not take the same purpose of the original shares. He said at 4,188:

> The question then arises whether the rights sold in this case should also be regarded as severed and distinct from the shares. Shares purchased pursuant to such rights, whether by the shareholder himself (*Bristowe v. F.C. of T.* (1962) 12 A.T.D. 520 (Kitto J.)) or by a purchaser of the rights would be different property from the original shares, and if profit

> on their sale was to be brought to tax under the first limb of sec. 26(a), **the basis would have to be the purpose of the acquisition of the shares so acquired by exercise of the rights, and not the purpose of the acquisition of the shares giving rise to the rights**. But the rights themselves, it was argued, fall within the "congeries of rights in personam" referred to by Dixon J. On the other hand, the company created the rights in such a manner and form as would enable them to be separately disposed of on the stock exchange. ...
>
> ...
>
> ...But in this case **the property that was sold, namely the rights to take up shares, was different from the shares originally acquired, and it accordingly does not follow from the fact that those shares were acquired by the taxpayer for the purpose of profit-making by sale that the rights were also so acquired.** ... [Emphasis added]

113. Rath J considered that the rights were also different property from the original shares that gave rise to the rights. Accordingly, the same purpose for acquiring the original shares could not be attributed to the rights.

114. In relation to the acquisition of property that is created from holding other property, it was noted that the new property exists independently of the original (at 4,189):

> In a case such as the present where the right and the share exist independently in the market place, I do not think that the reality of the situation is that the right is to be regarded simply as a part of the original share. The reality of the situation appears to me to be that the right is independent of the share, and that it is not an incident of the share. It has come into existence as a result of the actions of the company, and is not merely an internal or inherent development of the share itself.

115. Rath J also considered that the transfer of the rights did not amount to a "purposive acquisition" even though steps were required to direct the transfer, at 4,192:

> **In my view the mere holding or retention of shares at the time when the rights in this case accrued cannot be said to be a purposive acquisition. The following of the steps directed by the company as the mode of transfer of the rights did not amount to such a purposive acquisition.** This would be the correct conclusion even if those steps took the form of acceptance of an offer with an assignment of contractual rights to the transferee, because the taxpayer's main or dominant (probably, only) purpose would be disposition, not acquisition. However, I do not think the directed steps did take that form. So far as one can determine from the documentation available, the company required to be expressly informed if the shareholder chose any option, other than abandonment of the rights; and if his choice involved a transfer of all or some of his rights, there had to be proper notification of the transfer (presumably in accordance with the Marketable Securities Act). [Emphasis added]

116. On this basis, it could be argued that receiving new cryptoassets from a hard fork is like receiving a share rights issue. The person has not acquired them for any particular purpose as they were simply given to the person, without the person needing to turn their mind to the acquisition.

117. It appears from the above cases that a purpose can be attributed when shares are acquired through a rights issue. Presumably, steps taken to exercise those rights and acquire shares were sufficient to attribute a purpose to the acquisition of the shares. However, consideration will be paid to acquire those shares. The payment of consideration means that property is not passively acquired. In the case of taking possession of a new cryptoasset from a hard fork, no consideration is payable (although steps to take possession and often transaction fees are required).

118. *Macmine Pty Ltd v FCT* 76 ATC 4,350 also concerned the sale of shares and rights. Gibbs J said:

> It is clear that in fact and in law Macmine did not acquire any of the 42,000 shares until it exercised its rights under the option in March 1968. But although it is the purpose of the acquisition at that date, and not in 1965, that must be determined, the fact that the option had been granted in 1965 is relevant to the question what was the intention with which the shares resulting from the exercise of the option were acquired. It is, I think, a matter of crucial importance not only on this, but on other aspects of the case, that Macmine had acquired the option to take up the 75,000 shares in Minsec at a time when it had formed no intention of re-selling those shares at a profit and when it was not carrying on or carrying out any profit-making undertaking or scheme. In subsequently exercising the option to acquire shares in Minsec, Macmine was reaping the benefit of rights which it had already acquired with no purpose of the kind to which sec. 26(a) refers.

119. In *Macmine*, the court considered what the relevant purpose was when the rights were initially issued (which was passive) and that exercising the option to acquire shares was simply reaping the benefit of rights that had been acquired for no purpose.

120. The rights issues discussed in the cases above could be viewed as being similar to a holder of cryptoassets receiving new cryptoassets from a hard fork. That is, by holding the original cryptoasset, the person receives a right to receive new cryptoassets. If the property is passively acquired, the person cannot have a purpose in acquiring it. Where share rights are exercised, then a purpose can be ascertained in acquiring the shares themselves.

### *Share subdivisions*

121. Another comparable situation involves the issue of additional shares from a share subdivision (also known as a share split). This could be seen as similar to a hard fork as the new blockchain contains the same history as the original blockchain, which arguably is like a share subdivision where the holder receives additional assets in the same company. If this is the case, then the same purpose that the original cryptoassets were acquired for could apply to the new cryptoassets.

122. BR PUB 16/05 and 16/06: *Income Tax – Treatment of a disposal of subdivided shares under section CB 4* (April 2016) states the following regarding the application of s CB 4 to share subdivisions:

> 29. When a company subdivides shares, the Commissioner considers that at no point does the shareholder give up or lose their share rights as a result of the subdivision. The Commissioner considers that support for this view can be found in *Whittome* [*Whittome v Whittome (No 1)* (1994) SLT 114]. In that case, the court considered a subdivision did not affect the identity of the property held by the shareholders, nor did it affect the proportion of the ownership held by the shareholders. The court considered that the shares were not affected by the subdivision and the shares held following the subdivision were the same property as the shares held before the subdivision.
>
> 30. Given this, the Commissioner considers s CB 4 does not apply at the time a person's shares are subdivided.
>
> **Does s CB 4 apply at the time subdivided shares are disposed of?**
>
> 31. An amount derived by a person on the disposal of subdivided shares, where the original shares were acquired for the purpose of disposal, will be income of the person under s CB 4. Conversely, s CB 4 will not apply to an amount derived by a person on the disposal of subdivided shares where the original shares were not acquired for the purpose of disposal. This is because the shares held by the person after a subdivision are the same property as the shares held by the person before the subdivision.
>
> **What is the time of acquisition and cost base of subdivided shares held on revenue account?**
>
> 32. Given that subdivided shares are the same property as the original shares, the Commissioner considers that the time of acquisition of the subdivided shares is the time the original shares were acquired.
>
> 33. The cost of the original shares may be used to determine the cost base of the subdivided shares held on revenue account for s ED 1.

123. BR Pub 16/05 and 16/06 earlier stated:

> 18. … Cases on the issue of shares support the view that a subdivision of shares does not involve an issue of shares. The thrust of these cases is that an issue of shares involves something leaving the company and being provided to the shareholder: *Central Piggery Co Ltd v McNicoll* (1949) 78 CLR 594; *National Westminster Bank plc v IR Commrs* [1995] 1 AC 119 (HL). The Commissioner considers that, in the case of a subdivision of shares, nothing has left the company or been provided to the shareholder. The shareholder has the same bundle of rights before and after the subdivision. …

124. In a share subdivision, the value of the shares is affected by the split, as more shares of the same class are created and the amount initially paid for the shares is pro-rated across all shares. Also, the subdivided shares still relate to the same company and the shareholder does not have any greater entitlement than they originally held.

125. That is not necessarily the case here, as the new cryptoasset is different property, existing on a new blockchain with different protocols (although still carrying the history of the former blockchain). It will also have a different value to the original cryptoasset from which it split and the original cryptoasset's value may not have altered to a significant extent (although may be volatile immediately before and after the fork).

126. Some commentators have suggested that a hard fork is not like a share subdivision because a share subdivision does not change the recipient's proportional interest in the company – it creates no additional value. Also, the divergence of the network and the creation of two different blockchains differ from a share subdivision, which does not result in the creation of an entirely separate entity. [7]

### *Demergers*

127. A third possible comparison is a demerger (or corporate spinout) where shareholders who hold shares in one company are provided shares in the same proportion in the newly demerged company.[8]

128. Demergers involve an issue of new shares and may involve the cancellation of some original holdings. In any event, generally the value and proportion of shares that the

[7] See Danhui Xu, "*Free Money, But Not Tax-Free: A Proposal for the Tax Treatment of Cryptocurrency Hard Forks*"(2019) 87 Fordham L Rev 2,693 https://ir.lawnet.fordham.edu/flr/vol87/iss6/14/ and Nick Webb "*A Fork in the Blockchain: Income Tax and the Bitcoin/Bitcoin Cash Hard Fork*" (2018) 19 NCJL & Tech 283.

[8] In one demerger in New Zealand, the s CB 4 issue was specifically addressed by legislatively providing (in s 69XP of the Telecommunications Act 2001) that the shareholders would be treated as acquiring the new shares for the same purposes as they acquired the initial shares (and the new shares would be treated as being acquired at the same time as the initial shares). However, whether this clarified or changed the existing provision is unclear. In any event, this legislation does not apply generally to demergers (or to hard forks).

shareholder ends up owning is the same value as what the person previously held in the original company. This differs to a hard fork where no original holdings are cancelled and the holder ends up with two distinct assets, with a potential increase in value.

129. Several Inland Revenue statements have commented on whether shares acquired following a demerger are held on capital or revenue account (although without concluding on s CB 4). "Tower Limited Spin-off – Tax implications for New Zealand shareholders", *Tax Information Bulletin* Vol 17, No 3 (April 2005): 22 noted the following on whether new shares were held on capital or revenue account (at 22):

> The Spin-off involved the cancellation of a number of shares held by existing shareholders in Tower in consideration for the distribution by Tower of the shares it holds in AWM. Following the Spin-off, shareholders hold interests in both Tower and AWM.
>
> …
>
> **Were the AWM shares distributed to shareholders of Tower, as a result of the cancellation of the Tower shares, acquired on capital account by those shareholders who held their cancelled Tower shares on capital account at that time?**
>
> The Commissioner is satisfied that the AWM shares distributed to Tower shareholders were acquired on capital account by the shareholders who held their cancelled Tower shares on capital account at the time of the Spin-off. Conversely, if the Tower shares were held as revenue account property, e.g. as trading stock, the new AWM shares should be regarded as having the same status.

130. The statement did not consider the application of s CB 4 but notes that the capital or revenue treatment of the original shares follows to the new shares. A materially similar statement was also made in a further item, "AMP Group Demerger – Tax implications for New Zealand Shareholders", *Tax Information Bulletin* Vol 15, No 11 (November 2003).

131. Similarly, in "Company Restructuring: Demergers and Spin-outs" in *Tax Information Bulletin* Vol 15, No 6 (June 2003) the following was said:

> Where the shares in the "head" company are held on capital account the shares in the "spin-out" company should also be held on capital account. Thus there should be no tax implications for those shareholders who use the sale facility to sell their shares, or sell later, provided that the shares continue to be held on capital account. However, taxpayers, if uncertain, should obtain their own advice on the issue.

Sale proceeds, whether by way of the "sale facility option" or later, will be gross income if the "head" company shares which created the distribution entitlement were held on revenue account. A deduction is available for the cost of the shares.

132. The above references to new shares taking the same capital or revenue nature of the original shares could indicate that the same purpose for acquiring the initial property may be attributed to the new shares from the demerged company. However, in these situations the shareholders end up being in a similar position as they were before the demerger. In a hard fork, as noted above, the original cryptoassets held are not cancelled.

133. Some commentators have suggested that a demerger is the closest analogy to a hard fork given that a demerger produces two separate companies and two separate shareholdings, and a fork produces two separate blockchains and two separate cryptoassets. But others note that the demerged company does not replicate the original company. The new blockchain that a hard fork creates is a duplicate of the original blockchain and shares the same transactional history. These differences indicate that a demerger may not necessarily be directly comparable.[9]

***Summary - comparisons***

134. A comparison with a share rights issue would indicate that the third potential view listed in [91] above would be the correct view; that is, the acquisition could be viewed as passive. However, it could be argued that the steps to take possession are more like exercising a rights issue and acquiring the underlying share, which is active, which would indicate that the second potential view could be correct (active acquisition). A comparison with a share subdivision or demerger would indicate that the first potential view listed in [91] above would be the correct view; that is, the original purpose could be attributed to the new cryptoassets.

135. However, there are differences between things such as a share subdivision, rights issue or demerger and a hard fork, so such comparisons may not be appropriate.

136. To summarise, the above situations contain similarities to a hard fork, but the differences between a company issuing shares and a blockchain hard fork occurring mean a direct comparison is not possible. It is arguable that a hard fork takes on some

[9] See: Nick Webb "*A Fork in the Blockchain: Income Tax and the Bitcoin/Bitcoin Cash Hard Fork*" *(2018)* 19 NCJL & Tech 283; Danhui Xu, "*Free Money, But Not Tax-Free: A Proposal for the Tax Treatment of Cryptocurrency Hard Forks*" (2019) 87 Fordham L Rev 2,693; and Mattia Landoni and Gina C Pieters "Taxing Blockchain Forks" (2020) Stanford JBLP https://stanford-jblp.pubpub.org/pub/taxing-blockchain-forks.

characteristics of all three situations. Accordingly, a comparison with these situations does not definitively answer which of the three views should be preferred.

## Time of acquisition of the cryptoassets

137. A further issue that arises when considering the application of s CB 4, is that the relevant time for ascertaining a person's purpose is at the time the property is acquired.

138. This gives rise to difficulties in this context, as it is not immediately clear whether cryptoassets are acquired when the:

- right is first available, immediately following the snapshot date; or
- person has undertaken the necessary steps to take possession and control of the new cryptoasset.

139. If cryptoassets are considered to be acquired when the right is first available (immediately following the snapshot date), there can be no suggestion that taking steps to obtain possession and control of the cryptoassets would make the acquisition active. If cryptoassets are considered to be acquired when the person has possession of them, which is after steps have been taken to obtain possession, then arguably the acquisition could be considered active (and a purpose can be given).

140. Commentators have noted that, as intangible property, cryptoassets would normally be regarded as a chose in action. However, there is no obvious counterparty. In the context of a person's right to receive a new cryptoasset from a blockchain fork there appears to be no actionable right – there is no person or entity that could be sued to secure a person's right to the new cryptoassets as is usually the case with a chose in action. However, intangible property (such as cryptoassets) is typically not considered a chose in possession. Commentators note that cryptoassets could be argued to share characteristics of a chose in possession as they may be lost, and their transfer connotes a transfer of ownership. However, the cryptoassets themselves are not lost, as it is the private key that may be lost. Accordingly, cryptoassets cannot easily be categorised as either a chose in action or chose in possession.[10]

141. Our initial view is that it is arguable that control and possession of a cryptoasset (via a private key) are required for the person to be considered to have "acquired" the

[10] See Joanna Perkins *The legal aspect of virtual currencies* (2016) 10 JIBFL 569; Paul Sinclair QC and Aaron Taylor *The English law rights of investors in Initial Coin Offerings* (2018) 4 JIBFL 214; Dr Jason Grant Allen *Negotiability in digital environments* (2019) 7 JIBFL 459; and Amy Held *Private Keys v Blockchains: what is a cryptoasset in law?* (2020) 4 JIBFL 247.

relevant cryptoasset. This indicates that the time of acquisition would be when the person possesses the property (that is, after they have taken the necessary steps to acquire the cryptoassets).

142. If the time of acquisition is when the hard fork occurs and a person only has a right to the cryptoasset (but has yet to take possession of it), issues of timing and valuation would arise where receipts are taxable. The person may never take complete possession of that cryptoasset but could be taxed as if they had. In addition, it is possible that a fork may be announced and the new blockchain launched but the cryptoasset is not listed on any exchange or otherwise fails.

143. Accordingly, we consider that a person being considered to acquire a cryptoasset at the date the first right to the cryptoasset arises does not seem appropriate. The acquisition time should be taken at the time the person has undertaken steps to take possession of that cryptoasset (whether in a wallet or via an exchange) and has acquired the new cryptoassets Otherwise there is the potential for some people to be taxed on receipts of cryptoassets that they never actually acquire.

### Whether actions to take possession of the new cryptoassets are sufficient for the cryptoassets to be "actively" acquired

144. As noted earlier, when a person receives new cryptoassets following a blockchain fork, the new cryptoassets generally do not automatically appear in the person's wallet. If the person holds their cryptoassets on an exchange that does not support the fork they will need to remove those cryptoassets from that exchange before the snapshot date; otherwise they may not be entitled to the new forked cryptoassets. A person who holds their cryptoassets in a wallet they control (and not on an exchange) obtains a right to receive the new cryptoassets but does not have access or possession of the new cryptoassets until they have undertaken steps. To take possession of the new cryptoassets, the person may need to take steps such as:

- downloading the new wallet;
- importing their private key from the old address into the new wallet; and
- syncing the new blockchain.

145. Commentators note that these steps are proactive. For example, commenting from a US tax perspective, Chelsea D. Button states:[11]

[11] Chelsea D Button, "The Forking Phenomenon and the Future of Cryptocurrency in the Law" (2019) 19 UIC Rev Intell Prop L 1, https://repository.jmls.edu/ripl/vol19/iss1/1/

> However, receiving the new coin isn't automatic– holders need to perform steps to receive the split coin. Exchanges like Coinbase require a coin be on the exchange prior to the hard fork to receive the split coin after. If the coin remains in cold storage or in a wallet that does not recognize the fork, the second coin will not be realized. A holder who keeps the coin offline must take proactive steps, including downloading an application to split the coin. Owning a coin prior to a hard fork is not enough to trigger tax implications under *Glenshaw Glass*. Therefore, if a holder takes steps to retrieve the new coin, a realized gain exists and one part of the analysis has been fulfilled. If not, a holder misses the opportunity to gain the new coin. The holders of these coins should be aware of the tax implications of the newly minted coins.

146. It is arguable that the actions required for a person to take possession and control of their new cryptoassets means the person has had to turn their mind to acquire the cryptoassets.

### Summary – whether s CB 4 can apply

147. There are competing views about whether s CB 4 could apply to the disposal of a cryptoasset that was received by a person from a blockchain fork:

- It is arguable that the new cryptoasset, existing on a blockchain that has forked from the original blockchain and carries all transaction history, brings with it the original purpose of acquisition.
- It is arguable that the steps to be undertaken to take possession and control of the cryptoasset mean that the person has to turn their mind to take possession and control of the cryptoassets. In that case, a purpose could be attributed to that acquisition.
- It is also arguable that a person who receives a new cryptoasset from a hard fork acquired it passively, so no purpose can be attributed to that acquisition.

148. The above discussion attempted comparisons with various situations, but the analysis did not necessarily show that any of the above interpretations was more correct than the others. The above discussion referred to property received from a will or inheritance, share rights issues, share subdivisions and demergers. Issues arise as to when the cryptoasset is considered to be "acquired" and whether the recipient has done enough to make that acquisition an active one. The fact the new cryptoassets are derived from the original blockchain and share blockchain history up to the snapshot date could indicate that they are essentially derived from the same property and so the same purpose could be attributed to the new cryptoasset. However, the new cryptoasset is different property.

149. Before reaching any conclusions, we consider the position in other jurisdictions below.

## Treatment of hard forks in other jurisdictions

150. The above issues relating to s CB 4 do not arise directly in other jurisdictions. Other jurisdictions tend to have a capital gains tax (for instance, Australia, the United Kingdom and the United States) or have no equivalent provision to s CB 4 (for example, Singapore). How these jurisdictions treat cryptoassets received from hard forks are set out below.

151. The OECD notes the following about the tax treatment of hard forks across other jurisdictions (at 3.1.2):[12]

> Although guidance on hard forks is rare, three different treatments of the new virtual currencies for tax purposes are seen among OECD countries:
>
> 1. No taxable event on receipt, but taxed under capital gains on disposal: this is the most common approach, seen in Austria, Finland and the United Kingdom. Under this approach, the receipt of tokens following the hard fork does not give rise to a taxable event and the receipt of new tokens is not treated as taxable income for the recipient. Instead, the new tokens are taxed under capital gains rules on disposal, with differing approaches to calculating the basis. …
>
>    …
>
> 2. A taxable event occurs and income received at the time of the hard fork: this approach is seen in the United States, where a hard fork is treated as a taxable event if new virtual currencies are received, whether it is through an airdrop or some other kind of transfer. The value of the new tokens received is therefore treated as taxable income on receipt (i.e. when they are recorded on the blockchain). The Internal Revenue Service (IRS) indicate that it is necessary for the taxpayer to have dominion and control over the new tokens, i.e. that the receiver has the ability to transfer, sell, exchange or dispose of the virtual currency. No taxable income is received when a soft fork occurs (US Internal Revenue Service, 2019[72]).
>
> 3. Differential treatment of hard forks depending on whether virtual currencies are used in investment or business: this approach is seen in Australia. Virtual currencies that were held as investments do not generate income (either ordinary or capital gain income) at the time of a hard fork. The new tokens rather generate a capital gain on their disposal, with a cost base of zero. If held for more than one year, the discounted capital gains tax rates may apply. However, a hard fork in relation to virtual currencies that are held in the course of a business are treated as trading stock and must be

[12] OECD (2020), Taxing Virtual Currencies, an Overview of Tax Treatments and Emerging Tax Policy Issues (OECD, Paris) at 1.2.2 http://www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.pdf

accounted for as taxable income within the income year in which the new tokens are received (Australian Taxation Office, 2020[61]).

Hard forks give rise to a number of other considerations for tax purposes. Under any tax treatment, a question arises about whether and when the taxpayer has effective control of the new token type. Although the new tokens can be deemed to be received when they are entered on the blockchain, situations of difficulty can arise if an individual holds virtual currencies through an exchange that does not recognise the new virtual currency, rendering them unable to be received, used and sold. It is possible that an individual will be considered to have received property or income for tax purposes but be unable to dispose of the assets. The United Kingdom notes that situations like this will be addressed on a case by case basis. This situation is less problematic when the gains from new virtual currencies are taxable on disposal than when the income is taxable immediately. An alternative approach that may alleviate this question is to consider the new virtual currencies as received only when the user exercises dominion and control, for example by changing the wallet in which the tokens are stored, or by disposing of the assets.

Where new virtual currencies are considered to generate taxable income on receipt, further difficulties may arise. Firstly, the taxpayer may be deemed to have a tax liability after taking no action to generate or receive the new virtual currency types. Secondly, incurring a tax liability in this way can cause liquidity problems as it is not necessarily an anticipated event, rendering the taxpayer liable to making an unexpected tax payment without any increase in cash-flow. Finally, if the value of the new virtual currencies decreases sharply after they are issued, the capital loss may not be able to be recognised for tax purposes or deductions in respect of that loss may be restricted or delayed. Difficulties of this kind may arise with other types of assets in a tax system that treats the receipt of property as a taxable event, and therefore may be inherent in the tax rules of such a system.

## Australia

152. The Australian Tax Office (ATO) guidance states:[13]

> If you hold cryptocurrency as an investment, and receive a new cryptocurrency as a result of a chain split (such as Bitcoin Cash being received by Bitcoin holders), you do not derive ordinary income or make a capital gain at that time as a result of receiving the new cryptocurrency.

[13] https://www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-bitcoin/?anchor=Transactingwithcryptocurrency#Chainsplits

If you hold the new cryptocurrency as an investment, you will make a capital gain when you dispose of it. When working out your capital gain, the cost base of a new cryptocurrency received as a result of a chain split is zero. If you hold the new cryptocurrency as an investment for 12 months or more, you may be entitled to the CGT discount.

**Example 1**

Alex held 10 Bitcoin on 1 August 2017 as an investment, when Bitcoin Cash split from Bitcoin. Immediately after the chain split, Alex held 10 Bitcoin and 10 Bitcoin Cash. Alex does not derive ordinary income or make a capital gain as a result of the receipt.

On 25 May 2018, Alex sold the 10 Bitcoin Cash for $4,000. Because the cost base of the Bitcoin Cash was zero, Alex makes a total capital gain of $4,000 in the 2017–18 income year from the sale of the Bitcoin Cash.

…

**Cryptocurrency held in a business you carry on**

A new cryptocurrency you receive as a result of a chain split in relation to cryptocurrency held in a business you carry on will be treated as trading stock where it is held for sale or exchange in the ordinary course of the business. The new cryptocurrency must be brought to account at the end of the income year.

153. The ATO distinguishes between people who hold cryptoassets as an investment and those who hold them as part of a business. The ATO treats the receipt of cryptoassets from a hard fork as not taxable and the disposal will be a capital gain with a cost base of nil. A business will be subject to the trading stock rules.

154. The ATO also provides further advice on which cryptoassets are the continuing asset for capital gains tax purposes in relation to the Ethereum Classic/Ethereum hard fork and the Bitcoin Cash/Bitcoin Cash SV and Bitcoin Cash ABC hard fork.

## United Kingdom

155. Her Majesty's Revenue & Customs (HMRC) in the United Kingdom states:[14]

The value of the new cryptoassets is derived from the original cryptoassets already held by the individual. This means that section 43 Taxation of Capital Gains Act 1992 will apply.

[14] https://www.gov.uk/government/publications/tax-on-cryptoassets/cryptoassets-for-individuals

After the fork the new cryptoassets need to go into their own pool. Any allowable costs for pooling of the original cryptoassets are split between the pool for the:

- original cryptoassets
- new cryptoassets

If an individual holds cryptoassets through an exchange, the exchange will make a choice whether to recognise the new cryptoassets created by the fork.

New cryptoassets can only be disposed of if the exchange recognises the new cryptoassets. If the exchange does not recognise the new cryptoasset it does not change the position for the blockchain, which will show an individual as owning units of the new cryptoasset. HMRC will consider cases of difficulty as they arise.

Costs must be split on a just and reasonable basis under section 52(4) Taxation of Capital Gains Act 1992. HMRC does not prescribe any particular apportionment method. HMRC has the power to enquire into an apportionment method that it believes is not just and reasonable.

156. It appears that the receipt of new cryptoassets from a hard fork is not taxable in the UK. However, new cryptoassets received from a hard fork are pooled for capital gains tax purposes (with cryptoassets received from a fork being pooled separately to other cryptoassets). Subsequent disposals of these cryptoassets are treated as taxable under the capital gains tax regime.

## United States

157. The Internal Revenue Service (IRS) in the United States states:[15]

**Q21. One of my cryptocurrencies went through a hard fork but I did not receive any new cryptocurrency. Do I have income?**

A21. A hard fork occurs when a cryptocurrency undergoes a protocol change resulting in a permanent diversion from the legacy distributed ledger. This may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. If your cryptocurrency went through a hard fork, but you did not receive any new cryptocurrency, whether through an airdrop (a

[15] https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions

distribution of cryptocurrency to multiple taxpayers' distributed ledger addresses) or some other kind of transfer, you don't have taxable income.

**Q22. One of my cryptocurrencies went through a hard fork followed by an airdrop and I received new cryptocurrency. Do I have income?**

A22. If a hard fork is followed by an airdrop and you receive new cryptocurrency, you will have taxable income in the taxable year you receive that cryptocurrency.

**Q23. How do I calculate my income from cryptocurrency I received following a hard fork?**

A23. When you receive cryptocurrency from an airdrop following a hard fork, you will have ordinary income equal to the fair market value of the new cryptocurrency when it is received, which is when the transaction is recorded on the distributed ledger, provided you have dominion and control over the cryptocurrency so that you can transfer, sell, exchange, or otherwise dispose of the cryptocurrency.

**Q24. How do I determine my basis in cryptocurrency I received following a hard fork?**

A24. If you receive cryptocurrency from an airdrop following a hard fork, your basis in that cryptocurrency is equal to the amount you included in income on your Federal income tax return. The amount included in income is the fair market value of the cryptocurrency when you received it. You have received the cryptocurrency when you can transfer, sell, exchange, or otherwise dispose of it, which is generally the date and time the airdrop is recorded on the distributed ledger.

158. At the time a person has "dominion and control" of a new cryptoasset following a hard fork, the person is treated as deriving income under a provision (s 61 of the Internal Revenue Code) that treats all accessions in wealth over which a person has dominion as being subject to income tax. This treatment by the IRS means that holders of cryptoassets who do not undertake steps to acquire the new cryptoassets are not taxed until they take steps to acquire dominion and control over the cryptoasset.

159. Subsequent disposals of cryptoassets are taxable as a capital gain.

## Singapore

160. The Inland Revenue Authority of Singapore (IRAS) states:

This [receipt of a new cryptoasset from a hard fork] can be viewed as a windfall to the recipient as he had received the additional token without doing anything in return. As this is not an income, it is not taxable on the recipient at the point of receipt. Where the recipient is trading in payment tokens, the gains from the subsequent disposal of the tokens (including tokens received through hard fork or through airdrop) will be taxable.

161. Accordingly, in Singapore the receipt of a cryptoasset from a hard fork is not taxable. It appears that the subsequent disposal is taxable to traders only.

### Summary

162. In summary, while international practice differs, the general position appears to be that the receipt of the new cryptoassets from a hard fork is generally not income, but the amount received from disposal is generally a capital gain. This does not particularly assist when considering whether s CB 4 should apply to disposals.

## Initial conclusions

163. The tax consequences of disposing of new cryptoassets received from a hard fork depends on the recipient's individual circumstances.

164. Amounts derived from the disposal of cryptoassets received from a hard fork would be taxable income of cryptoasset businesses. The amounts would be income as the sale of trading stock in the ordinary course of that business, income from the business under s CB 1 or (for a dealer) income from dealing in personal property under s CB 5.

165. There may be instances where a disposal of cryptoassets received from a hard fork is part of a profit-making undertaking or scheme. In that event, the disposals may be taxable under s CB 3.

166. All other disposals could be subject to s CB 4. Issues arise when applying s CB 4 to a disposal of cryptoassets that were received from a hard fork. The issues identified above include:

- Does the purpose for acquiring the new cryptoassets from a hard fork take the same purpose as the original cryptoassets?
- Is the acquisition of cryptoassets from a hard fork passive, or do the steps taken to get possession involve a person turning their mind to acquiring the cryptoassets?
- Could the acquisition be compared with acquiring shares or rights under a share rights issue, share subdivision or demerger?
- When are the new cryptoassets acquired?

167. On balance, we consider that the better view is the first view set out above, that is that the new cryptoassets take the original purpose of acquisition. However, we

acknowledge that these issues are subject to debate. This issues paper seeks your feedback on the issues raised in relation to the application of s CB 4 in particular.

# Disposals of airdropped cryptoassets

168. The tax consequences of disposing of airdropped cryptoassets will depend on the recipient's individual circumstances. As previously stated, a disposal includes selling cryptoassets for fiat, exchanging them for other cryptoassets or using them to acquire goods or services.

## Sections CB 1 or CB 5 – business income

169. As with the above analysis on hard forks, amounts received from the disposal of airdropped cryptoassets would be taxable income of cryptoasset businesses (such as mining and dealing businesses), as the disposal would likely be the sale of their trading stock in the ordinary course of that business, or otherwise income from a business under s CB 1.

170. Alternatively, a cryptoasset dealer could be taxable under s CB 5, which includes as income amounts that a person derives from disposing of personal property if their business is to deal in property of that kind.

171. Other businesses are unlikely to be taxable under these provisions unless disposing of cryptoassets is something that occurs in the ordinary course of the business.

## Section CB 3 – profit making undertaking or scheme

172. As with the above analysis on hard forks, there may be instances where a disposal of an airdropped cryptoasset is part of a profit-making undertaking or scheme (as discussed in relation to receipt). This will be fact specific.

## Section CB 4 – purpose of disposal

173. For the purposes of s CB 4, the issues identified with hard forks do not generally arise with many airdrops. This is because, in many cases, the recipient is required to perform an action to receive the airdrop. This action may be minor, but the person has turned their mind to receive those cryptoassets, and so the acquisition is not considered passive (and a purpose on acquisition can be formed).

174. However, where a person receives airdrops without doing anything in order to receive it, similar issues as raised in relation to hard forks would appear to apply. That is, it could be argued that a purpose on acquisition may not be able to be attributed to the person if they have not turned their mind to the acquisition of the cryptoassets. Issues arise with whether taking steps to acquire possession of the cryptoassets such as downloading a new wallet and importing private keys is sufficient to be an active acquisition.

175. An example is where people used a platform and received airdrops some time afterwards (without their knowledge that an airdrop was to occur). The entitlement to the airdrop would appear to be passive in this event (although if the person has to undertake certain steps to acquire the airdropped cryptoassets this may mean the acquisition may not be passive). This could include downloading a new wallet, transferring cryptoassets between wallets and paying transaction fees. As with the position on hard forks, the application of s CB 4 is subject to debate and we invite feedback on these issues.

176. Accordingly, s CB 4 could apply to the disposal of airdropped cryptoassets. This will depend on the person's purpose for acquiring those cryptoassets. The Commissioner's view is that most cryptoassets are likely to have been acquired for the dominant purpose of disposal. However, as with hard forks, if acquisition is passive, there may be issues with applying s CB 4 to a subsequent disposal.

## Treatment of airdrops in other jurisdictions

177. For completeness, we also set out how other jurisdictions treat the receipt and disposal of airdropped cryptoassets.

### Australia

178. The ATO's guidance states:[16]

> Some projects 'airdrop' new tokens to existing token holders as a way of increasing the supply of tokens (for example, Pundi X and Tron). The money value of an established token received through an airdrop is ordinary income of the recipient at the time it is derived.

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[16] https://www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-bitcoin/?anchor=Transactingwithcryptocurrency#Stakingrewardsandairdrops

…

**Example 2**

Merindah has held TRX tokens since December 2018, entitling her to receive monthly BTT airdrops from February 2019.

The money value of the BTT tokens Merindah receives as a result of holding her TRX tokens is assessable income of Merindah at the time the tokens are derived.

The cost base of Merindah's airdropped BTT tokens will be their market value at the time they were derived.

179. The ATO guidance focusses on regular payments of airdropped cryptoassets being income. The regularity of receipts in the above example would also mean the receipt of such airdrops would likely be income under ordinary concepts in New Zealand.

## United Kingdom

180. HMRC's guidance states:[17]

> Income Tax will not always apply to airdropped cryptoassets received in a personal capacity. Income tax may not apply if they're received:
>
> - without doing anything in return (for example, not related to any service or other conditions)
> - not as part of a trade or business involving cryptoassets or mining
>
> Airdrops that are provided in return for, or in expectation of, a service are subject to Income Tax either as:
>
> - miscellaneous income
> - receipts of an existing trade
>
> The disposal of a cryptoasset received through an airdrop may result in a chargeable gain for Capital Gains Tax, even if it's not chargeable to Income Tax when it's received. Where changes in value get brought into account as part of a computation of trade profits Income Tax will take priority over Capital Gains Tax.

[17] https://www.gov.uk/government/publications/tax-on-cryptoassets/cryptoassets-for-individuals

181. HMRC considers that the receipt of an airdrop is income when received as part of a cryptoasset business or in return for a service. Where the person does not do anything to receive an airdrop, the receipt is generally not income. However, the disposal may be taxable as a capital gain or as part of trade profits.

### United States

182. The IRS guidance appears to only refer to the receipt of a new cryptoasset from a hard fork as being an airdrop, which is set out earlier.[18]

### Singapore

183. The IRAS states:[19]

> Provided that the payment token is not received in return for any goods or services performed, it would not be regarded as income of the recipient, and hence is not taxable. On the other hand, if the airdrop was given in return for, or in expectation of a service, it could be viewed as income subject to tax.

184. IRAS consider that the receipt of an airdrop is not income when it is not received for goods or services performed. The receipt could be income if the airdrop was given in return for a service.

## Initial conclusions

185. The tax consequences of disposing of new cryptoassets received from an airdrop depend on the recipient's individual circumstances.

186. Generally, the disposal of an airdropped cryptoasset by a cryptoasset business will be the disposal of trading stock in the ordinary course of that business, or will be income derived from the business under s CB 1 (or under s CB 5 for dealers). It is also possible that disposals of airdropped cryptoassets could be part of a profit-making undertaking or scheme.

187. In most cases, the relevant provision for taxing disposals will be s CB 4. Where a person has not done anything in order to receive an airdrop, similar issues arise as set

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[18] https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions

[19] https://www.iras.gov.sg/.../etaxguide_CIT_Income%20Tax%20Treatment%20of%20Digital%20Tokens.pdf

out for hard forks earlier. That is, if the person has acquired the airdropped cryptoassets passively, then it is arguable that no purpose on acquisition can be established. This may depend on whether taking steps to take possession of an airdropped cryptoasset is sufficient for an acquisition to be considered active. Where the person has performed an action of some sort in order to receive the airdrop, then a purpose on acquisition can be formed.

# Cost of cryptoassets received from a hard fork or airdrop

## Acquisition cost

188. Where the receipt of cryptoassets from a hard fork or airdrop is taxable, then deductions for expenditure may be available. Relevantly, under s DA 1 any expenditure incurred in deriving that taxable income may be deductible at the time the expenditure is incurred, provided that none of the general limitations in s DA 2 apply. However, generally, no expenditure is incurred when a person receives cryptoassets from a hard fork or airdrop, so no deduction will be available.

189. Where the disposal of cryptoassets received from a hard fork or airdrop is taxable, then deductions for the cost of the cryptoassets may be available. Relevantly, under s DB 23 a deduction is allowed for expenditure incurred as the cost of revenue account property. Cryptoassets will be revenue account property if their disposal is taxable. For revenue account property that is not trading stock, the deduction is deferred until the time of disposal under s EA 2.

190. Section DB 23 refers to expenditure incurred as the cost of the revenue account property. "Cost" is not defined in s YA 1 for the purposes of s DB 23. Various cases have considered the meaning of "cost".

191. In *Kettle River Sawmills Ltd v MNR* (1993) 64 NR 241 at 249 the Canadian Federal Court of Appeal said:

> Cost means the money or money's worth which is given up by somebody to get something. It is generally viewed as an objectively determinable historical fact, the answer to the question 'how much was paid?'

192. The *Kettle River Sawmills* definition was adopted by Panckhurst J in *Wilke v CIR* (1998) 18 NZTC 13,923 (HC). In *Case S66* (1996) 17 NZTC 7,412 (TRA) Judge Barber agreed that "cost" meant the price paid for a thing.

193. The meaning of "cost" was considered in the context where no money was paid in *Tasman Forestry Ltd v CIR* (1999) 19 NZTC 15,147 (CA). In that case, Tasman acquired the shares of 20 forestry companies at fair market value. Each company was wound up and the forestry assets of the company were distributed in specie to Tasman. The issue was determining the "cost" of the forestry assets Tasman acquired (as Tasman was allowed a deduction for this cost against profits or gains derived from the sale of timber).

194. The difficulty in determining the "cost" in *Tasman Forestry* arose from the fact that the forest assets were not transferred in the course of a direct sale transaction.

195. The court stated that:

- "cost" has a wider meaning than payment on purchase;
- the fact that determination of cost may require a valuation exercise does not mean there is no cost; and
- the taxpayer's submission that cost is to be equated with economic sacrifice was "perhaps too wide in an absolute sense".

196. The court stated at [37] that the correct approach was to view the transactions in their commercial reality:

> We consider the correct course is not to dissect the transactions by which the forests were acquired, but to view them in their commercial reality. As the Judge found, the shares were purchased as the means for, and with the intention of, acquiring the forests. For practical purposes the cost to Tasman in acquiring the forests was the amount paid for the company shares which gave access to the forest assets. The appropriate proportion of that cost is to be treated as the cost of the timber.

197. The court stated that for practical purposes the cost to Tasman in acquiring the forests was the amount paid for the company shares.

198. Accordingly, "cost" is that which must be given to acquire something, or the price paid for a thing - the money or money's worth given up by someone to get something, but can be considered in its commercial reality.

199. Arguably, nothing is given up to acquire cryptoassets from a hard fork or an airdrop, as the person does not pay anything or give anything up to receive them. Accordingly, no cost is attributed to the acquisition of those cryptoassets for the purposes of s DB 23. However, if transaction fees are incurred in relation to acquiring the cryptoassets, those fees can be included as a part of the cost incurred.

200. Accordingly, for the purposes of ss DB 23 and DA 1, the expenditure incurred on the cost of acquiring any cryptoassets from a fork or airdrop is nil (other than in relation to any transaction fees).

201. One issue that arises is whether the cost of the original cryptoassets would be pro-rated between the original cryptoassets and the new cryptoassets to provide a cost base. The United Kingdom appears to follow this approach under its capital gains tax regime. However, there appears to be no basis for this type of apportionment between different assets or items of property in New Zealand.

202. Also, the acquisition price of the original cryptoassets generally does not relate to the new cryptoassets. The new cryptoassets would be provided to all holders in relation to their current holdings, and not in relation to how much the holders paid for their current holdings. When a fork is imminent, the price of the original cryptoasset may be volatile due to market uncertainty, and there appears to be no way to reasonably determine whether any part of that could necessarily be apportioned to the fork (and new cryptoassets). Accordingly, we consider that an apportionment approach is not appropriate.

### The position when a person is taxed on receipt and again on disposal

203. A further issue that arises concerns an aspect of double taxation of the original value of a cryptoasset if a person is taxed on receipt and again on disposal. While this may not occur often, there may be occasions where a cryptoasset is taxed on receipt and again on disposal (for example, cryptoasset businesses and people with some types of profit-making schemes may possibly fall into this category).

204. If a person is taxed on both receipt and disposal of their cryptoassets, then a deduction should arguably be available at the time of disposal. This amount should relate to the overall cost of acquiring that cryptoasset at the time of disposal (taking into account the commercial reality). Allowing a deduction for this amount as being the cost of the revenue account property ensures that the person is taxed once on receipt (as to the full value) and on disposal is only taxed on the gain made since acquisition. This avoids the initial value on receipt being taxed twice. This position is considered to be consistent with comments made by the courts in *Sharkey v Wernher [1956] AC 58; Halliwell* v CIR (1991) 13 NZTC 8,197; and *Rangatira Ltd v CIR* (1996) 17 NZTC 12,727.

205. The same position would also be reached in relation to cryptoassets held as trading stock of a cryptoasset business. The cost of acquiring the trading stock under s DB 23 would usually be nil because the person has not incurred any expenditure in relation to obtaining those cryptoassets. However, as with the above, where the person has been taxed on receipt, an attributed cost should be available under s DB 23, equivalent to

the value on receipt, to ensure that the value of that cryptoasset is not taxed twice when it is disposed of. Under the trading stock rules, timing and valuation rules still apply.

**Summary**

206. Generally, no deduction is available for the cost of cryptoassets acquired from an airdrop or a hard fork. This is because the recipient has not incurred any expenditure in acquiring that property (other than potentially transaction fees which may be taken into account).

207. In some instances, a person may be taxed on receipt of a cryptoasset and again on the disposal of the cryptoasset. If no deductions were available, the person would be taxed twice on the value of that cryptoasset at the time it was received and again when it is disposed of. However, in this instance, at the time of disposal the cost of the cryptoasset should be treated as being equal to the value of the cryptoasset when it was received (in respect of which tax has already been paid).

## Initial conclusions

208. We consider that where cryptoassets received from a hard fork or an airdrop are taxable on receipt, no deduction is allowed under s DA 1 as no expenditure is generally incurred. We also consider that no deduction is generally allowed on a disposal under s DB 23, as there was no cost of that property. This is because the person has not paid or expended anything to acquire those cryptoassets (other than any transaction fees where applicable).

209. We consider that, where a person is taxed twice (on receipt and again on disposal), a cost should, at the time of disposal, be attributed to the cryptoasset to avoid double taxation on the original value received.

# Closing comments

210. This issues paper represents the Tax Counsel Office's initial views on the tax treatment of cryptoassets received from blockchain hard forks and airdrops.

211. The purpose of this issues paper is to stimulate discussion and invite feedback from interested parties. The issues are novel and complex and the cryptoasset industry is constantly evolving.

212. As mentioned at the outset of this paper, taxation officers, taxpayers and practitioners cannot rely on issues papers. Only finalised items represent authoritative statements of the Commissioner's stance on the particular issues covered.

213. We particularly invite your feedback on whether you:

- think our initial interpretation of the relevant tax law is correct;
- have any practical concerns about the interpretations reached; and
- think the result is correct from a tax policy perspective (i.e. does the tax law need changing or clarifying)?

Email your feedback, quoting reference IRRUIP14 to Public.Consultation@ird.govt.nz by Date 2020.

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# Appendix – Legislation

214. The issues paper refers to the following provisions in the Income Tax Act 2007:

**CA 1 Amounts that are income**

*Amounts specifically identified*

(1) An amount is income of a person if it is their income under a provision in this Part.

*Ordinary meaning*

(2) An amount is also income of a person if it is their income under ordinary concepts.

**CB 1 Amounts derived from business**

*Income*

(1) An amount that a person derives from a business is income of the person.

*Exclusion*

(2) Subsection (1) does not apply to an amount that is of a capital nature.

**CB 3 Profit-making undertaking or scheme**

An amount that a person derives from carrying on or carrying out an undertaking or scheme entered into or devised for the purpose of making a profit is income of the person.

**CB 4 Personal property acquired for purpose of disposal**

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.

**CB 5 Business of dealing in personal property**

An amount that a person derives from disposing of personal property is income of the person if their business is to deal in property of that kind.

**DA 1 General permission**

*Nexus with income*

(1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—

(a) incurred by them in deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income; or

(b) incurred by them in the course of carrying on a business for the purpose of deriving—

(i) their assessable income; or

(ii) their excluded income; or

(iii) a combination of their assessable income and excluded income.

*General permission*

(2) Subsection (1) is called the general permission.

…

**DB 23 Cost of revenue account property**

*Deduction*

(1) A person is allowed a deduction for expenditure that they incur as the cost of revenue account property.

…

*Link with subpart DA*

(3) Subsection (1) overrides the capital limitation but the general permission must still be satisfied. Subsection (2) overrides the general permission. The other general limitations still apply.

**EA 2 Other revenue account property**

*When this section applies*

(1) This section applies to revenue account property that is not—

(a) trading stock valued under subpart EB (Valuation of trading stock (including dealer's livestock)):

(b) livestock valued under subpart EC (Valuation of livestock):

(c) an excepted financial arrangement valued under subpart ED (Valuation of excepted financial arrangements):

(d) a film or a film right to which sections EJ 4 to EJ 8 (which relate to films) apply:

(e) property under a specified lease or a lease to which section EJ 10 (Personal property lease payments) applies:

(f) property that arises as a result of petroleum development expenditure or petroleum exploration expenditure to which sections DT 1, DT 5, and EJ 12 to EJ 20 (which relate to petroleum mining) apply:

(fb) property that arises as a result of mining development expenditure or mining exploration expenditure to which sections EJ 20B to EJ 20E (which relate to mineral mining) apply:

(fc) property fitted to an aircraft engine as part of an aircraft engine overhaul to which section DW 5 (Aircraft operators: aircraft engines and aircraft engine overhauls) applies:

(g) a financial arrangement valued under subpart EW (Financial arrangements rules).

*Timing of deduction*

(2) A deduction for the cost of revenue account property of a person is allocated to the earlier of—

(a) the income year in which the person disposes of the property; and

(b) the income year in which the property ceases to exist.

**EB 1 When this subpart applies**

This subpart applies when a person who owns or carries on a business has trading stock for the purpose of selling or exchanging it in the ordinary course of the business.

**EB 2 Meaning of trading stock**

*Meaning*

(1) Trading stock means property that a person who owns or carries on a business has for the purpose of selling or exchanging in the ordinary course of the business.

*Inclusions*

(2) Trading stock includes—

(a) work of the following kinds that would be trading stock under subsection (1) if it were completed:

(i) partly completed work:

(ii) work in progress:

(b) materials that the person has for use in producing trading stock:

(c) property on which the person has incurred expenditure, when the property would, if they had it, be trading stock under subsection (1) or paragraph (a) or (b):

(d) property leased under a hire purchase agreement when the property—

(i) is treated as having been acquired by the lessor under section FA 15 (Treatment when agreement ends: seller acquiring property); and

(ii) is an asset of a business that the lessor carries on.

*Exclusions*

(3) Trading stock does not include—

(a) land:

(b) depreciable property:

(c) a financial arrangement to which the financial arrangements rules or the old financial arrangements rules apply:

(d) an excepted financial arrangement that a life insurer has:

(e) an excepted financial arrangement held by a person if section CX 55 (Proceeds from disposal of investment shares) applies to the income of the person from a disposal of the excepted financial arrangement:

(f) livestock not used in a dealing business:

(g) consumable aids to be used in the process of producing trading stock:

(h) a spare part not held for sale or exchange:

(i) an emissions unit:

(j) a non-Kyoto greenhouse gas unit.