Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Transitional residency and cryptoassets

Decision date | Rā o te Whakatau: 27 August 2024

Issue date | Rā Tuku: 3 December 2024

TDS 24/22

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Subjects | Kaupapa

Cryptoassets, transitional residency, source of income.

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. The Taxpayer was a natural person who had previously been a New Zealand resident, (but not a transitional resident), had moved offshore for more than 10 years and was now looking to return to New Zealand.
2. The Taxpayer intended to purchase a property in New Zealand to be their permanent place of abode (PPOA) or would otherwise remain in New Zealand for a period greater than 183 days while looking for such a property.
3. The Taxpayer held cryptoassets in overseas centralised exchanges as well as decentralised exchanges (DEX). These assets were not intended to be a trading or business activity, being held long term, but may have been sold from time to time to rationalise the overall portfolio.
4. The Taxpayer had sought a ruling that they would be a transitional resident and that the sales of cryptoassets would be exempt income under these rules.
5. The Tax Counsel Office (TCO) were not asked to rule on whether the sales of the cryptoassets were income of the Taxpayer.

Issues | Take

6. The main issues considered in this ruling were:
    - Whether the Taxpayer would qualify to be a transitional resident.
    - Whether the amounts derived by the Taxpayer from the sale of cryptoassets through overseas centralised exchanges or DEXs have a source in New Zealand.

Decisions | Whakatau

7. TCO concluded that:

   - The Taxpayer would qualify to be a transitional resident (on the presumption certain conditions were met);
   - The amounts derived from the sale of cryptoassets did not have a source in New Zealand.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: hether the Taxpayer would qualify to be a transitional resident

8. Section HR 8 provides the rules for a person to be become a transitional resident. If a person is a transitional resident some of their income that would ordinarily be taxable in New Zealand will be exempt income so will not be taxable. To be a transitional resident the requirements of ss HR 8(2)(a)-(e) must be met including:

   - The person is a natural person;
   - The person is resident in New Zealand either through a PPOA (s YD 1(2)) or the 183 day rule (s YD 1(3));
   - The person did not, in the previous 10 years, meet the requirements of the preceding bullet point and was not a resident in New Zealand;
   - The person had not been a transitional resident preceding the 10 year non-resident period; and
   - The transitional period (48 months) has not ended.

9. TCO found that this was largely a factual enquiry and that the Taxpayer would meet all the elements of s HR 2.

10. To ensure that the requirements of s HR 2 would be met TCO included the requirements that the Taxpayer had not been a New Zealand resident at any time during the 10 year period they were offshore and had never been a transitional resident preceding that.

Issue 2 | Take tuarua: Application of the source rules

11. As TCO concluded that the requirements of s HR (8) would be met s CW 27 would then apply to treat foreign-sourced amounts as exempt income (excluding income from employment and supply of services), such amounts being amounts that are not treated as having a New Zealand source (s YA 1).

12. The issue was whether any income derived from the sale of cryptoassets held on overseas centralised exchanges or DEXs could be said to be sourced in New Zealand. TCO said that the potentially relevant source rules were those that dealt with: businesses carried on in New Zealand (s YD 4(2)), contracts made or performed in New Zealand (s YD 4(3)), property situated in New Zealand (s YD 4(12)), income from a trust fund that has a source in New Zealand (s YD 4(13)), or any other source in New Zealand (s YD 4(18)). TCO noted that key to this is understanding the ways in which cryptoassets can be acquired, held and traded.

13. The Taxpayer held their cryptoassets in two types of cryptoasset exchange namely overseas centralised exchanges and DEXs. To gain access and trade the cryptoasset both public and private keys are required. Centralised exchanges typically hold both keys, while with DEXs the owner holds the private key and the public key sits on various worldwide public nodes. The private key is held in a 'wallet' and is used to sign a transaction.

14. Centralised exchanges match buyers and sellers. When a seller places an order to sell cryptoassets there is no requirement that the purchaser communicates acceptance before paying for the cryptoassets. Instead, both parties submit their orders on the understanding the exchange would find a suitable counterparty and automatically complete the transaction between them, indicating a contract would be unilateral as acceptance was not required to be communicated.

15. For the DEX, where the Taxpayer held cryptoassets, the transactions occurred under a smart contract and via a liquidity pool[1] which did not require acceptance to be communicated. It is difficult to identify the counterparty in these circumstances.

Income from a business (s YD 4(2))

16. For s YD 4(2) to apply sales of cryptoassets must arise from and be wholly or partly carried out by a business carried on in New Zealand by the Taxpayer.

[1] A liquidity pool is very briefly a fund of cryptoassets deposited by users who receive a share of trading fees generated by the pool as consideration for making their deposits.

17. TCO noted that it is necessary to consider the nature of the activities carried on and the intention of a taxpayer. [2]

18. On the information provided TCO thought it likely that the Taxpayer had not acquired the cryptoassets for business purposes. The volume of trades over the intervening years supported this view.

19. To ensure that this view was reflected in the ruling TCO included a requirement that the Taxpayer would not conduct a business or trading activity that involved the sale of cryptoassets.

Contracts made or performed in New Zealand (s YD 4(3))

20. Section YD 4(3) provides that income derived by a person from a contract made in New Zealand or overseas has a New Zealand source to the extent it is performed here. A contract is made when and where acceptance of an offer has effect.[3] In the case of a unilateral contract the act of acceptance is the performance by the offeree of the act or acts required by the offeror.

21. TCO noted that sections 216 and 217 of the *Contracts and Commercial Law Act 2017* governs receipt of electronic communications and electronic acceptance and formation of a contract. Receipt occurs at the addressee's place of business and formation occurs at the time the communication enters the designated information system for electronic communications.

22. For a contract to be treated as sourced in New Zealand it also needs to be performed here. TCO noted that the performance of a contract implied physical acts that are performed here. [4]

23. In respect of the overseas centralised exchanges and DEXs TCO concluded that s YD 4(3) would not apply. For each type of exchange, the actions that constitute acceptance and performance will be carried out over the exchanges. As the overseas centralised exchanges are located outside New Zealand, the contracts will be made and performed outside New Zealand. As the DEX is decentralised, it is not practically possible to attribute a location to it and, as such, it will not be possible to conclude that the contract is made or performed in New Zealand.

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[2] *Grieve v CIR* (1984) 6 NZTC 61, 682.

[3] *Thomson v Burrows* [1916] NZLR 223; *Ayson v C of T* [1938] NZLR 282; *J A Redpath & Sons Ltd v Melville Ford & Co Ltd* [1950] NZLR 362).

[4] Interpretation Statement: IS 19/01: *Income tax - application of schedular payment rules to non-resident directors' fees.*

Disposal of property situated In New Zealand (s YD 4(12))

24. TCO noted that s YD 4(12) would be the most likely source rule to apply. This section requires there to be income from the disposal of property that is situated in New Zealand[5]. TCO noted that cryptoassets were considered property[6]. The question then is whether these were located in New Zealand.

25. TCO considered whether any of the following factors could be used to attribute a location to the Applicant's cryptoassets:

- the location of an underlying asset such as gold. This was not applicable to the cryptoassets held by the Applicant.
- the location of any centralised organisation that controls a cryptoasset. This was not applicable to the cryptoassets held by the Applicant.
- the location of the exchange on which a trade takes place. This was not considered appropriate as in many cases exchanges hold cryptoassets on trust and in other cases they act as a broker and it is virtually impossible to determine a location for a decentralised exchange.
- where a cryptoasset is accessed and controlled (ie, where the wallet or private key is). This was not considered appropriate as wallets and private keys do not represent the cryptoasset itself but merely control access to it. Also, it is possible for private keys to be in more than one location at the same time.
- where the nodes that make up a blockchain are located. This was not considered appropriate as the nodes in a decentralised blockchain are located all over the world.
- where a cryptoasset was mined or a transaction validated. This was not considered appropriate as it is difficult if not impossible to determine these locations.
- where the counterparties to a transaction are located. This was not considered appropriate because in many cases a person will not know who the counterparty to a transaction is.

26. TCO noted that while there were some overseas authorities that may provide some basis for attributing the location of cryptoassets (such as residency of a person)[7] these

[5] *CIR v NV Philips' Gloeilampenfabrieken* (CA)

[6] *Ruscoe v Cryptopia Ltd* [2020] NZHC 728

[7] *Fetch.ai Ltd v Persons unknown* [2021] EWHC 2254

were largely focussed on the jurisdiction of courts in a conflict of laws situation and not the source of income.

27. While determining an appropriate law to govern transactions and access to courts will be necessary where there are disputes, TCO noted this does not necessarily translate to always requiring a source or being taxed in a particular jurisdiction. That is, if a cryptoasset is not sourced or located in New Zealand, it is foreign sourced income in this particular context and it does not need to be determined exactly where that income is sourced.

28. TCO considered that intangible assets that operate over DEXs, and are not registered in any country, do not have a location. This position can be compared to other forms of intangible property where it has been held that they are located where they are registered (for example shares, debt, trademarks and intellectual property).[8]

29. TCO noted that, while not without doubt, the cryptoassets would not be situated in New Zealand merely because the Taxpayer would be resident here, therefore s YD 4(12) would not apply.

Beneficiary income (s YD 4(13))

30. Under s YD 4(13), income derived by a beneficiary from a trust will have a source in New Zealand to the extent to which the trust's income has a source in New Zealand. Beneficiary income is income that is derived by a trustee and paid to or vests absolutely in a beneficiary.

31. For s YD 4(13) to apply to the Taxpayer the amounts from the sale of their cryptoassets, must be derived by a trustee before being paid or distributed to the Taxpayer. Section YB 21 (Transparency of nominee) provides that if a nominee holds or does something for another person that other person does that thing and the nominee is ignored.

32. TCO noted the overseas centralised exchanges may hold cryptoassets as bare trustees for the Taxpayer and in such cases will be treated as nominees.[9] This means the exchange is limited to acting on the Taxpayer's instruction.

33. As the nominee is ignored, TCO said that s YD 4(13) does not apply to the Taxpayer as the income is not derived by the trustee. If the overseas centralised exchanges act as

[8] *Brassard v Smith* (1925) AC 371, *R v Lovitt (Irvine)* [1912] AC 212, and *Lecouturier v Rey* [1910] AC 262.

[9] *Ruscoe v Cryptopia Ltd (in liq)* [2020] NZHC 728.

bare trustee for the Taxpayer and contract as principal to sell the cryptoassets the exchange will be ignored and the Taxpayer is treated as deriving the sale proceeds.

Income from any other source in New Zealand (s YD 4(18))

34. Section YD 4(18) is a catch-all and provides for income being derived in New Zealand where the source of that income is in New Zealand.

35. TCO said that the following principles were important when considering this provision:[10]

- The "source" of income is what a practical person would regard as the real source as a practical, hard matter of fact.
- "Source" does not mean from where the money came, but the operating cause of the payment being made. It refers to the source or origin rather than the fund or place from which the income was taken.
- The "source" of income is connected to the location where the services are rendered, the location of the property in respect of which the income is derived or the location of transaction which provides the income.

36. Additionally, TCO said that case law has expanded on these principles, including:

- Identifying what the taxpayer has done to earn the profit. Profit was earned from the place in which the contracts of purchase were made.[11]
- Profits do not simply accrue to where the taxpayer exercised their skill or judgement. What matters most is the place at which the result of the transaction occurs.[12]

37. TCO concluded that s YD 4(18) did not apply. While not free from doubt, there is no causative link between where cryptoassets are bought and sold (on overseas centralised exchanges and DEX) and that income and source being in New Zealand.

[10] *CIR v NV Philips' Gloeilampenfabrieken* (CA).

[11] *CIR (Hong Kong) v Hang Seng Bank Limited* [1991] 1 AC 306 (PC)

[12] *Commr of IT (Bombay and Aden) v Chunilal B Mehta*