

A cryptocurrency is a digital asset designed to work as a medium of exchange that uses cryptography to secure its transactions, to control the creation of additional units, and to verify the transfer of assets.

Cryptocurrencies are increasingly becoming more popular today. This is a kind of currency that does not have any physical substance and only exists in the digital world. Investors see it as a great investment opportunity since the value of a digital coin like 'bitcoin' fluctuates over time. For instance, the value of bitcoin rose from USD32 in 2011 to USD19000 in 2017. However, recent price fluctuations and the lack of a regulated market has caused some uncertainty on how to account for crypto currencies. It is therefore important to understand its legal status and tax implications.

Legal Status of Cryptocurrency

The legal status of cryptocurrency is not yet fully established as it varies from country to country. According to SARS guidelines, cryptocurrencies are neither an official South African tender nor widely used and accepted in South Africa as a medium of payment or exchange. As such, cryptocurrencies are not regarded as a currency for income tax purposes or Capital Gains Tax (CGT). Instead, cryptocurrencies are regarded by SARS as assets of an intangible nature.

Are cryptocurrencies taxable?

The short answer is **Yes**. The South African Revenue Service (SARS) stated in a guideline issued that it will apply normal income tax rules to cryptocurrencies and will expect affected taxpayers to declare cryptocurrency gains or losses as part of their taxable income. The onus is on taxpayers to declare all cryptocurrency-related taxable income in the tax year in which it is received or accrued. Failure to do so could result in interest and penalties. Taxpayers who are uncertain about specific transactions involving cryptocurrencies may seek guidance from SARS through channels such as Binding Private Rulings (depending on the nature of the transaction).

Tax treatment

Whilst not constituting cash, cryptocurrencies can be valued to ascertain an amount received or accrued as envisaged in the definition of "gross income" in the Act. Following normal income tax rules, income received or accrued from cryptocurrency transactions can be taxed on revenue account under "gross income". Alternatively such gains may also be regarded as "capital" in nature, and be subjected to "capital gains tax". Determination of whether an accrual or receipt is revenue or capital in nature is tested depending on the circumstances of each case.

Taxpayers are also entitled to claim expenses associated with cryptocurrency accruals or receipts, provided such expenditure is incurred in the production of the taxpayer's income and for purposes of trade. If the gain is recognised as capital in nature then base cost adjustments can also be made if falling within the CGT paradigm.

Classification of Gains or Losses

Gains or losses in relation to cryptocurrencies can broadly be categorised with reference to three types of scenarios, each of which potentially gives rise to distinct tax consequences:

(i) A cryptocurrency can be acquired through so called "mining". Mining is conducted by the verification of transactions in a computer-generated public ledger, achieved through the solving of complex computer algorithms. By verifying these transactions the "miner" is rewarded with ownership of new coins which become part of the networked ledger.

This gives rise to an immediate accrual or receipt on successful mining of the cryptocurrency. This means that until the newly acquired cryptocurrency is sold or exchanged for cash, it is held as trading stock which can subsequently be realized through either a normal cash transaction (as described in (ii) or a barter transaction as described in (iii) below.

(ii) Investors can exchange local currency for a cryptocurrency (or vice versa) by using cryptocurrency exchanges, which are essentially markets for cryptocurrencies, or through private transactions.

(iii) Goods or services can be exchanged for cryptocurrencies. This transaction is regarded as a barter transaction. Therefore the normal barter transaction rules apply.

Value Added Tax (VAT) implications

The 2018 annual budget review indicated that the VAT treatment of cryptocurrencies still needs to be reviewed. Pending policy clarity in this regard, SARS has directed that it will not require VAT registration as a vendor for purposes of the supply of cryptocurrencies.