Shifting digital currency definitions: current considerations in Australian and US tax law

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Abstract
Digital currency as an intangible asset is designed, in part, to circumvent the reach of regulatory bodies. As such, the emergence of this asset into global markets requires tax regulators to be particularly nimble with respect to regulation.

This article reviews the rapidly shifting regulatory landscape of digital currency by comparing its definition, for tax purposes, as an intangible asset under Australian and US tax law. The article finds that reactive regulatory responses triggered a piecemeal inclusion of digital currencies into a pre-existing taxation framework, causing unintended regulatory consequences. The article concludes that the regulation of digital currency needs to be increasingly proactive, as the placement of new market products under an existing definitional framework leads to inconsistencies in regulatory application. While tax administration will not drive stabilisation of the digital marketplace, tax administrators might consider that regulation of digital currency, as a new hybrid intangible asset in a global marketplace, may provide an opportunity to consider forward-thinking global harmonisation.

Key words: taxation, digital currency, regulation, bitcoin, intangible assets

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1. DIGITAL CURRENCY AND TAX REGULATION: DEFINITIONAL INCONSISTENCIES AND ASSOCIATED ISSUES

1.1 Emergence of a new market product

Digital currency, such as Bitcoin or Ethereum, is designed to circumvent traditional financial markets and a variety of financial regulatory bodies and criminal enforcement agencies. The emergence of these ‘digital assets’ into global markets, and the extreme financial market disruption by digital assets, requires tax regulators to be particularly nimble with respect to the proper definition and regulation of these assets, and their interaction with anti-avoidance policies across, and within, differing jurisdictions.

Currently, digital currency including Bitcoin, the most well-known digital or cryptocurrency,\(^1\) encompasses a vast amount of perceived wealth and value in the world. While the financial reports vary, estimates indicate a broad global market effect. As of 2017, the Bitcoin worldwide market was estimated at USD 40 billion while the market for other digital currencies was considered to be USD 97 billion. As of June 2017, the market cap for digital currency in Australia was estimated at AUD 49.6 billion.\(^2\) For early 2018, individual users of bitcoin wallet are estimated at USD 24 million.\(^3\)

Bitcoin and similar digital currencies are relatively new digital currencies used by consumers both as a method to transfer items of value (used for buying and selling items) as well as investment (buying and selling of digital currency itself). Like any financial instrument and investment opportunity, such ‘currency’ can become commonplace and stable in the market (tangible items such as gold coins, new metals, palladium or intangible assets such as securities or government-backed bonds), or ultimately fail to withstand market shifts and destabilise to then lose value, such as junk bonds or other failed insurance instruments.

In part, the advantage of digital currency is due to the low transfer fees instituted by digital currency to transfer it into government-backed currency.\(^4\) Digital currency also allows for global transfers to avoid cross-border transfer costs, the need for fiat currency, and any interaction with regulatory frameworks, while still allowing for convenient and low-cost convertibility into government-backed currencies.\(^5\)

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1. This article uses the term ‘digital currency’ as inclusive of cryptocurrency, including Bitcoin. Various jurisdictions use similar terms, and there is not yet a single standard term or definition.
4. Bitcoin currently has a 1 per cent transfer fee, more than 2 per cent lower than traditional credit cards and can be transferred the same day. For more information on the company generally, see Bitcoin.com, https://www.bitcoin.com/faq.
5. Coinbase, www.coinbase.com, is one of the most popular ways to buy and sell digital currency including Bitcoin, Ethereum and others. Many other market participants also exist in this space.
1.2 Digital currency and the need to regulate

Digital currencies are ‘distributed, open-source, maths-based, peer-to-peer currencies that have no central administering authority and no central monitoring or oversight’.  

Digital currency is generally considered to be a representation of digital value that can be used as a medium of exchange. Digital currencies, especially those which are easily convertible to fiat currency, have many advantages to users including anonymity and portability and have become popular in both investment contexts as well as used as a form of money for typical consumer transactions.

Specifically, convertible digital currency is the product that regulators seek to bring within the scope of existing regimes. A convertible digital currency (as opposed to a non-convertible digital currency) is one that has an equivalent value in, and can be exchanged for, fiat (real) currency. A non-convertible digital currency cannot be exchanged for fiat currency in the same manner, and is used solely in a virtual market or domain, online gaming platforms being a dominant example of this. This article discusses definitional issues with respect to the former, being convertible digital currencies.

Due to the significant market changes brought about by the growth of convertible digital currency, regulators are facing the need to develop a consistent regulatory environment. Further, due to the anonymous nature of digital currency transactions, regulators also face the need for stricter anti-avoidance schemes encompassing the new markets. Stable regulatory bodies (such as in the G20 countries) include digital currency in regulatory frameworks, including taxation, securities, commodities and financial crimes laws.

Digital currency, with its large market share and accessibility to both large-scale investors and individuals, is disrupting both institutional markets, as well as being used by individuals in both legal and illegal contexts. As the likelihood of under-reporting

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7 In addition to general and legal dictionary definitions relating to money and currency in Australia and the US, for one of the only coordinating definitional documents, see the Financial Action Task Force (FATF), Virtual Currencies: Key Definitions and Potential AML/CFT Risks (FATF/OECD, June 2014), available at: http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf (accessed 9 January 2019).
8 Digital currency markets, with global portability and anonymity from many regulators, are designed to be outside current regulatory environments. Emerging and disruptive markets are, by design, inevitably attempting to affect consumer behaviour within particular markets, both the new market and previously existing markets. Ultimately if significant market disruption occurs, changes in regulatory schemes certainly must follow. For those involved in disruptive technologies and industries, the potential regulatory change, and its subsequent effects on a particular market, are no doubt part of risk analysis and risk tolerance. For example, consider the past effects of junk bonds and failed hybrid insurance products. The considerations for investors and businesses involved in the disruptive market of ‘digital currency’ are no different.
9 See, eg, Senate Economics References Committee, Parliament of Australia, Digital Currency, Game Changer or Bit Player (August 2015).
10 The US Securities and Exchange Enforcement Division announced creation of a cyber unit in September 2017; the IRS has also implemented two new enforcement groups (the International Tax Enforcement Group and the Nationally Coordinated Investigations Unit). The NCIU focuses on data analytics for enforcement purposes.
for digital currency is high, a variety of regulatory agencies including the Australian Taxation Office (ATO) and the US Internal Revenue Service (IRS) are increasing enforcement activities.

Taxing regimes often move more quickly than other regulatory schemes to define certain transactions as taxable events to ensure that the government is both fairly and equitably taxing citizens’ activities, and that the coffers of the government are not being shorted by failing to collect tax on taxable activities. The taxation of digital currencies and digital currency transactions are no exception.

The current governmental taxation framework in Australia and the US are two stable governmental systems, with worldwide taxation reporting requirements for their citizens. Thus, citizens (tax residents) of the US and Australia are required to report their income regardless of income source and location.

Tax law in both countries generally dictates filing on an annual basis. Due to the need to describe a taxable event with a discrete valuation, tax laws work best for both taxpayers and assessing agents when terms are specific, measurable, and reducible to a numerical value.

Further, because all governments are funded in large part by taxes, governments are generally vested in anti-avoidance regulations and act in fairly rapid fashion to changing market trends. Thus, as tax professionals must react, on an annual basis, to new governmental directives on behalf of their clients, the effects of changing tax regulations are a matter of immediate implementation.

As digital currency becomes a well-known investment vehicle and trading commodity, extreme change is occurring in the financial industry, an industry that is both highly regulated and particularly risk averse. As such, governments that monitor and regulate financial markets have taken initial steps to define and regulate digital currencies. With the release of new products, consumers and businesses face new considerations in risk

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12 See, eg, recent US litigation based on a ‘John Doe’ subpoena in US v Coinbase Inc, (US District Court, N. Dist Ca 2017) 2014WL4652121, 4:13-CV-416, 17-cv-01431-JSC; requesting Coinbase provide information relating to transactions over USD 20,000 where 1099-k reports have not been filed.


14 Generally, there may be filing requirements, but many tax codes allow for certain offsets in both systems for some deductions or non-reporting requirements.

15 This is not to say that valuation of intangibles is simple or that they are easily valued. Many areas provide significant challenges; for example, intellectual property valuation challenges are well beyond the purview of this article. See, eg, Michael Shaff, ‘Taxation of Intellectual Property’ (22 November 2013), available at: https://stubbsalderton.com/taxation-of-intellectual-property-by-michael-shaff/ (accessed 29 January 2019).

management needs in relation to digital currency and its inclusion as a new product into an existing definitional and regulatory framework.

1.3 Inclusion of a new product into existing regulatory framework

In an attempt to bridge the regulatory gap between traditional finance instruments and digital assets, regulatory bodies have taken steps to manipulate existing tax law definitions to bring ‘digital currency’\(^{17}\) within the ambit and scope of current regulatory regimes.\(^{18}\)

This article addresses the current definitional structure used by Australia and the US tax regulators and focuses on the current Australian and US regulatory schemes as relating to digital currency and taxation. Review of the rapidly shifting regulatory landscape of digital currency is undertaken by comparing its definition, for tax purposes, as an intangible asset under both Australian and US tax law. We find that current definitions for tax purposes have created particularised concerns relating to a lack of definitional specificity across both jurisdictions. That is, significant issues faced by regulators in relation to digital currency concern existing definitions surrounding intangible assets, currency, and money.

Digital currencies have some essence of value within the digital marketplace because of the peer-to-peer transferability. Such transferability ultimately makes those digital currencies operate like a financial asset. As an asset, digital currency can be defined generally as property with either the right to possess, use and enjoy a determinate thing and any external thing over which the rights of possession, use and enjoyment are exercised. As a subset of the property definition, intangible property is property that lacks a physical existence, including bank accounts, stock options, and business goodwill.

Significant discussion exists surrounding the practical and applicational definitions regarding the valuation of intangible assets broadly.\(^{19}\) Digital currency fits squarely into a classical definition of intangible asset. Digital currency itself is just beginning to receive academic focus likely stemming from the rapid implementation of both regulatory structures and enforcement activities in a relatively short timeframe.\(^{20}\)

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\(^{17}\) The term ‘digital currency’ is an interesting usage of language to describe the blockchain technology and usage of technology to derive a fungible value. While digital currency functions in the marketplace as a currency, digital currency does not fit the technical and legal definitions of currency for most jurisdictions. Currency is generally considered to be coined money and such bank notes as are authorised by law and circulate as a medium of exchange.


\(^{19}\) See, eg, International Accounting Standards Board, ‘IAS 38 Intangible Assets’ (12 May 2014); Australia Accounting Standards Board, ‘Intangible Assets AASB 138’ (14 December 2015); Financial Accounting Standards Board, ‘Statement of Financial Accounting Standards No 142 Goodwill and Other Intangibles’ (June 2001). See also International Valuation Standards Council. For tax purposes, see also United States tax law code (26 US Code) s 197 (listing a variety of intangible assets which may be eligible for amortisation).

\(^{20}\) There is beginning to be more depth of academic discussion and debate. For some interesting references, see, eg, Stern, above n 6; Jeffrey Matsuura, Digital Currency: An International Legal and Regulatory Compliance Guide, (Bentham Science, 2016); Emery and Stewart, above n 18; Isakov, above n 18.
Both legislative and industry definitions exist for intangible property. The Australian Accounting Standards Board defines intangible asset to be an ‘identifiable non-monetary asset without physical substance’.\(^{21}\) This approach, being one of practice over theory, has seen the piecemeal inclusion (and exclusion) of digital currency into existing tax law definitions. Comparative analysis of the tax law definitional frameworks into which digital currencies have been transplanted demonstrates that there are immediate unintended consequences of defining digital currency as an intangible asset and not ‘money’. These are further discussed below.

### 1.4 Tax law definitional framework: an Australian and US comparison

Both Australian and US tax regulators define digital currency as intangible property for tax purposes. While currency and money are considered a subset of intangible property, the tax definition of digital currency does not reference currency or money.

For the purposes of this article, money and currency, as a medium of exchange, compares most closely with the use of digital currency. Money and currency can act as an intermediate in the exchange of goods and services, and thus is a medium of exchange.\(^{22}\) In this process, money and currency also become a measure of value or unit of account. Digital currency is now operating in the same manner, being used as a medium of exchange and a measure of value.

Reactive regulatory responses, however, have triggered a piecemeal inclusion of digital currencies into a pre-existing regulatory framework, causing unintended regulatory consequences. Failure to reference currency and money into the digital currency definition leaves a significant regulatory gap. While tax law continues to develop for defining and valuing intangible assets, the current definition as intangible property is likely too generic.

#### 1.4.1 Australia Tax Office definition of digital currency for tax purposes

In 2014, the ATO provided a fairly stable set of initial regulations to address the primary tax implications of Bitcoin and cryptocurrencies\(^ {23}\) including goods and services tax (GST) implications in transactions, determinations as to whether they are trading stock, whether they are subject to fringe benefits tax, their effects on salary sacrifice, and their nature as an asset for capital gains tax (CGT).\(^ {24}\) In summary, the position of the ATO is that bitcoin is neither money nor foreign currency, but is an asset for CGT purposes.

In answering whether bitcoin would constitute foreign currency, ATO Taxation Determination TD 2014/25, ‘Income tax: is bitcoin a ‘foreign currency’ for the purposes

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\(^{22}\) Money generally has properties that include fungibility, durability, portability, and recognition of its value.


\(^{24}\) Ibid.
of Division 775\textsuperscript{25} of the Income Tax Assessment Act 1997\textsuperscript{?}, states that bitcoin is not a foreign currency. This Determination considered whether bitcoin is foreign currency, or ‘currency’ for income tax purposes in circumstances where the term is not defined in the tax Assessment Acts.

In reaching the conclusion that digital currency is not foreign currency, the Commissioner considers the legal meaning of the term ‘currency’ with reference to the *Currency Act 1965* (Currency Act).\textsuperscript{26} The term was explained in the case of *Leask v Commonwealth*\textsuperscript{27} and judicial commentary of the term ‘currency’ focuses on the notion that currency ‘consists of notes or coins of denominations expressed as units of account of a country and is issued under the laws of that country for use as a medium of exchange of wealth’.\textsuperscript{28} With reference to the Currency Act, the Commissioner notes that the ‘critical character of the Currency Act’s concept of “currency” is State recognition and adoption of a monetary unit under law’.\textsuperscript{29} That is, bitcoin is not a monetary unit recognised and (legally) adopted by foreign states and can therefore not be ‘foreign currency’ for the purposes of Division 775 of the *Income Tax Assessment Act 1997*. The Commissioner, as a result, confirms and concludes that ‘bitcoin does not constitute “currency” nor “foreign currency” in the context in which those terms operate for the purposes of Australian tax law’.\textsuperscript{30}

In relation to GST, the Commissioner initially ruled in GSTR 2014/3, ‘Goods and services tax: the GST implications of transactions involving bitcoin’ (withdrawn December 2017)\textsuperscript{31} that as bitcoin was not defined as money, the exclusion in the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) for supplies of ‘money’ did not apply and that, as a result, the supply of bitcoin would be taxable. In this Ruling the Commissioner also determined that the supply of bitcoin was not a financial supply, or any other type of input taxed supply.

While there are many tests as to what may constitute property and proprietary rights, the Commissioner states that, in relation to bitcoin, the relevant relationship with respect to property to be considered is:

a) the object or thing, bitcoin, being the digital representation of value constituted by three interconnected pieces of information (a Bitcoin address; the Bitcoin holding or balance in that address; and the public and private keypair associated with that address), and

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\item \textsuperscript{25} *Income Tax Assessment Act 1997* (Cth) Div 775 relates to foreign currency gains and losses for income tax purposes and details the extent to which a foreign currency gain is to be included in a taxpayer’s assessable income.
\item \textsuperscript{26} Australian Taxation Office, ‘Income tax: is bitcoin a “foreign currency” for the purposes of Division 775 of the *Income Tax Assessment Act 1997*?’, Taxation Determination TD 2014/25 (17 December 2014) [28].
\item \textsuperscript{27} *Leask v Commonwealth* [1996] HCA 29; 187 CLR 579.
\item \textsuperscript{29} Australian Taxation Office, ‘Income tax: is bitcoin a “foreign currency” for the purposes of Division 775 of the *Income Tax Assessment Act 1997*?’, Taxation Determination TD 2014/25 (17 December 2014) [31].
\item \textsuperscript{30} Ibid [26].
\item \textsuperscript{31} Australian Taxation Office, ‘Goods and services tax: the GST implications of transactions involving bitcoin’, GST Ruling (Withdrawn) GSTR 2014/3W (18 December 2017).
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b) the bundle of rights (hereafter referred to as ‘Bitcoin holding rights’) ascribed to a person with access to the bitcoin under the Bitcoin software and by the community of Bitcoin users.\(^{32}\)

Property generally is capable of ownership, and the ownership rights of property are transferable. That is, the owner can deal with an item in the manner in which they wish; and property rights detail the legal relationship over that item.\(^{33}\) A determination of whether something constitutes property requires a weighting of various factors, being those of excludability, enforceability, and value.\(^{34}\) In concluding that bitcoin (and other similar digital currencies) are proprietary in nature (the right to hold the coin being a proprietary right), it follows that bitcoin will be a CGT asset for income tax purposes.

1.4.2 US definition of digital currency for tax purposes

In comparison to Australia’s use of a transactionally based definitional scheme, the IRS deemed digital currency to be ‘intangible property’, and treats it as such for tax purposes.

In March 2014, the IRS released notice 2014-21, a set of FAQ’s and written directives on tax principles are applied to transactions using virtual currency.\(^{35}\) For purposes of taxation, the IRS notes that ‘virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value’. IRS notice 2014-21 further states that ‘[f]or federal tax purposes, virtual currency is treated as property’.\(^{36}\) Similarly, ‘[g]eneral tax principles applicable to property transactions apply to transactions using virtual currency’.\(^{37}\) Under US tax law, tax regulators can deem events as long as the definition of an item is ‘inclusive’. Thus, defining digital currency as something (in this case an intangible asset) provides more than a sufficient framework to apply the full US tax code and all anti-avoidance regulations.\(^{38}\)

Further, the IRS policy statement notes that virtual currency is not treated as currency for tax purposes, but describes digital currency as intangible property,\(^{39}\) with little more

\(^{33}\) Yanner v Eaton (1999) 201 CLR 351 at 365-367 [17]-[19].
\(^{34}\) Australian Taxation Office, ‘Income tax: is bitcoin a “CGT asset” for the purposes of subsection 108-5(1) of the Income Tax Assessment Act 1997?’, Taxation Determination TD 2014/26 (17 December 2014) [7].
\(^{37}\) Ibid.
\(^{38}\) Note that the US definition of income, for tax purposes, is largely inclusive of all gross income. In other words, it includes everything not excluded from income.
\(^{39}\) On a federal level, no broad or further action has been taken in relation to defining digital currency. The most recent federal action to affect digital currency occurred in the December 2017 tax bill, in which the US Congress closed another loophole relating to undertaxation of digital currency transactions. While digital currency was not directly addressed, IRC s 1031 was amended to allow for tax deferred exchanges only on real property. Under the prior tax provision, the language allowed for any property to be a like kind exchange, hypothetically including exchange of one digital currency such as Bitcoin for another digital
direction. As noted above, intangible property is the most proper, inclusive definition of digital currency. Both the US definitional language and the Australian definitional language are similar in determining that digital currency is not traditional currency backed by a government or other stable valuation methodology. Current definitions lack depth in consideration of the usage of digital currency and the impact of ancillary enforcement laws. Digital currency as a new product, however, acts exactly like currency or money in the marketplace. Thus, tax definitions and marketplace actions are inconsistent.

1.5 Digital currency as property: unexpected regulatory issues when digital currency is not further defined for tax purposes

While digital currency is properly designated as intangible property, that categorisation is too broad for practical application. For tax purposes and other regulatory requirements, other intangible assets are generally also defined in a more narrow fashion, including as a security, money, currency, or other financial instrument.

Failing to provide sufficient specificity in definitional structure has created regulatory failings in both Australia and US regulatory schemes.

1.5.1 The ATO’s recent change in regulatory posture

In relation to the tax consequences resulting from the disposal of capital assets, as noted above the Commissioner has determined that bitcoin constitutes a CGT asset for the purposes of section 108-5 of the Income Tax Assessment Act 1997. Section 108-5 defines a CGT asset as any kind of property or a legal or equitable right that is not property. With respect to digital currencies, they are considered under the first limb of the statutory definition of a CGT asset, being ‘property’.

The change in regulatory posture for digital currency and tax treatment for GST demonstrates the challenges for regulators attempting to define new financial and hybrid products. As discussed earlier, in applying the ruling that digital currency was not ‘money’, certain GST exemptions did not apply, and as a result the supply of bitcoin was found to constitute a taxable supply. This position was retracted by the Commissioner when it became evident that such an approach would have unintended outcomes, being double taxation.

Post withdrawal of GSTR 2014/3, the position of the Commissioner now is that the supply of digital currency constitutes a ‘financial supply’ and will therefore be input taxed. This change was initiated to remove the double taxation of GST that occurred when GST was paid on both the purchases of digital currencies and on their use to acquire (purchase, exchange etc) other goods and services subject to GST. Legislative amendments made after the withdrawal ensure that the purchase of digital currency will


not attract GST, by providing that a supply will generally not include a supply of digital currency.\textsuperscript{42}

The effect of making a ‘financial supply’ is that GST is not paid (collected and remitted to the ATO) on sales of digital currency, but GST credits cannot be claimed for GST included in purchases necessary to make the supply. As a result, ‘digital currency will have the equivalent treatment to money and in certain circumstances supplies of digital currency will be treated as financial supplies’.\textsuperscript{43}

The broadening of the ‘money’ exemption for GST extended to digital currencies has allowed for proper regulation insofar as it is equitable and in accordance with general taxation principles (and the avoidance of double taxation). The rationale behind this change was to ‘remove an obstacle for the financial technology (fintech) sector to grow in Australia’.\textsuperscript{44}

1.5.2 US reporting issues regarding foreign money

Under US law, defining digital currency as intangible property, but not ‘foreign currency’ or other financial instrument, creates an absolute tax-reporting requirement for all transactions. All transactions must be reported for tax purposes, unless a specific statutory exemption exists. For example, US tax law allows for personal transactions relating to the exchange of foreign currency\textsuperscript{45} with less than USD 200 in gain to be excluded from reporting requirements. In relation to this issue, Lopez has argued that transactions should instead be treated as a foreign money transaction, thus eliminating the need for tracking and reporting all transactions: ‘[f]rom an ethical perspective, the treatment of virtual currencies as a property creates a large burden on the average person to maintain accurate records for each and every virtual currency transaction’.\textsuperscript{46}

While there is clear data of under-reporting taxable income derived from digital currency transactions,\textsuperscript{47} requiring a taxpayer to report each transaction, regardless of increase or decrease in value of digital currency, would be particularly unwieldy for both taxpayers and regulators. Even US regulators, after arguing that significant under-reporting is occurring, have softened attempted enforcement actions requiring reporting of all transactions. In the Coinbase case, the IRS first requested data as it relates to all taxpayers with annual transactions, but ultimately narrowed its investigatory subpoena to taxpayers with transactions above USD 20,000 per year. In November 2017, a District Court ordered Coinbase to provide information relating to users who made transactions

\textsuperscript{42} Treasury Laws Amendment (2017 Measures No 6) Act 2017 (Cth).
\textsuperscript{43} Australian Taxation Office, ‘Goods and services tax: the GST implications of transactions involving bitcoin’, GST Ruling (Withdrawn) GSTR 2014/3W (18 December 2017) [2].
\textsuperscript{45} See IRC s 988, Treatment of Certain Foreign Currency Transactions, which sets forth specific and extensive rules for the tax treatment of foreign currency transactions. Subsection (e)(3) allows for an exemption for gains on personal transactions with less than USD 200 worth of gain.
over USD 20,000 between 2013 and 2015, which is 8.9 million transactions over 14,355 different account holders.  

This particular reporting concern is not unique to digital currency, but overlays all tax reporting matters relating to property transactions such as barter, or transactions not easily traced under current reporting schemes.

The broad application of existing tax law definitions to digital currencies demonstrates a mismatch between a need to regulate, and the incapacity for existing definitions to adequately cover a new market product. In relation to procedural matters (double taxation and reporting requirements as examples of this) there may be little damage in the misalignment of regulatory definitions. In defining digital currency broadly as ‘not money’, we see significant ramifications in relation to anti-money laundering and the possibility for illegal transactions to be unmonitored and unregulated. In such circumstances, the consequence of inadequate definitions can be more significant.

1.6 Defining digital currency as ‘not money’: the creation of issues in anti-money laundering enforcement

Defining a new or hybrid financial instrument can have unintended consequences both within the original regulatory scheme, as well as associated regulatory and criminal enforcement matters.

In addition to its current functionality for merchants and investment options, digital assets provide a level of anonymity to users. The complexities to enforcement actions relating to illegal activities using digital currency are constant, and government regulators are just barely scratching the surface of regulation and enforcement.

The comparative definitions for digital currency in Australian and US federal tax law provide for an illustrative view of the inherent challenges in governmental definitions of a new vehicle entering a market for the very purposes of market disruption. An analysis of regulatory response to digital currencies in light of anti-money laundering (AML) highlights the issues that arise with lagging responses to regulation. Digital currency as a new product did not ‘fit’ within pre-existing exclusionary definitions of ‘money’ and as such, avoided regulation. While the effects may be more limited in reporting requirements noted in previous sections, the use of digital currency for illegal activities occurs on a consistent basis, as noted in other sections of the article.

We now see instances in which the US is slowly including ‘virtual currency’ in the definition of monetary instruments, within the definition of money laundering. This approach is also reflected in Australia as legislators seek to amend legislation to include digital currencies in the definition of money for the purposes of AML regulation. Both jurisdictions have ultimately reversed their earlier exclusionary definitions that provided that digital currency was not ‘money’. As a result of significant time elapsing between an initial inability for digital currency to be included in money-laundering

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48 US v Coinbase (N.D. Cal 2017), 28 November 2017; 17-cv-01431-JSC.
49 For an excellent example of global coordination around definitional language of digital currency in a criminal enforcement context, see Financial Action Task Force, Virtual Currencies: Key Definitions and Potential AML/CFT Risks, above n 7. For US global enforcement activity, consider the Katz v US, 389 US 347 (1967) discussion regarding the fourth amendment test, and applicability to Icelandic servers used in the Silk Road matters. There is certainly a question of whether the US government going outside its own jurisdictional boundaries is a step too far in enforcement.
challenges and regulation, and the subsequent inclusion of this new product in regulatory schemes, digital currency has been exploited by users for money laundering and has operated as the medium for illegal activities.

1.6.1 Digital currency and anti-money laundering enforcement in the US

The US governmental definition of cryptocurrency involves an exclusionary definition – cryptocurrency is not money for tax purposes. Such an exclusionary definition has led to governments’ initial inability to include cryptocurrency in money laundering criminal charges. This unintended consequence of definitional exclusion merely highlights the challenges of including a new product into an existing legal system.

Failing to define bitcoin as money, while in line with the definition of money as a government-backed fiat currency, fails to allow charges of money laundering in relation to the use of bitcoin. Perhaps most problematic is that bitcoin has long been used to avoid governmental interference into allegedly illegal activities such as Silk Road.\(^5\) By defining digital currency as property, and not currency, the IRS forces a new financial-type instrument (already prone to use in illegal activities) into an existing definitional space, regardless of issues relating to that definitional framework for this intangible property. Several money-laundering cases discussed below demonstrate that defining digital currency as something other than money or currency prevents law enforcement from using tools previously available to them.

The Florida 11th Circuit Court’s discussion of bitcoin in a money laundering case where the defendant used bitcoin as a medium of exchange, *Florida v Espinoza*, is illustrative of new market activities and regulatory tensions. Judge Pooler granted the defendant’s motion to dismiss, which argued that bitcoin could not be considered money for the purposes of both the money laundering charge and acting as an unlicensed money service operator.\(^6\)

The Court dismissed the first charge of unauthorised money services business. In discussing the charges of unauthorised money transmitter, the Court analysed whether the four-part test for a money transmitter business was met, and ultimately determined that the defendant was merely a seller of his own property, that bitcoin did not fall under the statutory definition of ‘payment instrument’, and thus ultimately bitcoin did not have the attributes of what the Court considered to ‘commonly refer to as money’. The Court noted that ‘[t]his court is not an expert in economics, however, it is very clear, even to someone with limited knowledge in the area, that bitcoin has a long way to go before it is the equivalent of money’.

In addressing the second count of money laundering, the Court noted that money laundering is commonly understood to be a process where proceeds from illegal activities become legitimised. Under the facts of the case, the Court considered that there is an indication of intent to promote an illegal activity. The Court noted that ‘[t]his court is unwilling to punish a man for selling his property to another … when his actions

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5 For a brief description of Silk Road, see Financial Action Task Force, *Virtual Currencies: Key Definitions and Potential AML/CFT Risks*, above n 7, 11.

6 *Florida v Espinoza*, F14-2923 (Fla, 11th Cir., Judge T Pooler, 2014). Defendant Espinosa was charged under Fla. Code 560.125(5)(a) – illegal money services and Fla. Code 869.101(5)(a) and (5)(b) – money laundering. The Court noted in its dismissal that the defendant failed to fit the definition of ‘payment instrument seller’ and that bitcoin was not a ‘payment instrument’.
fall under a statute that is so vaguely written that even legal professionals have difficulty finding a singular meaning’.

With reference as to whether the state could prevent further cases like Espinoza’s from a similar conflict, it was noted that ‘there is unquestionably no evidence that the defendant did anything wrong, other than sell his bitcoin to an investigator who wanted to make a case’.

The Espinoza case highlights the lag time between market activity and regulatory interpretation. The Court noted that bitcoin has a long way to go before it is ‘money’, when bitcoin has, for all intents and purposes, actually become ‘money’ as well as having significant market effect as noted earlier in the article.

This disconnect between digital currency’s legal definition as property for tax purposes and its commercial importance has driven additional legislative action at the US state level. As of June 2017, Florida state legislators passed a new state law, which includes ‘virtual currency’ (as well as mediums that are in electronic or digital forms) in the definition of monetary instruments for the purposes of money laundering, in direct response to the Espinoza dismissal. Further, eight of the 50 US states have considered legislation relating to blockchain technology but not necessarily specific to definitions relating to taxation, or regulation, of digital currency.

Having for some time stated that bitcoin, and all digital currency, is not money per se, Australia will likely face similar problems in charging criminal activities as those already identified in the United States.

1.6.2 Digital currency and anti-money laundering enforcement in Australia

The Australian Transaction Reports and Analysis Centre (AUSTRAC) is Australia’s financial intelligence agency responsible for regulating anti-money laundering and counter-terrorism financing. Digital currencies have now been brought into the regulatory scheme under Australia’s AML and counter-terrorism financing regime. In December 2017 the Anti-Money Laundering and Counter-Terrorism Financing Amendment Act 2017 (Amendment Act) was passed, with changes proclaimed to come into effect on 3 April 2018. Prior to this amendment, the AML regulations did not cover digital currencies.

In comparison to the US we are yet to see many examples of money laundering charges or investigations relating to digital currencies in Australia. This does not mean there is no need for amendment, as illustrated by the examples in the US discussed above.

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52 On an international front, courts may drive further definitions of bitcoin, as bankruptcy and arrests occur in the Mt Gox cryptocurrency exchange scandal (on which, see, eg, Darryn Pollock, ‘The Mess That Was Mt. Gox: Four Years On’, cointelegraph.com (9 March 2018), https://cointelegraph.com/news/the-mess-that-was-mt-gox-four-years-on (accessed 9 January 2018)) and other issues arise. Many countries also provide frameworks for consideration of bitcoin and digital currencies as currency and/or property.


An earlier investigation into Craig Wright was undertaken in 2016 by the Australian Federal Police and the ATO in relation to alleged substantial transactions in gold, software and bitcoin but, as of early 2018, he has not yet faced charges.\textsuperscript{55}

Further, and from a more general perspective, even in the absence of criminal charges in relation to the use of digital currency, there are undoubtedly illegal transactions being facilitated with the use of digital currencies.\textsuperscript{56} The \textit{Australian Financial Review} has noted that ‘banks, who are deeply sensitive about any suggestion that their systems could inadvertently be used for money laundering following last year’s bruising revelations that they provided a safe haven for illegal transactions, are believed to be working closely with authorities’.\textsuperscript{57} Recently, it was also reported that an estimated AUD 740 million was transferred overseas to Korea in suspected illegal foreign currency transactions, some of which involved cryptocurrencies.\textsuperscript{58} Recent forensic investigations in the area used forensic finance techniques to report on general usage for bitcoin finding that approximately half of bitcoin transactions (and a quarter of bitcoin users) are associated with illegal activity.\textsuperscript{59}

Whether in response to pressure from industry bodies, stakeholders and community members, or in response to possible money laundering schemes, Australia has now taken steps to successfully regulate digital currencies by bringing them within the scope and ambit of existing regulatory regimes.

The Attorney-General’s Department, while undertaking statutory review of the \textit{Anti-Money Laundering and Counter-Terrorism Financing Amendment Act 2006} (Cth) (AML Act), noted that:

\begin{quote}
...industry stakeholders and partner agencies strongly supported the inclusion of all new payment types and systems that pose a level of ML/TF risk under AML/CTF regulation, particularly digital wallets and digital currencies. Stakeholders consider that it was critical that the AML/CTF regime applied equal treatment to all providers of similar products or services to maintain a high degree of competitive neutrality and ensure a ‘level playing field’.\textsuperscript{60}
\end{quote}


There were, however, definitional restrictions on the inclusion of digital currency within the existing framework.

The AML Act operates to regulate ‘money’, a term within which digital currencies could be included for the purposes of regulation. The AML Act had defined money to include ‘e-currency’, which is defined to be an ‘internet based, electronic means of exchange that is backed either directly or indirectly by precious metal, bullion or a thing prescribed by the AML/CTF Rules and is not issued by or under the authority of a government body’. 61

The current legislation includes e-currency in the definition of money, and e-currency is further defined to include digital currency. 62 In conclusion, recommendations were made in relation to the statutory review to amend existing definitions of e-currency in the AML Act by expanding it to include convertible digital currencies not backed by a physical ‘thing’, as required under existing definitions. 63 As cryptocurrencies are backed by an algorithm, and not a thing, they were not covered within this definition.

The Amendment Act inserts into the definitions section of the AML Act the following definition of digital currency:

\[
\textit{digital currency} \text{ means:
}\]

\[
(a) \text{ a digital representation of value that:\n}\]

\[
(i) \text{ functions as a medium of exchange, a store of economic value, or a unit of account; and}\n\]

\[
(ii) \text{ is not issued by or under the authority of a government body; and}\n\]

\[
(iii) \text{ is interchangeable with money (including through the crediting of an account) and may be used as consideration for the supply of goods or services; and}\n\]

\[
(iv) \text{ is generally available to members of the public without any restriction on its use as consideration; or}\n\]

\[
(b) \text{ a means of exchange or digital process or crediting declared to be digital currency by the AML/CTF Rules;}\n\]

\[
\text{but does not include any right or thing that, under the AML/CTF Rules, is taken not to be digital currency for the purposes of this Act.}\n\]

This approach to defining digital currencies, in a roundabout manner, includes them within the definition of money, successfully bringing digital currencies within the scope of regulation under the AML Act. This amendment, however, comes some time after the recognition by stakeholders and regulators that digital currency was failing to be regulated under existing criminal prosecution regimes.

Regarding the approach to regulation it was stated that:

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61 Ibid 45.
63 Australian Government, Attorney-General’s Department, above n 60, 49.
It is important to note that future regulation must be proportionate to the risks faced and balanced with the potential benefits of digital currencies. If regulation and associated compliance costs are perceived as too great, providers may move offshore to jurisdictions with weaker AML/CTF controls. The proposed reforms should be developed in consultation with the digital currency industry to ensure an appropriate balance is achieved.64

National and international regulatory issues arise as a result of discrepancies and inconsistencies between digital currency definitions for the purposes of securities and tax law. Consistency in regulatory responses to new market products at the national level can be shown to assist cross-border definitional collaboration and, as such, is a necessary initial step in streamlining regulation of international products. Such a collaborative approach is necessary in circumstances where digital currencies operate at a multi-jurisdictional level, with both national and international cross-border transactions requiring regulation.

2. DIGITAL CURRENCY AND SECURITIES REGULATION AS A BASIS FOR DEFINITIONAL COLLABORATION

While broad definitions used in Australia and US tax regulations yield certain regulatory failings, parallel definitions of digital currency are being developed in other regulatory markets. For example, both Australian and U.S. securities regulators hypothesise that use of digital currency ‘might subject’ digital currency investment activities to securities regulation.

The value of a digital currency is determined on an open market in a similar manner to that of other securities or traded commodities. As discussed above, unlike other forms of currency, the value of bitcoin is not derived from gold or government fiat, but from the value that people assign it.65 There has been a trend towards utilising digital currencies for investment purposes, and as such, their use as a medium of exchange for goods or services has been relatively minor.66 In that sense, digital currencies are traded in a similar manner to securities.

While the US and Australian tax regulators deem digital currency to be property, and the general jurisdiction courts have deemed digital assets as ‘not money’, securities cases, in contrast, have taken a different tack.

2.1 Digital currency and securities regulation in the US

The US Securities and Exchange Commission (SEC) has treated virtual currency as ‘money’ for purposes of securities crimes since before 2014. In SEC v Shavers,67 Shavers created a classic Ponzi scheme using bitcoin. He argued that no Ponzi scheme existed because there was not ‘money’, and thus the classic investment contract scheme under the Howey case (discussed more fully below) did not apply. The SEC challenged that notion, and the District Court agreed.

64 Ibid 50.
66 Stern, above n 6, 8, 10.
In July 2017, after several enforcement actions including Shavers, the SEC issued a regulatory statement about treatment of digital currency and securitisation. The SEC noted that the use of digital currency can create a securities transaction that is regulated by the SEC. The s 21(a) report notes that digital currency can be securitised and that the question of whether a securities transaction is occurring (triggering registration of the securities, the sellers or the need for an exemption under law) looks to the traditional Howey test. The report, in discussing whether securities laws applied to activities relating to ‘The DAO’ (a decentralised autonomous organisation) matter specifically, as well as providing general guidance for the public, notes the key definition of an investment contract:

Under Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act, a security includes ‘an investment contract’. See 15 U.S.C. §§ 77b-77c. An investment contract is an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. See SEC v Edwards, 540 U.S. 389, 393 (2004); SEC v W.J. Howey Co., 328 U.S. 293, 301 (1946); see also United Housing Found., Inc. v Forman, 421 U.S. 837, 852-53 (1975) (The ‘touchstone’ of an investment contract ‘is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.’)

This definition embodies a ‘flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits’. Howey, 328 U.S. at 299 (emphasis added). The test ‘permits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of “the many types of instruments that in our commercial world fall within the ordinary concept of a security”’. Id. In analyzing whether something is a security, ‘form should be disregarded for substance’, Tcherepnin v Knight, 389 U.S. 332, 336 (1967), ‘and the emphasis should be on economic realities underlying a transaction, and not on the name appended thereto’. United Housing Found., 421 U.S. at 849.

The report continues, noting investors invested money, which does not need to be ‘cash’.68

In determining whether an investment contract exists, the investment of ‘money’ need not take the form of cash. See, e.g., Uselton v Comm. Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991) (‘[I]n spite of Howey’s reference to an “investment of money”, it is well established that cash is not the only form of contribution or investment that will create an investment contract’). Investors in The DAO used ETH to make their investments, and DAO Tokens were received in exchange for ETH. Such investment is the type of contribution of value that can create an investment contract under Howey. See SEC v Shavers, No. 4:13-CV-416, 2014 WL 4652121, at *1 (E.D. Tex.

In December 2017, in released public remarks, the Chairman of the SEC, Jay Clayton, noted that no initial coin offerings have been registered as securities transactions. His statement highlights that a weak regulatory environment can be both good and bad for an investor. With the weak regulatory environment, much volatility comes into digital currency value. While most investors and regulators are experienced with the tax and securities laws relating to an initial public offering (IPO), the digital currency industry now uses the ICO, an ‘initial coin offering’, essentially crowdfunding via cryptocurrency. Crowdfunding itself provided great challenges to the traditional US securities regulatory scheme, with fairly new federal guidance released in 2015. To layer crowdfunding with cryptocurrency strains the regulatory environment as use of these hybrid products and activities continues at a rapid pace.

Bloomberg and other reporting services report the ICO as a billion dollar industry; raising around USD 4 billion in 2017, with more ICOs raising billions in 2018. The crowdfunding campaign has pushed on the regulatory function of securities regulation for several years. With the wide span of social media, crowdfunding allows for broad-based investment into an idea or company. Limiting crowdfunding to a particular jurisdiction or set of investors is challenging (in point of fact, that is not the goal of crowdfunding.) Putting crowdfunding together with digital currency creates a situation new to regulators. Small investment by a potentially large number of investors using only a form of investment capital not recognised by governments may lead to serious issues for consumer protection. In March 2017, and again in 2018, the SEC rejected an application for a USD 100 million Exchange Traded Fund regarding concerns over

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70 Australia has income tax levied upon capital gains. Thus, taxpayers must determine total capital gains in a particular year, in consideration of both capital gain and capital losses.

71 A company that goes public typically refers to when a company undertakes its initial public offering, or IPO, by selling shares of stock to the public usually to raise additional capital. After its IPO, the company will be subject to public reporting requirements and its shares often become listed on a stock exchange. See US Securities and Exchange Commission, ‘Fast Answers: Initial Public Offering (IPO)’ (14 October 2014), https://www.sec.gov/fast-answers/answers-comppublichtm.html.

72 In 2013, Title III of the JOBS Act (P.L.112-106) created a federal exemption under the securities laws so that non-qualified investors could lawfully invest in crowdfunding projects without securities laws violations. The rules, entitled ‘Regulation Crowdfunding’ were initially released in May 2016, with updates in April 2017 are and available at www.sec.gov. The requirements of compliance include a maximum offering amount of USD 1,070,000 raised in 12 months, a limit on unqualified investor investments in a 12 month period, and an intermediary registered online platform requirement. Companies already listed, non US companies, and other requirements may prevent certain companies from using this exemption from registration. Disclosures and registration is required. See US Securities and Exchange Commission, Compliance Guide (13 May 2016), https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm.


regulation, recognising that the rapid growth and anonymity associated with digital currencies lead to regulatory difficulties.75

The taxation matters of an ICO76 would be straightforward if digital currency was treated as if it was currency, either domestic or foreign.77 However, an ICO in the US is not effected using currency, but rather intangible property.78 The definition of cryptocurrency as intangible property79 will not protect investors attempting to avoid reportable taxable activities in the way that the exclusion will for avoiding money laundering charges (as noted in section 1.6 above). As regulators look more closely at investor activity with digital assets, avoidance of tax as relative to digital currency will become increasingly risky from a tax compliance perspective.80 Taxpayers attempting to under-report will soon find tax laws provide few if any loopholes to avoid tax on transfers, whether cash, property or digital currency.

2.2 Digital currency and securities regulation in Australia

The Australian Securities and Investments Commission’s treatment of digital currencies provides a comparative framework with respect to definitional treatment of the new product into an existing market. This treatment is particularly important in consideration of the ATO’s definition of digital currency as property, and the popularity of digital currency trading on various platforms. The Australian definitional framework can be compared to that of the US. While the Australian Securities and Investments Commission (ASIC) and the SEC (as the respective regulators) similarly state that digital currency transactions may be subject to regulation, we see arguably a better and more advanced definitional framework for the inclusion of digital currencies within the ambit of securities regulation for the US as compared to that of Australia. Of note is that ASIC does not discuss digital currency’s inclusion in regimes as an ‘intangible asset’, but focuses on whether it can constitute a financial product for the purposes of regulation.

Securities are broadly regulated pursuant to various provisions of the Corporations Act 2001 (Corporations Act) and the Australian Securities and Investments Commission Act 2001 (ASIC Act) the breach of which may give rise to civil and criminal penalties and

75 Foley et al, above n 59.
77 For Australian tax purposes, foreign exchange gains are taxable when derived from movement in currency. See Div 775 of the Income Tax Assessment Act 1997. This section would be applicable to bitcoin if digital currency constituted foreign currency. But, ATO does not consider digital currency as foreign currency.
78 Consider that the IRC s 1091 wash sales rule applies to securities, so now under a new regulatory environment, those rules might also be applied to digital currency. See IRC 1091; 26 CFR 1.1091-1, et seq. (limiting buying and selling when a loss is claimed.)
79 In a third regulatory option, the US Commodity Futures Trading Commission (CFTC) describes digital currency as a commodity, even though it fails to fit into that definitional framework as well. A commodity typically is an asset with underlying usability, that is then traded based on an expectation of value spread. There is no underlying asset in the commodification of digital currency, even though it trades on the market like that. For more information on the CFTC generally, see US Commodity Futures Trading Commission, http://www.cftc.gov/index.htm.
80 Under the new US tax laws, an IRC s 1031 exchange is now limited to real property exchanges only, closing the potential loophole which, in theory, would allow for a s 1031 tax deferred digital currency exchange. See IRC s 1031 and accompanying regulations.
consequences for individuals and entities. ASIC is the responsible body for the regulation of Australian companies, financial markets, and financial services organisations and professionals.81 Enforcement action in relation to contraventions of the legislative provisions is undertaken by ASIC which, as Australia’s markets regulatory body, oversee, administers and enforces the law with respect to the trading of securities, foreign exchange, and financial products broadly.

As new products emerge into established markets, it follows that existing legal rules and definitions are applied to these new developments. ASIC faced two main issues in relation to regulating digital currencies. The first was whether digital currencies were financial products requiring regulation by ASIC pursuant to the Corporations Act or the ASIC Act. The second was whether digital currencies facilitated certain types of crime in this area (predominantly financial).

In answering these two questions, ASIC has stated that ‘digital currencies themselves do not fit within the current legal definitions of a “financial product”’.82 A financial product is, broadly, a facility through which a person makes a financial investment, manages financial risk or makes a non-cash payment.83 For the purposes of regulation, ASIC finds that digital currency does not fall within the scope of that definition, stating that ‘the definition of “making a financial investment” does not include real property or bullion and we consider that it would similarly not include digital currencies’.84 Digital currencies are also generally not a facility through which a person manages risk, or makes a non-cash payment.85

Comparable to the position of the ATO, ASIC considers that digital currency is not ‘currency’ or money. Relevantly, ASIC states:86

…digital currencies are not a currency or money for the purposes of the Corporations Act. Digital currencies such as bitcoins are more akin to a commodity. We note that this view is consistent with the views expressed by the Australian Taxation Office (ATO) that digital currencies are not a ‘currency’. For this reason, we consider that contracts for the exchange of digital currency with a national currency are not foreign exchange contracts.

In providing some guidance on an appropriate definitional framework for digital currencies, ASIC notes that they could be treated in a similar manner to national currencies. This point was not discussed in great detail, concluding that it would need further consideration as such a definition could create ‘a more significant issue for other Australian regulators, and so broader consideration of the impact of such a change is appropriate’.87

While a definitive statement has not been provided by ASIC as to their definitional treatment of digital currencies, it is suggested that for securities purposes they are more

82 Australian Securities and Investments Commission, ‘Senate inquiry into digital currency - Submission by the Australian Securities and Investments Commission’, Submission 44 (December 2014) [5].
83 Ibid [46].
84 Ibid [47].
85 Ibid [48], [49].
86 Ibid [50].
87 Ibid [12].
likened to a commodity. ASIC suggests, in circumstances where regulatory change is required, that the law can accommodate new products within existing regimes, this being the approach that they have taken with respect to digital currencies. More specifically, ICOs are illustrative of this approach.

An ICO in Australia may be subject to various and differing regulations, pending the treatment and characterisation of any given ICO. Such characterisation will depend on the terms of the offer. That is, the legal status of an ICO is ‘dependent on the circumstances of the ICO, such as how the ICO is structured and operated, and the rights attached to the coin (or token) offered through the ICO’. As such, an ICO could constitute a managed investment scheme (MIS), an offer of shares, or a derivative.

In brief, if an ICO constitutes an MIS then there will be obligations under the Corporations Act with respect to reporting and disclosure. If the ICO is a share offer, a register must be kept and disclosure requirements may apply. Further, where an ICO is a derivative, the company will need to be licensed, requiring a financial services licence if advice is being provided in relation to products. As ASIC note:

…many of the obligations under the legislation ASIC administers apply to the issuers of financial products, who are responsible for the obligations to product holders under the terms of the product. On the other hand, digital currencies do not have an identifiable ‘issuer’, as there is no centralised authority responsible for their creation or any obligations owed to digital currency holders.

The regulatory issue with ICOs is faced with placing each ICO (after an assessment of its characteristics) into one of the existing regulatory frameworks above. While this is perhaps a more supportive attitude to digital currencies, this approach arguably increases regulatory issues with a lack of clear boundaries and compliance requirements. This then leads to a piecemeal inclusion of ICOs into different ‘product’ categories, each having different compliance, reporting and disclosure obligations.

Comparatively, we can see that the US approach is stricter in relation to ICOs insofar as having implemented a requirement to comply with various legislation which ensures protection of consumers with registration and reporting requirements.

While both the US and Australia have provided an arguably broader inclusion of digital currency within the securities regulatory scope, two issues become apparent. First, securities definitional structure is not in alignment with tax definitional structure within each country. Second, the definitions used by securities regulators are not necessarily specific enough to cover market activities such as ICOs. These points highlight that both securities and tax definitions, while different, do not properly cover the scope of market activity of digital currency.

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90 Australian Securities and Investments Commission, ‘Senate inquiry into digital currency - Submission by the Australian Securities and Investments Commission’, above n 82, [43].
2.3 New market of digital currencies needs national definitional consistency to allow for international collaboration

Responses by regulators often attempt to force disruptive technology into an existing regulatory framework. In the instance of digital currencies, the digital currencies are consistently being used in parallel to traditional markets, and regulatory drag and failures consistently allow such activity to occur.

3. DEFINITIONAL SOLUTIONS AND CROSS-DISCIPLINARY CONSIDERATIONS

Because digital currencies are not just being used in black and grey markets, or particular legal financial markets, it is critical that regulators get the definition correct to avoid as many unintended regulatory lags and failings as possible. As Daniela Sonderegger notes in her article arguing for bitcoin regulation:

“Governments around the world, threatened by Bitcoin’s ideological underpinnings but awed by its technological potential, find themselves in somewhat of a dilemma. On the one hand, regulation seems necessary. On the other, Bitcoin rejects centralized control and exists exclusively on the Internet, meaning that true, effective regulation can exist only through worldwide cooperation, which is costly, not to mention highly complex (citations omitted).”

3.1 Definitional solutions must be cross-disciplinary

As discussed above, both the Australian and US regulatory models relating to digital currency fail to be consistent across regulatory bodies. Regulation of digital currency for tax purposes does not match the language used in securities regulation in either jurisdiction, causing unintended enforcement issues. In the first instance, a particular jurisdiction should consider hybrid and new products from a larger lens.

Generally, in any market, compliance with corporate governance codes is enforced by regulatory and judicial bodies, but strengthened through societal approval or disapproval. It follows that what may be acceptable behaviour on a domestic basis may not be permissive in international dealings, particularly when developed countries are entering foreign underdeveloped markets. The converse is also true. Discrepancies between theory and practice will be considerations for all market participants and their regulators (domestic or otherwise). Misconduct can lead to decreased confidence in the market, and it is the state that is responsible for the correction of market failures through regulation and enforcement.

Although it is conceded that high regulation leads to large compliance costs (which in turn could outweigh some benefits to regulation), a balance is required between

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allowing free market participation that is adequately, consistently and appropriately regulated and the costs or work associated with compliance.

Inconsistencies arise when domestic and international regulators consider the regulation of digital currencies with specific reference to the legislative enactments for which they are responsible. It is necessary that regulatory solutions are made in consideration of the main regulatory bodies and their interaction at both the national, and international level.\textsuperscript{95}

As digital currency is specifically designed for cross-border usage, specific jurisdictions would benefit from a broader digital currency market perspective which would provide consistency across anti-avoidance language as well as enforcement activities.

### 3.2 Several global financial regulatory models already available

Both the Global Foreign Exchange Code model and the Organisation for Economic Co-Operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) model are recent developments in cross-jurisdictional enforcement that can provide guidance for global financial considerations. These examples take a broader market-based approach to regulatory structure, allowing for collaborative definitional development.

#### 3.2.1 The Global Foreign Exchange Code

An example of cross-jurisdictional cooperation regarding regulation can be seen in the implementation of the Global Foreign Exchange (FX) Code (Global Code). The Global Code is a global set of good practice principles aimed at promoting the integrity and effective functioning of the wholesale spot FX market.\textsuperscript{96} Distinguishable from digital currencies, the issues faced by foreign exchange regulators were not definitional and did not relate to a new market product. It is an example however, of a collaborative approach to regulation, which ultimately sought to articulate and identify good practices and processes as a supplement to formal regulatory instruments.

The Global Code was developed through a public sector-private sector partnership between central banks and market participants from 16 jurisdictions around the globe and published in May 2017, applying to ‘all FX Market Participants that engage in the FX Markets, including sell-side and buy-side entities, non-bank liquidity providers, operators of E-Trading Platforms, and other entities providing brokerage, execution, and settlement services’.\textsuperscript{97}

Two separate working groups were created, the first being the Foreign Exchange Working Group (FXWG) which was established to operate under a ‘Markets Committee’ composed of senior officials responsible for market operations in 21 central banks that represented the largest currency areas.\textsuperscript{98} The FXWG also promoted the adoption of the Global Code. The second group, relating to the private sector, was the Market Participants Group (MPG), also established by FXWG. This group would ‘help co-ordinate across the regional foreign exchange committees (FXCs) and

\textsuperscript{95} Australian Securities and Investments Commission, ‘Senate inquiry into digital currency - Submission by the Australian Securities and Investments Commission’, above n 82, [Section F].


\textsuperscript{97} Ibid 3.

\textsuperscript{98} Ibid 1.
representatives of the FX Market in other regions, in order to engage a broad and diverse set of Market Participants in the process of developing and promoting the Global Code'.

Throughout the process of drafting the code, various consultations occurred with industry bodies and a broad range of market participants. The effort was entirely collaborative, and occurred at a global scale. Such a globally comparative approach to the definition of digital currencies may have seen more consistencies between markets (at the national and international level), and resulted in a more coherent approach to the inclusion of digital currency in existing regulatory regimes.

### 3.2.2 OECD BEPS model

The BEPS project also took a global market approach to a cross-jurisdictional tax problem. In 2013, the G20 countries and the OECD convened to revise tax rules to avoid BEPS by global corporations. BEPS refers to the tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no tax locations. Over 100 countries and jurisdictions are collaborating to implement BEPS. The goal of the project is to ensure that ‘profits are taxed where economic activities are carried out and value is created’. This ‘soft-law’ project reviewed the interplay of different jurisdictional tax rules, establishing an action plan with 15 identified actions to provide coherence in domestic rules affecting cross-border activities, improving transparency and international standards, and creating certainty for corporations who do not take aggressive tax positions.

The first of the 15 actions, ‘Action 1: Digital Economy’, notes that BEPS is addressing the tax challenges of the digital economy, specifically noting that the digital economy affects and has transformed all sectors of the economy.

In developing the BEPS action plan, stakeholders, developing countries and G20 countries were engaged extensively. In a global context, the BEPS process can provide a model for managing cross-jurisdictional regulatory frameworks which consider both the independence of a jurisdiction, and the recognition of global economic activity that now, more than ever, transcends borders. Regulatory changes to implement the goals of the BEPS project are ongoing, including changes to bilateral tax treaties, domestic law implementation, country-by-country reporting and other measures.

### 3.3 Regulation of digital currency and timing matters

As demonstrated by the change in regulatory posture relating to both definitions and enforcement, a jurisdiction must consider the timing of regulatory action. When a jurisdiction moves too quickly to include a new product into an existing regulatory structure, there is insufficient information about the underlying market structure and effects. Thus, the regulatory structure can be improperly developed, as noted in the
discussion of GST and bitcoin and anti-money laundering definitional issues. However, when a jurisdiction fails to act in a timely manner, proper enforcement actions can also be lost, as demonstrated by the significant under-reporting concerns stated by regulators in the Coinbase case.

Initially, with the emergence of a new product, there is a need to understand how that product operates in the market before it can be adequately regulated. Indeed, time is required in observing a new product, its market interaction, and how it functions, before it can be accurately defined. It is once a definition is formed that the appropriate regulatory framework within which the product is to be placed can be identified.

In that regard, there is tension between a need to define and identify a product to place it quickly within a framework, therefore rendering it subject to regulation. With reference to digital currencies, it would be a ‘valuable undertaking to definitively assess the volume and value of digital currencies’ use relative to the mainstream payment system in order for regulatory agencies, such as taxation offices, to form a definitive response to their use’. The size and role of the product must first be established in the industry before it can be decided how to regulate it.

There have been varying proposals put forward in relation to the appropriate ‘model’ for regulatory adoption. These include those of graduated regulation, self-regulation, or a ‘wait-and-see’ approach to regulation. Ascertaining the best approach is no straightforward task, and there will be advantages and disadvantages for both early regulation, and a ‘wait-and-see’ approach. As stated by Mr Michael Saadat of ASIC:

...there is a bit of a chicken-and-egg issue around whether you wait for something like that to happen before you decide what regulatory framework you should apply, or you try and come up with a regulatory framework in anticipation of that occurring. I do not think there is an easy answer to that question because the risk in creating a regulatory framework in anticipation of something happening is that you get it wrong.

4. Conclusion

Initial characterisations of digital currency definitions in both the US and Australia are less than five years old, and in particular, it has been less than three years in relation to securities definitions in both jurisdictions.

Both countries are already taking different views of regulatory definitional structure in multiple financial regulation areas. This is expected in a new industry as policy-makers in differing jurisdictions come to regulation with differing views. We posit, however, that a broader jurisdictional and regulatory ‘cosmopolitanism’ will benefit all jurisdictions in the regulation of a global financial instrument such as digital currency.

104 Stern, above n 6, 11, citing Senate Economics References Committee, Parliament of Australia, above n 9, [5.59]-[5.62].
105 Senate Economics References Committee, Parliament of Australia, above n 9.
106 Ibid ch 5.
107 Mr Michael Saadat (Australian Securities and Investments Commission), Senate Economics References Committee, Hansard (7 April 2015) 38 and Senate Economics References Committee, Parliament of Australia, above n 9, [5.55].
This article concludes that the regulation of digital currency needs to be increasingly proactive, as the placement of new market products under an existing definitional framework for regulation leads to inconsistencies in regulatory application. Examples of the Global Foreign Exchange Code and OECD Base Erosion and Profit Shifting project demonstrate that regulatory cosmopolitanism provides necessary coherence to properly regulate a global financial product. Once cohesively defined, even with global harmonisation, tax administrators will further face daunting collection and enforcement challenges for a digital asset that is borderless, non-fiat, and anonymous.

While tax administration will not drive stabilisation of the digital marketplace, tax administrators might consider that regulation of digital currency, as a new hybrid intangible asset in a global marketplace, may provide an opportunity to consider forward-thinking harmonisation considerations for global tax administration.