

Income Tax Treatment of Digital Tokens

Overview

On 17 April 2020, the Inland Revenue Authority of Singapore (“IRAS”) published an e-Tax Guide titled “Income Tax Treatment of Digital Tokens”. The e-Tax Guide provides guidance on the income tax treatment of transactions involving digital tokens, including the issuance of digital tokens through an Initial Coin Offering (“ICO”). This publication by the IRAS is especially relevant to taxpayers operating in the ICO eco-system and provides significant clarity on many of the income tax issues faced by such taxpayers.

We summarise the salient points of the administrative guidance provided by IRAS below.

Income Tax Treatment of Digital Tokens

The general income tax treatment of digital tokens depends on the type of digital token involved.

Payment tokens

Transactions involving the use of payment tokens as payment for goods or services are viewed by IRAS as barter trade and the value of goods or services transferred should be determined at the point of transaction.

Where a business receives payment tokens for the goods or services it has provided, the business would be taxed on the value of the underlying goods or services provided.

Conversely, where a business uses payment tokens to pay for goods and services, the value of the deduction allowable (subject to tax deduction rules) will be based on the value of the underlying goods or services received.

While IRAS does not prescribe any methodology to value payment tokens, for the purposes of valuation, taxpayers can use an exchange rate that best reflects the value of the tokens received,

provided that the following two conditions are satisfied:

- The exchange rate must be reasonable and verifiable.
- The methodology used should be consistently applied year on year.

In addition, where the gain or loss on disposal of payment tokens is taxable, such as when the taxpayer is a trader in payment tokens, IRAS will accept the “first in first out” or weighted average cost methods of valuing the payment tokens disposed.

In determining the source of income for a transaction involving payment tokens, IRAS will consider the whole operation of the taxpayer’s trade or business when determining what the taxpayer has done to derive the income in question, and where those activities are performed. There is no single factor that is conclusive, and all facts will have to be considered holistically to determine if the activities that gave rise to the income are mainly carried on in Singapore. Some relevant factors include whether the company has any physical presence in Singapore, and whether the key activities (such as operating and maintaining a token exchange platform) are carried out in Singapore.

Utility tokens

When a user acquires a utility token to exchange for goods or services to be provided in future, the amount incurred by the user to purchase the relevant utility token will be treated as prepayment. Subject to tax deduction rules, a deduction will be allowed on the amount incurred at the point the token is used to exchange for the goods or services.

Security tokens

Generally, since security tokens are accounted for as a form of debt or equity (depending on the rights and obligations created by the token), interest or dividends derived by the owner of the security token will be taxed accordingly.

Where the security token is disposed of by the owner, tax treatment of the gain or loss on disposal will depend on whether the security token is a capital or revenue asset to the owner.

Income Tax Treatment for ICOs

The taxability of the ICO proceeds in the hands of the token issuer depends on the rights and functions of the tokens issued to investors.

- Payment tokens

Generally, the ICO issuer is treated to be trading in payment tokens. Hence, the proceeds from the issuance of payment tokens will generally be taxable.

- Utility tokens

As the proceeds from the issuance represent consideration for the payment of the service, such proceeds, being revenue in nature, are taxable. However, the proceeds are regarded as a form of deferred revenue as it is generally necessary for the ICO issuer to complete the development of a service platform before it can fulfil its performance obligations.

- Security tokens

The proceeds from the issuance of security tokens are akin to proceeds from the issuance of a debt or equity, and are thus capital in nature and not taxable.

If the security tokens pay interest or dividends, such payments may be deductible (subject to tax deduction rules).

Quick Observations

In addition to this e-Tax Guide by IRAS on income tax treatment, earlier in November 2019, IRAS had also issued an e-Tax Guide on the goods and services tax (“GST”) treatment of digital payment tokens.

The guidance provided by IRAS is consistent with general Singapore income tax and GST principles in respect of conventional transactions, and provides certainty to digital token issuers and users on their tax obligations. From our experience, Singapore is one of the few jurisdictions which ICO issuers readily consider because of our robust regulatory framework. This tax certainty will provide the additional boost for the argument why ICO issuers should issue their tokens out from Singapore.

The development of technology and the digital marketplace means that many more transactions and services will be making the shift to electronic platforms. Based on market trends, digital tokens and ICOs do feature prominently in this evolutionary process. The expectation is that once the global economy re-opens after this COVID-19 crisis, interest in digital tokens and ICOs will pick up again as companies continue to innovate and deliver new ideas and products. Digital tokens have a wide variety of uses and no two ICOs are exactly the same; there would often be many regulatory and tax considerations which need to be addressed. It is therefore critical for taxpayers to always seek comprehensive advice before embarking on their digital token journey.

If you would like information and/or assistance on the above or any other area of law, you may wish to contact the partner at WongPartnership whom you normally work with or the following:



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