

Sharing the Burden - Tax Reform's Shifting Winners and Losers – The Taxation Treatment of non-Australian currency gains and losses

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by

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Slide 1: Context

- Australian taxation law - foreign currency amounts translated into Australian currency.
- How this conversion occurs and its timing necessarily shifts burdens.
- Creation of winners and losers.
- Between taxpayer and taxation commissioner.
- Between taxpayers themselves.
- Context of taxpayers as commercial entities.
- Appreciation or depreciation of Australian dollar.
- Against currency in which commitment is denominated or discharged by payment.
- Results in an exchange gain or loss.

Slide 2: Practical application

- Increasing use by Australian enterprises of overseas financial facilities.
- To fund their daily business activities and longer-term investment strategies.
- Australian dollar has been floated since December 1983.
- Instability in its value relative to major foreign currencies at times has been significant.
- It has become a frequent characteristic of international money markets.
- Economic ramifications of appreciation and depreciation of Australian dollar.
- Floating value of Australian dollar subject to the foreign exchange gain and loss rules.
- Division 775 of the *Income Tax Assessment Act 1997* (Cth) – described as fairly “obscure”.
- May 2016 budget announcement – review.
- Try making them more straightforward to understand and apply.

Slide 3: Functions of money

These include:

- Measure of value;
- Medium of exchange;

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- Standard of postponed payment;
- Basis of credit;
- Unit of account;
- Measure of value;
- Store of value.

Reference: <http://www.economicdiscussion.net/money/functions-money/top-6-functions-of-money-discussed/12710> accessed 12 January 2018

- Importance of the existence of distinctive monetary systems to the functions of money

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 65-98 [2.01]-[2.82] Clarendon Press, Oxford

Slide 4: Additional complication of digital currencies

- Businesses and individuals globally are turning to digital currencies such as bitcoin.
- Includes for individual investment and consumption.
- Volatility of bitcoin's value is notorious- speculative transactions and investments.
- A digital asset.
- Designed to work as a medium of exchange.
- Uses cryptography:
 - To secure its transactions;
 - To control the creation of additional units; and
 - To verify the transfer of assets.
- Use decentralized control.
- As opposed to centralized electronic money and central banking systems.
- Use of a block chain transaction database.
- In the role of a distributed ledger.

Reference: *Cryptocurrency* at <https://en.wikipedia.org/wiki/Cryptocurrency> accessed 12 January 2018.

Slide 5: Relevant budgetary developments

- Another announcement made in 2016 by the Federal Treasurer, the Hon Scott Morrison MHR.
- Confirmed with May 2017 budget.
- Digital currencies, such as bitcoin, no longer suffer a "double taxation" burden.
- By their use in payment effectively bearing Goods and Services Tax twice.
- Once on purchase of digital currency and again on its use in exchange for goods and services.
- Objective: to remove an obstacle for the financial technology sector to grow in Australia.
- Digital currencies in Australia; do they remain niche?
- Distributed Ledger Technology inspired by bitcoin's "block chain".
- Generated significant interest.
- E.g. ASIC in 2017 has expected range of DLT's potential uses to grow exponentially.

Slide 6: Illustration of Identifying the winners and losers

- Move is said to result in a small but unquantifiable decrease in GST collections.
- Decrease in associated payments to States and Territories over the forward estimates period.
- Ramifications of shift in tax burden.
- Impact upon growth of financial technology sector in Australia.
- What further changes might need to be made.
- Includes protection of taxation base.

Slide 7: Winners and losers re tax in age of digital revolution

- Rise of bitcoin and other “cryptocurrencies”.
- The past: beyond imagination even as science fiction.
- The past: abstract conception by computer “wizkids” but no practical application.
- The present: to what extent are they already fully fledged market changers?
- The future: likely to stay with revolutionary effects.
- Potential of blockchain on which digital currencies based.
- One of fastest growing areas of digital revolution.
- Likely to shake up traditional financial processes.
- Leverage of digital currencies will create winners and losers, including in tax.

Slide 8: Traditional view of “money”: chattel

- Money is a chattel personal.
- The European Currency Unit is not a chattel: this is one of the many reasons why it is not money.
- From primitive periods until the present day, as in all civilised countries.
- Accustomed to connect money with definite quantities of metal or coins or notes.
- Money can be followed *in rem* only:
- Against a holder who is *mala fides* or who did not provide valuable consideration;
- If it can be identified in or disentangled from a mixed fund.
- Otherwise money has no “earmark”.

Reference: F A Mann, *The Legal Aspect of Money* (5th ed 1992) 8-12 Clarendon Press, Oxford

Slide 9: Traditional view of “money”: the State

- Only those chattels are money to which such character has been attributed:
- By or with the authority of the State.
- The necessary consequence of the sovereign power over currency.
- To permit the circulation of money that is not created or at least authorised by the State.
- Tantamount to denial of the State’s monetary prerogatives.
- Chattel issued by the State only the external sign of the many aspects of sovereign power over money from which it is derived.
- Involves much more than the mere issue of money.
- Comprises the whole of monetary, credit, fiscal and budgetary policy.

- As well as those measures which economists tend to include in the concept of money.
- Viz. its supply and use, the control of inflation, interest rates, exchange control, and so forth.

Reference: F A Mann, *The Legal Aspect of Money* (5th ed 1992) 14-15 Clarendon Press, Oxford

Slide 10: Traditional view of “money”: prerequisite of sovereignty

- Sovereignty is the prerequisite of money control in its widest sense
- And of the issue of money in particular.
- State confers upon circulating media their nominal value.
- This nominal value is independent of the material they are made of, their purchasing power and their external value.
- Money cannot lose its value except by virtue of formal demonetisation.
- Only those chattels issued by or on behalf of the State are money:
- Which are denominated by reference to a distinct unit of account.
- Such unit of account peculiar to the State which creates it for the purposes of denominating its currency.
- Therefore the characteristic feature of a national currency system.
- Chattels denominated by reference to such a unit of account are money if they are meant to serve as universal media of exchange in the State of issue.

Reference: F A Mann, *The Legal Aspect of Money* (5th ed 1992) 15-28 Clarendon Press, Oxford

Slide 11: Updated definition of “money”: modify traditional definition, rather than discard it

- It is clear that the State retains a significant role in the creation of a monetary system.
- Only the State can define and replace the unit of account.
- Only the State can provide legal tender status to physical cash.
- But it can no longer be accepted that money can exist only in a physical form.
- Nor can it be accepted that the State has a monopoly over the creation of money.
- However, “State theory” of money does not necessarily have to be discarded in its entirety.
- It may be sufficient to modify it to reflect developments since originally formulated.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 40 [1.67] Clarendon Press, Oxford

Slide 12: Updated definition of “money”: how modify the traditional version

- Requirement that money should exist in the form of a chattel no longer tenable.
- The issue of *physical* currency a State monopoly.
- Such physical notes and coins can no longer be treated as *sole* form of money within a particular country.
- It follows that the expression “money” an essentially abstract rather than a physical concept.
- Money must be expressed by reference to a name and denominated by reference to a unit of account.
- Which, in each case, the name and unit are prescribed by law of the State concerned.

- The currency and unit so prescribed must be intended to serve as the generally accepted measure of value and medium of exchange within the State concerned.
- The legal framework for the currency must include a central bank or monetary authority responsible for the issue of the currency.
- There must be included appropriate institutional provisions for management of the currency through the conduct of monetary policy and the oversight of payment systems.
- Monetary laws can define the monetary system and define the unit of account.
- They cannot now readily limit the definition of “money” itself.
- Nor can they directly limit the amount of money in circulation.
- Monetary policy can only influence, rather than control, such matters.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 40-42 [1.68]-1.69] Clarendon Press, Oxford

Slide 13: Updated definition of “money”: application of relevant criteria

- If money is to exist in several different forms, then the law should ensure that the rights of a person who receives “money” are essentially the same, irrespective of the precise form in which that money is received.
- “the representation of money which is made available by delivery only must be subject to the same rules as the money which it represents”: *Wookey v Poole* (1820) 4 B & Ald 1 (use of banknotes).
- To constitute “money”, new means of payment must display characteristics which are in most respects similar to the traditional, physical forms of money.
- Consider some of the special attributes of cash, and examine the extent to which money in a non-cash form can be treated on the same basis.
- “by the use of money, the interchange of all other forms of property is most readily accomplished. To fit it for its purpose, the stamp denotes its value and possession alone must decide to whom it belongs”: *Wookey v Poole* (1820) 4 B & Ald 1 (use of banknotes).
- In the case of physical cash, a transfer of possession generally connotes a transfer of ownership, at least provided that the transfer has acted in good faith and given value, and will constitute “payment” in respect of the debt obligation concerned.
- If funds have been transferred to the payee by means of a bank transfer or through electronic means, then the credit to the transferee’s account will generally be irrevocable and will constitute the transferee’s possession of, and thus the transferee’s *prima facie* entitlement to the funds concerned.
- If the transferee received the funds in good faith and for value, then the transferee is entitled to retain them by way of payment and the transferee is not required to enquire as to the transferor’s original source of funds, or any other matter (as a general principle, leaving aside such legislation as that dealing with money laundering which may require the transferee to make enquiries in certain cases).
- Non-physical forms of “cash” may constitute “payment”, so long as the transferee is immediately able to dispose of the full amount of the funds concerned and to apply them in discharge of the transferee’s own obligations. Payment in this form is, to this extent, equated with payment in physical cash.

- The recipient of a bank transfer acting in good faith would appear to acquire good title to the funds free of any prior equities. The bank transfer enjoys some of the features, if not the formalities of negotiability.
- A creditor who receives payment by means of a bank transfer is not in any sense concerned with the debtor's credit standing nor usually with any error, mistake or want of authority on the part of the bank that remits the funds.
- In a private international law context, the ability to acquire a good title to notes and coins appears to be governed by the law of the place in which the transaction occurs and the moneys are physically handed over to the creditor.
- Likewise, in the case of a bank transfer, the creditor's entitlement to the funds and the validity of the creditor's title to them will be governed by the law of the place to which the funds are remitted to the account of the creditor.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 43-48 [1.72]-1.75] Clarendon Press, Oxford

Slide 14: Updated definition of "money": summary

- Payment by means of a bank transfer shares many of the legal characteristics of payment in physical money.
- Funds standing to the credit of a bank account should be regarded as "money" for legal purposes.
- A new form of payment may be regarded as "money" if it broadly meets the requisite criteria.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 48 [1.76] Clarendon Press, Oxford

Slide 15: Electronic money: definition

- Electronic money has been defined as monetary value represented by a claim on the issuer which is stored in an electronic device and accepted as a means of payment by undertakings other than the issuer.
- Electronic money must continue to be available once it has been issued to a holder.
- For example, an electronic money institution:
 - Must have been authorised by an appropriate authority;
 - Must be meeting minimum capital and "own funds" requirements;
 - Must "ringfence" funds placed with it to purchase electronic money;
 - Must both sell and redeem electronic money only at its face or par value;
 - Must be prohibited from paying interest.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 50 [1.80] Clarendon Press, Oxford

Slide 16: Why electronic money can satisfy definition of "money"

- Electronic money may be stored on a card which may not disclose the name of the holder.
- The use of the card entails an immediate transfer of funds to the creditor's bank account.

- The creditor can thus accept electronic money without reference either to the identity or the credit standing of the holder.
- In the absence of bad faith, the creditor would obtain an unimpeachable title to the funds transferred.
- Electronic money exhibits some of the physical characteristics of physical cash.
- To this extent, electronic money may thus qualify for the label of “money”.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 50 [1.81] Clarendon Press, Oxford

Slide 17: Why bank deposits and electronic money can satisfy definition of “money”

- The fact that both bank deposits and electronic money constitute obligations of, or are issued by, private organisations does not prevent them satisfying the definition of “money”, if they:
- pass freely throughout the community in the payment or discharge of debts.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 50-51 [1.81] Clarendon Press, Oxford

Slide 18: Traditional view of “foreign money”: a commodity?

- Where the payment of a sum of foreign money is promised, a monetary obligation exists.
- The foreign money functions as money.
- The legal character of the obligation being inherently identical with that of an obligation to pay a sum of domestic money.
- The principle of nominalism applies to obligations to pay foreign money.
- This rule presupposes the monetary character of such an obligation.
- If a defendant has sold foreign money against domestic money and undertaken to deliver the foreign money at a certain place abroad, the defendant’s failure to do so makes the defendant liable to repay the domestic money received, not the value of the foreign money promised.

Reference: F A Mann, *The Legal Aspect of Money* (5th ed 1992) 196-202 Clarendon Press, Oxford

- Foreign money is not a measure of value in Australia and hence should not be regarded as money in this country: e.g. *Caltex Ltd v Federal Commissioner of Taxation* (1960) 106 CLR 205, 220 per Dixon CJ.
- This is perhaps the best (albeit insufficient argument) for treating foreign money as a commodity: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 52 [1.84] Clarendon Press, Oxford.

Slide 19: Even on traditional view foreign currency should be able to have been “money”?

- It has often been said that “a contract to pay in a foreign currency is a contract to provide a commodity”: *In re British America Continental Bank Ltd v Credit General* [1922] 2 Ch 589, 595 per P O Lawrence J: F A Mann, *The Legal Aspect of Money* (5th ed 1992) 198 Clarendon Press, Oxford.

- The suggestion that a contract for the payment of foreign money is a monetary obligation or a debt should always have been obvious.
- Such a conclusion is now firmly supported by the effect of, and the philosophy underlying, the decision of the House of Lords in *Miliangos v George Frank (Textiles) Ltd* [1976] AC 443.
- There is was held in the case of a foreign money obligation English courts were entitled and bound to give judgment in terms of the foreign currency contracted for.

Reference: F A Mann, *The Legal Aspect of Money* (5th ed 1992) 197-198 Clarendon Press, Oxford

- Foreign currency cash itself can be a CGT asset

Reference: Australian Taxation Office, *CGT and foreign exchange gains and losses* at <https://www.ato.gov.au/Forms/Guide-to-capital-gains-tax-2013-14/?page=18> and *Foreign Exchange Gains and Losses* at <https://www.ato.gov.au/Business/Foreign-exchange-gains-and-losses/> (1 March 2016) accessed 12 January 2018

- Goods and Services Tax: Explanation of how to convert amounts of consideration that are expressed in foreign currency into Australian currency for GST purposes

Reference: Australian Taxation Office, Goods and Services Tax: foreign exchange conversions at <http://law.ato.gov.au/atolaw/view.htm?docid=GST/GSTR20012/NAT/ATO/00001>

(4 October 2017) accessed 12 January 2018)

Slide 20: Summary of modern view re foreign currencies as money

- Foreign currency is to be regarded as “money” under precisely the same circumstances as domestic currency is to be regarded as “money” – it is always to be regarded as “money” except where delivered for its intrinsic metallic, rarity or curiosity value.
- Foreign currency cannot constitute legal tender for Australian dollar debts in this country: including debts to the Federal Commissioner of Taxation or to State revenue authorities. Anything which is legal tender must be money, but not all money is legal tender.
- It seems that foreign currency can be negotiable in Australia in that it is capable of being transferred by delivery (or endorsement, rather than by assignment), and such a transfer takes effect free from prior equities or claims, even where the foreign currency has previously been stolen.
- Legislation can confirm how foreign currency is to be regarded as “money” within Australia. For example, section 544C of the *Corporations Act 2001* (conversion into Australian currency of foreign currency debts or claims).
- An action for money had and received can be brought regardless of the currency in which the relevant funds were received, and it follows that foreign currency is “money” for the purposes of this type of action.
- An obligation to pay a fixed sum in a foreign currency may be a “debt”, with the result that it can provide a basis for a statutory notice leading to a winding up or petition.
- *Daewoo v Suncorp-Medway* [2000] NSWSC 35 considers and largely dismisses the commodity theory of foreign currency.

Reference: Charles Proctor, *Mann on the Legal Aspect of Money* (7th ed 2012) 53-55 [1.86] Clarendon Press, Oxford

Slide 21: Conclusion

- Some reform already occurred.
- Further reform positive and even necessary.
- Is it necessary for taxation obligations to be discharged in legal tender?
- Changing context of what “non-Australian” currency gains and losses can come to mean!
- Essential for taxation burdens to be shared or apportioned on relatively predictable bases.
- Shifting winners and losers inherent in tax reform.
- Wins and losses should be relatively predictable in sound tax reform.
- Distinction between electronic money and cryptocurrencies.
- Taxation system requires widespread medium of exchange.
- Taxation system requires a reasonably stable measure of value.
- Taxation system requires a reliable standard of postponed payment and credit.
- Taxation system requires a widespread use of a unit of account.
- Taxation system requires a secure store of value.
- Crypto currencies can create huge winners and losers.
- On an unpredictable basis.
- Contrary to any taxation-related policy.
- Therefore, a sound taxation system presently cannot “adopt “a cryptocurrency.