Your trusted adviser

# TAX AND CRYPTO

# TAXING CRYPTOCURRENCY IN AUSTRALIA - EBOOK

This eBook shares important information that aims to educate individuals about the tax obligations associated with cryptocurrency in Australia.  It also shares information about the basics of cryptocurrency so that people who have little to no knowledge of digital currency can make a more informed decision about whether or not cryptocurrency is something that they wish to invest in sometime in the foreseeable future.

## What Is Cryptocurrency and How To Get It?

Cryptocurrencies also known as digital currencies are created and held electronically. Unlike traditional money, cryptocurrencies aren't printed and no one controls them. Cryptocurrencies are produced by people and in more recent times by businesses who are running computers all over the world, by using software that attempts to solve mathematical problems.

There are estimated to be over 4,000 cryptocurrencies in the world. Bitcoin is the most well-known type of cryptocurrency. Other well-known kinds include; Ethereum, Ripple XRP, Litecoin and NEO.

There are three ways to obtain cryptocurrencies. You can get them by mining them, buying them or providing goods and services in order to earn them.

Mining is the process by which cryptocurrency is created. A computer will crunch through a number of difficult mathematical problems and by succeeding with the right answers the person who uses the computer is rewarded with a unit of the currency.

A person can also create an 'online wall' or acquire the digital currency by visiting a 'cryptocurrency exchange system' that aims to put sellers in touch with people who are interested in buying. The buyers will pay for the cryptocurrency they purchased by transfer money via their online banking account.

As a result of cryptocurrency becoming a more accepted virtual currency by businesses and individuals around the world, the third and final way to obtain the digital currency which is providing goods and services has become an increasingly common occurrence. Most commonly it is done in restaurants and cafes that accept bitcoin as a form of payment. This is sometimes done by completing online surveys or undertaking some form of affiliative marketing.

## THE IMPORTANCE OF DECLARING CRYPTOCURRENCY RELATED ASSETS

As cryptocurrencies become more and more entrenched in the mainstream, one of the biggest challenges in accounting for them has been that some investors may not be aware that it is a requirement for them to disclose crypto assets to their accountants.

Craig Dangar says that one of the biggest misconceptions Australians have about cryptocurrency is the fact that taxpayers must report their cryptocurrency related earnings. "You need to report it. It is not a hidden transaction and it is really important that businesses understand that they are obliged to report the receipts from cryptocurrency in their tax returns," says Craig Dangar from Vault Accountants.

It is super important for financial advisers to educate themselves in relation to cryptocurrency. Advisers need to make sure that when they're dealing with their clients, they're asking the question such as; "have you been involved in buying and selling, or investing in cryptocurrencies over the course of the past year?""

On top of encouraging their clients to disclose their crypto assets, advisors should see this current period as a "warning flag" and familiarise themselves with how cryptocurrencies work before the ATO moves forward and introduces compliance action.

When looking at the big picture, the basic tax rules apply for cryptocurrency as the rules applied for other forms of investments. It is important for advisers to understand how to treat cryptocurrency transactions, and compare how other kinds of transactions are treated, and get a handle of the kind of records that people have in relation to cryptocurrencies.

## WHAT IS THE ATO DOING TO TAX CRYPTOCURRENCY?

The Australian Tax Office (ATO) has estimated that somewhere between 500,000 and one million Australians have currently invested in crypto related assets. Many of these individuals have failed, or will fail, to properly report the profits they have made for tax purposes.

In response to this common occurrence, the ATO is gathering bulk records from Australian cryptocurrency designated service providers (DSPs) as part of a data matching program which aims to ensure that people trading in cryptocurrency are paying the amount of tax that is required for them to pay.

The data that has been provided to the ATO consists of cryptocurrency sales and purchase information. The data will identify Australian taxpayers who have failed to disclose their income details correctly.

A number of Australian taxpayers may find themselves being contacted by the ATO as a result of the data matching exercise. Those who are contacted will be given an opportunity to amend their tax returns to include any information highlighted by the ATO.

Individuals will have a timeframe of 28 days to clarify any information that has been obtained via the data provider. Thousands of letters have already been issued to taxpayers across the country and more will continue to be sent.

Recipients of the letters who fail to modify their tax return to include the missing transactions will be met with more forceful compliance action which could include a full tax audit.

## HOW THE ATO TAXES CRYPTOCURRENCIES

Generally speaking, there is no income tax or GST implications if you are not in business or carrying on an enterprise and you simply pay for goods or services using cryptocurrency. An example of this would be purchasing personal goods or services on the internet with bitcoin.

Cryptocurrency is regarded as capital gains tax (CGT) assets therefore CGT potentially applies when an Australian resident sends a unit of the currency to another individual. Despite this, transactions are excused from the CGT if the cryptocurrency is used to pay for services or goods for personal use for example online hotel bookings, or at a café or restaurant which accepts bitcoins.

Transactions are also exempted from CGT if the cost of the cryptocurrency used to pay for the transaction is under $10,000 (this is the exemption for personal use assets).

If the cost of the cryptocurrency used in a transaction surpasses $10,000, the personal use exemption will be unavailable and Capital Gains Tax will apply. The capital gain is calculated as the increase in value of the cryptocurrency between the time it was acquired and the time it was disposed of.

An individual can easily lodge your tax return via MyTax, which is available VIA a taxpayers MyGov account. You can personalise your tax return and declare capital gains or losses by selecting the 'Capital gains tax (CGT) related items'.

# HOW IS CAPITAL GAINS TAX (CGT) APPLIED TO CRYPTOCURRENCY

The way Capital Gains Tax (CGT) is calculated is based on the difference between the amount you paid for the cryptocurrency and the amount you disposed of in order to obtain it. Any profit you make is subjected to CGT, but this can be potentially reduced by 50 percent if you hold the cryptocurrency for over 12 months.

## Outline of How A Capital Gain Is Calculated:

- Deduct the cost base from the sale proceeds – The cost base is the price you paid for the cryptocurrency in addition to any incidental costs.
- The next step is to take away any capital losses.
- You must than discount the gain – Individuals are eligible to receive a 50 percent discount if you hold the crypto asset for 12 months or more.
- The resulting figure is your net capital gain - This is subject to tax at your marginal rate. The associated legal and professional costs to set up a sole trader business are minimal and the business has no separate legal existence from its owner, meaning you are responsible for all the liabilities of your business.
- The disposal occurs when:

  a.) Selling cryptocurrency for Australian dollars

  b.) Exchanging one cryptocurrency for another

  c.) Gifting cryptocurrency

  d.) Trading cryptocurrency

  e.) Using cryptocurrency to pay for goods or services. In some cases (such as when you gift it), market value is substituted for proceeds.

It is important to keep in mind that CGT is not always relevant If you are acquiring the cryptocurrency in order to trade it, you might be deemed to be running a business of trading cryptocurrency. In this type of scenario, you will be required to pay income tax on the business profits. This is usually less advantageous than CGT because the 50% CGT discount cannot apply.

## WHAT HAPPENS IF AN INDIVIDUAL MAKES A LOSS

If your cryptocurrency related sale proceeds are less than your cost base, then you will make a capital loss. A capital loss can be offset against capital gains arising in the same year and, to the extent they are not used up, they can be carried forward indefinitely until capital gains arise to absorb them. Capital losses can only be offset against capital gains, but not against any other form of income.

If you dispose of cryptocurrency during the year and net a capital gain, you might want to consider disposing of any other assets you own that are sitting at a loss. This way the capital loss can be offset against the capital gain. If you lose your coins, they are stolen or you are otherwise subject to fraud, you may be able to claim the value of your losses as a capital loss.

## HOW DOES SELLING OR SWAPPING CRYPTOCURRENCY ALTER YOUR TAX OBLIGATIONS

Whether you sell cryptocurrency for Australian dollars or exchange one form of cryptocurrency for another, the tax treatment is the same:

You will always be liable for CGT and will need to record any gain on your tax return. The gain is basically the sale proceeds (substituted for market value for some transactions) less the cost.

Some taxpayers mistakenly think they can buy up to $10,000 of cryptocurrency and avoid CGT by taking advantage of the 'personal use' exemption.

The 'personal use' exemption only applies when the cost of the cryptocurrency does not exceed $10,000 and you can demonstrate that the cryptocurrency was to fund genuine personal consumption, such as paying for a holiday, a car or your wedding.

Mistakenly relying on this exemption is one of the biggest reasons people get in trouble with the ATO. If you use it, expect to be asked to provide proof that you either did or that you intended to use your cryptocurrency to fund personal spending on goods or services.

If the cost of your cryptocurrency assets exceeds $10,000, the 'personal use' exemption will not be available and CGT will apply, regardless of whether the asset was for personal use or not.

During a period of ownership, the way the cryptocurrency you have acquired is kept or used may change. An example of this would be when the cryptocurrency you originally acquired for personal use and enjoyment, eventually began being kept or used as an investment, to make a profit on ultimate disposal or as part of carrying on a business.

The longer your cryptocurrency is held, the less likely it is that it will be a personal use asset, even if you ultimately use it to purchase items for personal use or consumption.

## CRYPTOCURRENCY AND INCOME TAX

In Australia income deriving from cryptocurrency is liable for income tax in the same way that salaries, dividends and bonuses are taxed. In crypto terms, the parallels look roughly like this:

- Getting paid in cryptocurrency – like a salary
- Staking rewards – like dividends
- Airdrops – like bonuses
- DeFi interest – like bank account interest
- Referral bonus – like commission

## THE LOSS OR THEFT OF CRYPTOCURRENCY

It might be possible to claim a capital loss if you lose your cryptocurrency private key or your cryptocurrency is stolen.

In this type of situation, the issue is likely to be whether the cryptocurrency is lost, whether you have lost evidence of your ownership, or whether you have lost access to the cryptocurrency.

In most cases when an item can be replaced it is not lost. A lost private key can't be replaced. Therefore, to claim a capital loss you must be able to provide the following kinds of evidence:

- when you acquired and lost the private key
- the wallet address that the private key relates to
- the cost you incurred to acquire the lost or stolen cryptocurrency
- the amount of cryptocurrency in the wallet at the time of loss of private key
- that the wallet was controlled by you (for example, transactions linked to your identity)
- that you are in possession of the hardware that stores the wallet
- transactions to the wallet from a digital currency exchange for which you hold a verified account or is linked to your identity.

## IMPORTANT INFORMATION ABOUT TRADING CRYPTOCURRENCY

If you buy and sell cryptocurrency on a regular basis with the goal of making a profit, then the profit on disposal of the cryptocurrency will not be subject to CGT. Instead, it will be assessable income as you will be regarded as a 'trader' rather than an 'investor'.

In this type of situation, you will be regarded as being in business as a buyer/seller of cryptocurrency. It can be a fine line between being an investor and a trader. Generally speaking, if you are turning over your cryptocurrency every few days chasing profits, you have many transactions and you are running a business-like structure for example; with a business plan, accounts and records of trading stock, business premises, licences or qualifications, a registered business name and an Australian business number you are considered a trader.

If you are holding the cryptocurrency with the goal of long-term gain, you are likely to be an investor. The rules regarding trading cryptocurrency for business or profit (versus buying/selling it as an investment) are essentially the same as those applying to share traders versus investors.

## AUSTRALIAN BUSINESSES USING BITCOIN TO BUY AND SELL GOODS AND SERVICES

If you are a business owner who has received cryptocurrency for your goods or services, you will need to record the value of the cryptocurrency units in Australian dollars as a requirement when reporting your ordinary income for tax purposes.

When your business purchases items (including trading stock) with cryptocurrency you are entitled to a tax deduction based on the arm's length value of any item you acquire.

The disposal of cryptocurrency may have may also have capital gains tax consequences if you are running a business. However, it is important to know that the any capital gain is reduced by the amount included in assessable income as ordinary income (so you aren't taxed twice on the same amount).

Examples of businesses that involve cryptocurrency include;

- cryptocurrency trading businesses
- cryptocurrency mining businesses
- cryptocurrency exchange businesses (including ATMs).

Not all people acquiring and disposing of cryptocurrency will be carrying on businesses. To be carrying on business, you will usually:

- carry on your activity for commercial reasons and in a commercially viable way
- undertake activities in a business-like manner – this would typically include preparing a business plan and acquiring capital assets or inventory in line with the business plan
- prepare accounting records and market a business name or product
- intend to make a profit or genuinely believe you will make a profit, even if you are unlikely to do so in the short term.

There is also usually repetition and regularity to your business activities, although one-off transactions can amount to a business in some cases.

Whether you are carrying on a business and when the business commences are important pieces of information. If you're still setting up or preparing to go into business, you might not yet have started the business.

Money received (or property received) prior to a business being carried on is not generally assessable income. Likewise, you can't claim deductions incurred prior to the business being carried on.

## MINING CRYPTOCURRENCY AS A BUSINESS

If your business is mining cryptocurrency, any income resulting from the transfer of the mined digital currency to someone else is included in assessable income. Any expenses which occur as a result of the mining activity are allowed as a deduction.

Any losses resulting from the mining of cryptocurrency might also be subject to the non-commercial loss provisions, this means they won't automatically be available to offset against other income (there are tests you will have to meet first).

The non-commercial loss provisions exist to prevent individuals or businesses from using up losses from activities which they never realistically had a chance of making a profit or which don't arise from genuine business activities. For example; people who are trading as a hobby or are engaging in speculation which is basically a form of gambling.

If you are carrying on a business of mining with the intention to sell the currency, it is a form of trading stoke. You will therefore need to bring into account any currency on hand at the end of each income year.

A huge advantage of getting involved in cryptocurrency is that there are very few barriers stopping you from getting involved. With a few Internet searches, you can set up your computer to start mining coins for you.

With cryptocurrencies such as bitcoin, you are unlikely to make any money mining without a gargantuan rig, but on some lesser-known coins, you might be able to set up your computer to generate some extra money for you without putting in much effort.

## TAXPAYERS CONDUCTING A CRYPTOCURRENCY EXCHANGE (INCLUDING ATM'S)

If you are running a business that aims to buy and sell cryptocurrency as an exchange service, the proceeds resulting from the sale of the currency are included in assessable income.

Any expenses accumulated as a of the exchange service, including the acquisition of the cryptocurrency for sale, are tax deductible.

## DISPOSING OF CRYPTOCURRENCY ACQUIRED FOR INVESTMENT

When acquiring cryptocurrency as an investment, CGT will apply, however when the cost of the cryptocurrency does not exceed $10,000 the personal use asset exemption may apply if you can prove that the cryptocurrency was to fund personal consumption.

The ATO pays extra attention to taxpayers who try to rely on the personal use asset exemption to avoid CGT; prepare to be asked to provide evidence that you either did or intended to use your cryptocurrency to fund personal spending on services and goods.

When the price of the cryptocurrency surpasses $10,000, the personal use exemption will not be available and CGT will apply. The capital gain is calculated as the increase in value of the cryptocurrency between the time it was acquired and the time it was disposed of.

If the transactions result in profit-making undertaking or plan then the profits on disposal of the cryptocurrency will be assessable income since you will be viewed as a trader instead of an investor.

The rules around trading cryptocurrency for business or profit in comparison to buying and selling cryptocurrency as an investment are pretty much the same as those applying to share traders versus investors. There are number of things to take into consideration but generally speaking, if you are holding the cryptocurrency with a goal to long term gain, you are most likely to be an investor. If you are buying and selling cryptocurrency over the short term with a view to making profits, you are likely to be perceived as a trader.

## RECORD KEEPING

Every Australian dealing with cryptocurrency is required to maintain the following records for tax purposes: the date of every transaction, the amount in Australian dollars at the time when the transaction was made, why the transaction was made and the details of the other party involved in the transaction.

Maintaining detailed records is very important to prove your transactions and associated expenses.

### Your records must include:

- The date of the transactions
- The value of the cryptocurrency in Australian dollars at the time of the transaction (this can be taken from a reputable online exchange)
- The purpose of the transaction and the details of the other party (even if it's just their cryptocurrency address)

### Types of records you should keep include:

- Receipts of purchase or transfer of cryptocurrency
- Exchange records
- Records of agent, accountants and legal costs
- Digital wallet records and keys
- Software costs related to managing your tax affairs

It is important to remember that you must keep records for five years from the date you lodge your tax return.

## TIMING SALES TO BE MORE TAX EFFECTIVE

When you are subject to CGT, it's a good idea to hold on to cryptocurrency for 12 months, because then you become eligible for the 50 percent discount (literally halving the tax you pay). If you sell before the 12-month ownership period is up, you are liable for CGT at the full rate.

It also makes sense to defer any cryptocurrency sales until 1st July or later because then the tax will not be due until the next financial year. By deferring the sale into the next financial year, you also defer the tax by one year.

Finally, always try to match capital profits against years when your other income is low so the capital gains will be the top slice of your income. If you don't have other income, your capital gains will be tax-free and/or taxed at the lowest rates of tax. If on the other hand you have other income which exceeds $180,000, your capital gains will be taxed at the highest rate of 45 percent.

## GST AND CRYPTOCURRENCY

For supplies or payments made on or after 1 July 2017, the GST treatment of cryptocurrency is similar to that of money. Prior to 1st July 2017, sales and purchases of cryptocurrency (such as bitcoin) were subject to GST. This means that if you were registered for GST, you had to pay GST and were entitled to GST credits on any transactions in relation to cryptocurrency.

This means that previously businesses that used cryptocurrency as a medium of payment or receipt within their business would have two GST transactions: One relating to the actual supply of goods or services from their business, and the other relating to the sale or purchase of cryptocurrency associated with the payment or receipt.

Since 1st July 2017, sales of cryptocurrency are now input taxed sales (financial supplies), which means that:

GST is not paid on the sales of cryptocurrency made, and GST credits generally can't be claimed for the GST included in the price paid for anything purchased to make those sales.

However, it may be possible to claim GST credits on purchases used to make cryptocurrency sales in the following situations:

- If the financial acquisitions threshold isn't exceeded, in which case there is a full entitlement to GST credits for purchases relating to cryptocurrency sales, or
- If the financial acquisitions threshold is exceeded, it may be possible to claim reduced GST credits if specific types of purchases are made.

The financial acquisitions threshold is exceeded if, based on purchases made over a 12-month period, you make or are likely to make, financial acquisitions where the input tax credits related to making those acquisitions would exceed the lesser of either: $150,000, or 10% of the total amount of input tax credits to which you would be entitled.

## OFFERING CRYPTOCURRENCY AS A FORM OF PAYMENT FOR YOUR BUSINESS

Offering cryptocurrency as a form of payment for goods and services is a trend that is becoming more and more common across Australia. Craig Dangar says that businesses who are wanting to offer cryptocurrency as a form of payment in their business should start off slow and make sure they understand the basics of crypto before introducing it into their business model.

“Start slow and understand the basics. Whilst preparing a lot of crypto tax returns this year we have seen traders often do substantially worse off than those who took a buy and hold approach. If you are thinking of adopting crypto as a payment mechanism, feel free to give us a call, we have a few good stories and but also a few horror stories about using cryptocurrency as form of payment for a business,” says Craig Dangar.

Mr. Dangar also encourages business not to accept all coins as a form of payment and to “make sure that the coin is widely traded so you can convert it back to traditional money. This is because there is significant market volatility a fair margin or fee should be charged on this transaction to cover your costs. As most of your suppliers and the ATO won’t accept coin, it is important to ensure that you keep substantial Fiat transactions,” says Craig Dangar.

“Interestingly, for people who hold cryptocurrency we are finding offering the option to pay in cryptocurrency rather than Fiat is becoming common place.  At Vault Accountants we have adopted a policy of accepting cryptocurrency as fees for those that are active traders or are looking for alternative payment options. Other sectors which should be considering it as a primary option continue to be those in the IT space, but we feel that there is no real limit on sectors that should consider it.  Every business should be open-minded and prepared to have a discussion about potentially making the leap into offering cryptocurrency as a form of payment for their customers and clients,” says Craig Dangar.

## THE ATO BEGAN TO CRACK DOWN ON CRYPTOCURRENCY AT TAX TIME IN 2021

The Australian Tax Office (ATO) engaged around 100,000 taxpayers ahead of tax time to inform them about their required tax obligations as it moves to strengthen its stance on accounting for cryptocurrency.

On Friday 28th May 2021, the ATO warned taxpayers that they will likely be contacted as there are growing concerns that many taxpayers incorrectly believe their cryptocurrency gains are tax-free or only taxable when their holdings are cashed into Australian dollars.

Data from the ATO illustrates that there are over 600,000 taxpayers across Australia who have invested in crypto assets following a surging interest in the currency over the duration of the covid-19 pandemic.

Furthermore, the ATO anticipates that their proactive engagement will result in at least 300,000 taxpayers to make note of cryptocurrency in their 2021 tax returns.

The ATO's tough crackdown is followed by a softer educative approach adopted through the 2020 income year. Last year, the Tax Office contacted 100,000 taxpayers who had traded crypto assets and provoked 140,000 taxpayers to lodge returns.

The ATO is concerned that the anonymous nature of trading crypto assets led taxpayers to believe their investments were untraceable. ATO will head into tax time with access to more data and the ability to track those investing in crypto assets more closely.

The ATO is alarmed that a number of taxpayers think that the anonymity of cryptocurrencies provides a licence to ignore their tax obligations.

Although it appears that cryptocurrency operates in an anonymous digital world, the ATO has the power to closely track where it interacts with the real world through data from banks, financial institutions and cryptocurrency online exchanges to follow the money back to the taxpayer.

The ATO will use data-matching methods to link transactions from cryptocurrency-designated service providers to individuals' tax returns, to ensure investors are paying the correct amount of tax.

Craig Dangar asserts that the ATO have been productive in the steps that they have taken to better educate Australians about the tax obligations that are related to taxing cryptocurrency. "Data matching and the communication have been excellent. In regards to assisting taxpayers with preparing their tax return the ATO has a lot of data and are very approachable and keen to assist with making it easier for you to understand your obligations. A common misconception is that the ATO is adversarial, the opposite is the case, they will give you guidance if you ask them for it," says Mr. Dangar.

# THE DEFINITIONS OF KEY TERMS RELATED TO CRYPTOCURRENCY THAT YOU SHOULD KNOW BEFORE INVESTING

If you, like millions of Australians, are curious about cryptocurrency and are thinking about investing in digital currency it is important to know the basics and understand the meanings of these key definitions:

**Cryptocurrency** – Cryptocurrency is the term used for a currency that is both digital and decentralised. Cryptocurrency can be used to both buy or sell goods or services, it can also be used as a long-term store of value.

**Decentralisation** - Decentralisation is the principle of distributing power away from a central point. Blockchains are traditionally decentralised because they require majority approval from all users to operate and make changes, rather than a central authority as in the case of a banking system of a country.

**Bitcoin** - Launched in 2009, bitcoin is the first ever and the most popular form of cryptocurrency. Bitcoin was created as a reward for a process which is commonly referred to as mining.

Bitcoin can be exchanged for other currencies, services or products. However, the real-world value of bitcoin is extremely volatile and unpredictable. Although its value has climbed steadily since 2009, it has witnessed fierce fluctuations over time.

**Mining** - Crypto mining is when a person gains cryptocurrency by solving cryptographic equations through the use of computers.

The process of crypto mining involves validating data blocks and adding transaction records to a public record (ledger) known as a blockchain.

**Blockchain** - Blockchain can be best described as a system of recording information in a way that aims to make it difficult or almost impossible to change or hack.

A blockchain is a digital ledger of transactions that is duplicated and distributed across the entire network of computer systems on the blockchain. Every block in the chain contains several transactions, and every time a new transaction occurs on the blockchain, a record of that transaction is added to every participant's ledger.

The decentralised database managed by multiple participants is known as Distributed Ledger Technology (DLT).

Blockchain is a type of DLT in which transactions are recorded with an immutable cryptographic signature called a hash.

On cryptocurrency blockchains, blocks are made up of transaction records as users buy or sell coins. Each block can hold only a certain amount of information. Once it reaches that limit, a new block is formed to continue the chain.

**Hash** – Whenever a transaction of cryptocurrency has been verified and needs to be added to a block in a chain, it will be put through a hash algorithm to convert it into a set of unique numbers and letters, similar to what would be created by a random password generator.

As a result of this, two transaction hashes will be combined, and put through the hash algorithm to create another unique hash. This process of combining multiple transactions into new hashes continues until finally there remains just one hash which is the 'root' hash of several transactions.

The thing that makes hashes unique, and a major security feature for blockchains, is that they only work one way. While the same data will always produce the same hash of numbers and letters, it is impossible to 'un-hash', or reverse the process, using the numbers and letters to decipher the original data.

This means that while you can carry out a crypto transaction to transfer a certain amount from A to B, you are unable to reverse the transaction from B to A in the case of an incorrect transaction; as would be possible in the case of a bank transaction.

**Wallet** – Your wallet is the place where an individual keeps their cryptocurrency holdings digitally. Cryptocurrency wallets keep your private keys, the passwords that give you access to your cryptocurrencies making them safe and accessible, enabling you to send and receive cryptocurrencies like Bitcoin and Ethereum.

Cryptocurrency wallets come in many forms, from hardware wallets like Ledger that looks like a USB stick, to mobile apps which makes using cryptocurrency as easy as shopping with a credit card online.

**Altcoin** – The word altcoin is used to define any type of coin that isn't a bitcoin. Altcoin can be best described as alternative currencies that were established after the success of Bitcoin. Altcoins usually try to brand themselves as better replacements for Bitcoin. Bitcoin's emergence as the first peer-to-peer digital currency was paving the way for many to follow.

The majority of altcoins are trying to target any perceived drawbacks that Bitcoin has and come up with competitive advantages in newer versions.

The term 'altcoin' is a combination of the two words: 'alt' and 'coin' meaning that alt means 'alternative' and coin means 'cryptocurrency'. This combination of words implies a category of cryptocurrency, that is an alternative to the Bitcoin cryptocurrency.

**Cryptocurrency Exchanges** – A cryptocurrency exchange is an online platform where uses can exchange one kind of digital currency for another. The most popular crypto exchanges are currently Binance and GDAX.

It is important to avoid confusing cryptocurrency exchanges with cryptocurrency wallets or wallet brokerages. Cryptocurrency wallets and wallet brokerages usually enable you to buy and sell a small range of popular digital assets (Bitcoin and Ethereum), which you can then send to a different exchange to trade for other digital assets like altcoins.

In most cases, the majority cryptocurrency exchanges will usually limit their users to only trade digital assets for digital assets, but a few allow trades of fiat currencies such as AU dollars for cryptocurrencies.

**Fork** - The term Fork is the word used whenever a blockchain's users make changes to its rules. These changes to the protocol of a blockchain may result in two new paths, one that follows the old rules, and a new blockchain that splits off from the previous one. An example of fork would be when Bitcoin resulted in Bitcoin Cash.

In simple terms a Blockchain fork is a split in the blockchain network. The network is an open source software, and the code is freely available.

This means that anyone can recommend improvements and change the code. The option to experiment on open source software is a fundamental part of cryptocurrencies, and also facilitates software updates to the blockchain.

Forks occur when the software of different miners become misaligned. It's up to miners to decide which blockchain to continue using. If there isn't a unanimous decision, then this can result in the creation of two versions of the blockchain. There can be periods of increased price volatility around such events.

## CRYPTOCURRENCY IN AUSTRALIA

Despite all the ups and downs and huge swings in value, a recent survey established that three quarters of Australians who have invested in cryptocurrency still managed to make a profit off their investment.

In a 12-month period between July 2020 and July 2021, Australians on average made over $10,000 in profit from their cryptocurrency investments. This amount is equivalent to almost two months of the average Australian salary.

All in all, more than three quarters of Aussies made a profit from their crypto investments over the 12-month period, according to research from YouGov, with the average profit adding up to $10,662.

The survey also found that one in five Aussie cryptocurrency holders admitted that they made a massive amount of profits worth over $30,000.

The data showed that Australian parents who had children under the age of 18 living at home were the most likely to make money from their cryptocurrency trading, with 86 percent reporting a profit that added up on average to $12,428.

The survey revealed that, men achieved an average of $11,357 profit on their cryptocurrency over the past 12 months, while women achieved an average of $9,176.

In terms of geographical location, cryptocurrency users in Brisbane were the most likely to report a profit with 83 percent making money, followed by Sydney and Melbourne at 76 percent and then Perth.

Another survey published in October 2021 found that Australia has the third highest rate of cryptocurrency ownership in the world. Australia's rate of crypto ownership currently sits at 17.8 percent. The global average for all the countries surveyed is 11.4 percent. The survey conducted included the responses of 41,600 individuals from 22 different countries.

Of the nearly 1 in 5 Australian adults who own some form of cryptocurrency, the survey found that bitcoin is the most popular coin with 65.2 percent of Australians who own crypto owning some form of bitcoin, the fifth-highest percentage of all of the 22 countries surveyed.

Ethereum is the second-most popular coin in the country with a share of 42.1 percent among those who own crypto, while cardano was ranked in third place at 26.4 percent.

Two other cryptos Australian crypto owners hold are Dogecoin 23 percent and Binance Coin 14.6 percent.

## WHY IS CRYPTOCURRENCY SO POPULAR?

In recent years cryptocurrency has continued to rise in popularity, here are a few reasons that can explain it's ever increasing popularity.

**Cryptocurrencies Aren't Associated with World Governments** – The fact that cryptocurrencies aren't associated with a world government means that the price of cryptocurrencies have the potential to remain stable even when there is turmoil in a specific country. A large number of investors believe that cryptocurrency is as a great way to protect your wealth and this is a major reason why cryptocurrency has continued to rise in popularity in recent years. The potential that cryptocurrencies could be safer than some official government currencies is very appealing.

**Cryptocurrency Is A Very Secure Form of Payment** – We all know how hard cyber security has become in recent years. Protecting your identity and money is super important. Using cryptocurrency to pay for items online is a lot safer than many other traditional payment options. If you're someone who is worried about cybersecurity issues, then deciding to use cryptocurrency might be a great idea.

**Cryptocurrency's Fees Are Pretty Low** – One of the biggest reasons why cryptocurrency is so popular is because there are very few fees associated with using it. When you're using various other types of online payment options, you often incur large fees. The super low fees that you have to deal with when using various cryptocurrencies will be a much better deal for you. It makes sense for many people to use cryptocurrencies to pay for items online and lots of people also find it to be safe.

**There Is The Potential To Make A Lot of Profit** – The potential to make a profit is another major reason why people get involved with cryptocurrencies. If you are strategic and purchase bitcoin while it's at a low price, then you can potentially profit when that price rises. Lots of people who invested in cryptocurrencies before they become super popular end up making huge profits.

**It's Becoming Easier To Use Cryptocurrency** – Overtime cryptocurrency has become easier to use, this is due to the fact that more online companies are adopting it. Each year more and more websites are starting to accept cryptocurrencies as payment and this will only become more predominant in the future.

It's also fascinating to mention that there are now things such as cryptocurrency debit cards popping up in certain places. This might not be widespread right now but it is something that is very much happening.

As cryptocurrency continues to become more mainstream, it's going to reach more and more people. This results in an increase in the awareness and an overall surge in popularity. More people understand that this is an option now and many of the questions about what cryptocurrency is are being answered. Lots of people nowadays have at least a bit of knowledge about what things such as Bitcoin are and this makes it more desirable.

## DISADVANTAGES OF CRYPTOCURRENCY

Although there is huge potential for individuals to make massive profits from investing in cryptocurrency it is also important to be aware of the risks. Cryptocurrency trading is in a lot of ways similar to trading a stock or currency. This is due to the fact that you are trying to purchase at a lower price than the price you eventually sell it at.

Here is a list of the potential disadvantages of cryptocurrency that you should be mindful of when deciding if investing in cryptocurrency is something that you aspire to pursue.

**Cryptocurrencies Are Extremely Volatile** – Stocks have intrinsic value and dividends that they give you, Australian Dollars and other major currencies are backed by central banks. This is not the case for cryptocurrency and this is one of the major reasons why cryptocurrencies are highly volatile.

Making money is possible in a volatile trading environment, but at the same time it means that you could lose a lot with just one small mistake.

Not being controlled by central banks means a coin's value is whatever buyers on the open market will pay. But it also means there's nothing tethering any cryptocurrency's value to reality, and any coin could theoretically become worthless in an instant if demand for it goes away. Everything in cryptocurrency is high-risk, and you should do your research and talk to other investors so that you can make more informed decisions about whether you should invest, buy or sell.

**Cryptocurrency Is Less Liquid Than Fiat Currency or the Stock Market** – Even the best cryptocurrency exchanges do not hold a candle to the liquidity that is tied to any stock market.

Institutional investors in more established markets create price walls by putting a lot of orders into the system at prices surrounding the current range of trading prices. This means a single big order tends to move the price less, as a lot of other automated trading happens around each big move.

In nearly all cryptocurrency markets, these price walls have not yet been established. A single large investor selling their crypto can cause a major swing in market prices as they go through filling the orders from the best price downward. This increases the volatility higher  than it would be otherwise because sudden trades can lead to price shocks.

This risk piles atop the currencies' existing everyday volatility to create further shifts in the market.

**There Is No Recourse for Digital Asset Recovery** – Around the world there is tens of thousands of dollars of real money locked in computers because the owners do not know how to recover them. In some cases, the user forgot a key password, or maybe they forgot that they purchased a couple of Bitcoin a few years ago or they might have bought it as a joke and consequently cannot remember where it is located.

As soon as you take your cryptocurrency off a trading platform and into your own control, you are the sole person responsible for it. If you lose your private keys, the coins are gone for good. If your coins are stolen, there's no way to track them down and generally no recourse for recovering them.

Furthermore, if a dishonest seller cheats you in a cryptocurrency transaction for example by demanding upfront payment for goods they never intend to send you have no legal means to claw back your funds.

Though some newer cryptocurrencies attempt to address this significant weakness, solutions remain incomplete and largely unproven. For now, cryptocurrency users simply can't count on being able to recover lost or stolen coins.

By comparison, fiat currency users have plenty of protections, although none are totally foolproof.

For example; banks have insurance that can protect your funds in case they fail. Stock markets have regulations that prevent a number of dodgy dealings from going on, and brokerages carry insurance in case they fail as well.

Fait currency processors and credit card networks including; Visa, PayPal and Mastercard resolve buyer-seller disputes via chargeback polices that are specifically designed to prevent the occurrence of seller fraud.

**Mining Coins Requires Serious Resources** – In order to make serious money from mining cryptocurrency you are required to commit a lot of time and a lot of money. You will need to use a serious set of hardware, with many creating specialized computers or servers for the task. Even then, you need to pick a coin that you can make money from, instead of never realizing your investment.

The energy-intensive nature of cryptocurrency mining is problematic for another reason: It's very bad for the environment.

The biggest culprit is Bitcoin, the world's most popular cryptocurrency. Although Bitcoin boosters point out that Bitcoin mining only consumes a small fraction of the energy of the global financial sector, it's inarguable that Bitcoin has a massive carbon footprint relative to its reach and utility. It is estimated that Bitcoin accounts for just over 0.5 percent of the planet's global energy output. This statistic has been made worse by the fact that some of the world's largest Bitcoin mines are located in largely coal-powered countries like China and Russia. However, in September 2021, The Chinese Communist Government introduced a national ban on cryptocurrency.

**Cryptocurrencies Lack of Regulation Facilitates Black Market Activity** – One of the biggest downfalls of cryptocurrency is its ability to facilitate illicit activity. Cryptocurrency has been used to facilitate a large number of black-market online. For example; the infamous dark web marketplace Silk Road used Bitcoin to facilitate illegal drug purchases and other illicit activities before being shut down in 2014. Cryptocurrencies are also increasingly popular tools for money laundering. Due to the potential for cryptocurrency to remain anonymous individuals on the black market can hide their identity and conceal any evidence of their purchases made on the black market.

**Cryptocurrency Has Huge Potential for Tax Evasion in Some Jurisdictions** – As a result of cryptocurrencies not being regulated by national governments and usually exisiting outside of their direct control, cryptocurrency naturally attracts tax evades. Many small employers pay employees in Bitcoin and other cryptocurrencies to avoid liability for payroll taxes and help their workers avoid income tax liability, while online sellers often accept cryptocurrencies to avoid sales and income tax liability.

Although the ATO is becoming stricter on Australian taxpayers when it comes to reporting the capital gains they acquire via cryptocurrency there are other countries around the world who are falling behind and failing to implement legislation to hold their nations taxpayers more accountable when it comes to reporting their crypto related assets.

## WHY IS CRYPTOCURRENCY SO VOLATILE?

The volatility of cryptocurrency is one of the major reasons why many people refuse to invest in the digital currency. The key reason for cryptocurrencies volatility is their newness. Throughout history, there have been many new phenomena's that have taken time to settle down and be accepted and the same holds true for cryptocurrencies. The asset class, the market as well as investors and speculators are still finding their feet and so it is still the initial stages of price discovery.

Due to the lack of understanding and rules, at present time trading cryptocurrency highly speculative. Investors bet on the prices going up or down, and these speculative bets cause a sudden influx or outgo, leading to an increase in volatility.

Here are some of the major factors that contribute towards cryptocurrencies high levels of volatility.

**Lack of A Controlling Agency** – When compared to other asset classes that have some sort of governing or controlling agencies, cryptocurrencies are by their very nature not controlled by any entity in the traditional sense as fiat currency or equity or bonds are. The anonymity is what attracts investors or makes them sceptical.

**The Sentiment Factor** – When cryptocurrencies become even more popular and become more accepted, more investors will understand the factors that influence their movement. In the meantime, a lot of the movement is speculative in nature as investors are buying or selling based on sentiment.

**Limited Supply And Major Holdings** – In comparison to traditional fiat currency, some cryptos such as Bitcoin are in limited supply. Bitcoin supply is limited to 21 million, but since it is among the most popular cryptos, demand and supply forces come into play. For example, Litecoin has a maximum supply of 84 million, while Chainlink's (Ehtereum-based) limit is 1 billion. Furthermore, cryptocurrency is a digital asset, the price is determined entirely by the laws of supply and demand.

Even those who are looking at cryptos for the long term are doing so as they believe that the asset class will gain acceptance. Tesla founder Elon Musk, for example, explained that he owned Dogecoin because many of the employees at Tesla and SpaceX own Dogecoin.

Furthermore, a large number of young investors are putting money into cryptocurrency with a motive to invest and hopefully earn quickly. As a result of this when they lose a big amount, they usually quit the market, thus leading to volatility in the market.

**Developing Technology** – The blockchain or other alternative technologies on which these coins function are still evolving. It has only been a decade since the Bitcoin idea was first proposed. There is the scalability problem, when a smart contract is not validated with the timeframe expected, creating sudden downward pressure.

**Emerging Market** – Cryptocurrency is still an emerging market, gaining rapid popularity as well fuelling quick disenchantment among investors. Despite all the media attention, this market is still minuscule when compared to traditional currencies, or even gold. This means even smaller forces a group of people holding large amounts of crypto coins can influence the trade. Even if they sell only Bitcoins, it would be enough to crash the whole market.

"The market is in its infancy and in the absence of controls there will be years of volatility, understanding that there are underlying conditions that change rapidly will means that there will be constant fluctuations over the short and medium term," says Craig Dangar.

**Purely Digital Asset** – Most cryptocurrencies, including Bitcoin and Ether, are purely digital assets with no backing of any physical commodity or currency. Which means their price is determined entirely by the laws of supply and demand. In absence of any other stabilising factor, like government backing, any number of reasons may lead to a fluctuation in demand or supply.

## CONCLUSION

To conclude, this eBook has given its readers access to important information that will make it easier for them to understand the tax obligations associated with holding and trading cryptocurrency. This eBook has also shared plenty of information that will help readers who are thinking about investing in cryptocurrency in the future to make a more informed decision about whether or not cryptocurrency is for them.

Craig Dangar from Vault Accountants asserts that "cryptocurrency is here to stay and it is important to ensure that if you are planning to dabble in the market that you understand there is a risk that you will lose it all. For businesses that are planning to adopt a payment approach using cryptocurrency, don't be afraid of it, but make sure you are well educated," says Craig Dangar.

For Australians starting out with crypto Craig Dangar says encourages individuals to "practice and learn by investing smaller amounts to begin with, a quick win is not indicative of a future result and remember that the market is completely unregulated so you have everything exposed," says Craig Dangar.

It is also important to remember that cryptocurrency is taxable. "You need to report it. It is not a hidden transaction and it is really important that businesses understand that they are obliged to report the receipts from cryptocurrency in their tax returns. Failing to report crypto in your tax return could get you in serious trouble with the ATO, as failing to report crypto is a form of tax avoidance," says Craig Dangar.

## CONTACT US

Please take this opportunity to call and book in with one of our experienced financial advisers or accountants.

You can make an appointment or ask any question directly via our website.

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