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Making money from cryptocurrency? The taxman may call on you

Liu Hern Kuan and Vincent Ooi

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Miners, forgers, hobbyists, traders – different rules apply. Just don't assume crypto investment is somehow immune to taxation.

The range of potential investment opportunities in Singapore involving cryptocurrency continues to grow over time as these asset classes gradually gain mainstream acceptance. While there are risks involved in such investments and investors should certainly do their homework before blindly jumping on the bandwagon, for those lucky enough to have their investments pay off, the question arises as to whether a portion of those gains has to be shared with the tax authorities.

Thus far in Singapore, the Inland Revenue Authority of Singapore (Iras) has issued two e-Tax Guides on cryptocurrency, with one focusing on income tax and the other on goods and services tax. They provide an excellent introduction to the basic tax issues which cryptocurrency investors should be aware of.

Moving forward, as cryptocurrency becomes even more firmly entrenched in the local investment space, investors might well expect the Iras to become more interested in exploring the revenue options in this area, as many overseas tax authorities have already done.

As a starting point, investors should understand that there is nothing "magical" about cryptocurrency that takes it out of the tax system.

Quite often, essentially the same tax provisions apply to transactions involving cryptocurrency as they apply to any other kind of asset. Thus, if investments in cryptocurrency generate returns, one will have to consider whether these returns might be taxable. There are quite a few ways in which one might secure some returns from these investments, which we will cover in turn.

First, one might engage in "mining" or "forging". Miners and forgers provide services in verifying transactions in the blockchain and in doing so receive new cryptocurrency as a result.

"Miners" typically invest in (increasingly expensive and quite electricity-hungry) "mining rigs" that race to solve complex equations under a "proof-of-work" protocol that ensures that transactions are properly verified. "Forgers" operate on systems that rely on a "proof-of-stake" protocol instead, but which forces them to risk the forfeiture of the tokens which they "stake" should the transaction which they verified turn out to be fraudulent.

Depending on the precise protocol which a distributed ledger system runs on, either "miners" or "forgers" have a role in keeping the system running smoothly and are compensated with cryptocurrency for their services.

It is important to note that Iras has in its e-Tax Guide on income tax distinguished between "recreational" or "hobby mining" on the one hand, and situations where there is a "habitual and systematic effort to make a profit" on the other hand.

In the absence of any evidence of the latter, individuals will generally be presumed by Iras to be engaging in "hobby mining". Iras has indicated that tokens earned from this will not be taxed in Singapore. No express guidance has been given for "forging", but it is likely that such activities will be treated in a similar fashion as for "mining".

So "hobby miners" may not have to pay tax on their activities even if they do make some money out of them. Naturally, one cannot have it both ways. If returns from "hobby mining" are not taxed, then taxpayers cannot expect to be able to deduct the expenses of that activity. Iras is not going to entertain any deductions of increased electricity costs as a result of "hobby mining".

Second, one might decide to buy and sell cryptocurrency, possibly aiming to "buy low and sell high" and "hodl" (sic) until prices go up. In such cases, the taxability of any gains from these activities would largely depend on how the activities are precisely carried out.

Buying and selling cryptocurrency very frequently with the intention to make quick profits are likely to result in a taxpayer being considered to be a "trader". There are a set of indicia in tax law that are used to assess whether one is a trader. If a taxpayer is considered to be a "trader" then any gains from the buying and selling of cryptocurrency will be taxable trade income.

But even if one does not buy and sell cryptocurrency frequently, it may still be possible that gains from the disposal of cryptocurrency may nevertheless be taxed as income due to a tax provision which "sweeps up" and taxes all miscellaneous income.

A taxpayer who purchased cryptocurrency with an intention to make a profit and who did not intend to hold the tokens as a long-term investment may well be taxed on the gains from the disposal of the cryptocurrency.

Essentially, given the considerable scope of the taxing provisions in this area, it may be difficult for a taxpayer to argue that gains from the disposal of cryptocurrency are not taxable so long as they are income and not capital gains in nature. Unfortunately, the law in this area is not the most straightforward and taxpayers should seek the advice of a tax professional in sorting out their tax obligations on this.

Third, the rise of decentralised finance (DeFi) means that investors now have new opportunities to step into areas which used to be the sole domain of banks, and lend money to others. There is a bit of a legal minefield here, with a whole range of banking and finance-related regulation that must be considered, including the highly relevant Moneylenders Act.

But assuming that an investor is able to successfully navigate all of this and actually obtain some returns from DeFi investments, the question arises as to whether those returns would be taxable.

Broadly speaking, DeFi transactions tend to involve debt instruments analogous to loans, which offer rates of returns which are generally not pegged to the financial performance of the borrower (barring its insolvency).

As far as tax is concerned, returns on debt instruments such as interest payments are generally likely to be taxable as income. Much will depend on the precise way in which the DeFi transaction is structured, but there is a decent chance that some tax may be due on the periodic returns from lending money to others.

There are a multitude of ways in which an investor could potentially make money from cryptocurrency, some of which are more likely to be taxable than others. Investors may wish to start seeking tax advice early and set aside money to pay potential tax bills. Better to be certain as to one's potential tax liabilities than bank on the wishful thinking that cryptocurrency transactions are somehow exempt from tax, or that Iras will never come calling.

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