



TaXavvy

7 September 2022 | Issue 18-2022

Guidelines on Tax Treatment of Digital Currency Transactions



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Guidelines on Tax Treatment of Digital Currency Transactions

The Inland Revenue Board (IRB) has issued the Guidelines on Tax Treatment of Digital Currency Transactions (“the Guidelines”) dated 26 August 2022. Matters covered in the Guidelines include:

- General tax treatment on acquisition and disposal of digital currencies
- Tax treatment for specific business transactions involving digital currencies
- Tax treatment for investments in digital currencies
- Acquisition cost of digital currencies

What is digital currency?

For the purpose of the Guidelines, IRB makes reference to the definitions of digital currency and digital token by the Securities Commission Malaysia as follows:

“Digital currency” means a representation of value which is recorded on a distributed ledger whether cryptographically-secured or otherwise, that functions as a medium of exchange and is interchangeable with any money, including the crediting or debiting of an account.

“Digital token” means a representation which is recorded on a distributed ledger whether cryptographically-secured or otherwise.

The terms “digital currency” and “digital token” are used interchangeably by IRB in the Guidelines and they include digital currencies such as Bitcoin and Ethereum (Ether).

General tax treatment on acquisitions and disposal of digital currencies

There is no specific provision in the Income Tax Act 1967 dealing with the tax treatment of digital currencies transactions. These transactions would fall within the scope of Malaysian income tax if they relate to income accruing or derived from Malaysia, or received in Malaysia from outside of Malaysia. The IRB regards such transactions to fall under the scope of Malaysian income tax if:

- the key activities and business operations are performed in Malaysia, or
- where there is a business presence in Malaysia.

The IRB applies the badges of trade in determining whether the gain or loss from the disposal of digital currencies is capital or revenue in nature (outlined in Appendix A of the Guidelines, reproduced in page 7 for reference). A person who actively trades in digital currencies may be viewed as generating revenue which is taxable. On the other hand, gains derived by an individual who trades occasionally may be viewed as capital gains which are not subject to income tax.



Tax treatment for specific business transactions

Trading (buying and selling) of digital currencies

Profits from a business of trading in digital currencies are taxable in a similar manner to profits from trading of stocks, i.e.:

- Proceeds from sale of digital currencies are taxable
- Cost of sale (cost of acquisition of digital currencies) is deductible

Mining of digital currencies

Profits from mining of digital currencies are subject to income tax if the mining activities are carried out with a profit-seeking motive.

Business transactions carried out using digital currencies

Businesses that accept digital currencies as a mode of payment should generally record the transaction for income tax purposes based on the open market value of the underlying goods or services in Ringgit Malaysia. These transactions include:

- Sale of goods / provision of services
- Purchase of goods and services
- Purchase of assets

In situations where a transaction is agreed based on units of digital currencies, the value of the transaction for income tax purposes is determined based on the value of the digital currency at the point of transaction.

Realisation of digital currencies obtained from business transactions

Where a business transaction was carried out using digital currency, e.g. for sale of goods, the tax treatment of the subsequent disposal of the digital currency received from the business transaction will depend on the analysis of the capital / revenue character of the subsequent disposal. Under Examples 3 and 6 of the Guidelines, the IRB recognises that the nature (revenue or capital) of the gain from the subsequent disposal of digital currencies obtained from an earlier business transaction is to be evaluated before determining its tax treatment. Where the nature of the gain meets the criteria of capital gain, the gains from its realisation is not subject to income tax.

Salaries and wages in digital currencies

Salaries and wages paid in digital currencies are taxable in the hands on the employee and deductible to the employer based on the value stated in the employment contract.

The IRB has reminded that employers' existing obligations to withhold and remit monthly tax deduction from employees remuneration remains applicable even if the salary and wages are paid in digital currencies.

Tax treatment for investment in digital currencies

Realisation of digital currencies

Gains from realisation of digital currencies are subject to income tax where they are considered as a business (revenue). On the other hand, the gains are not subject to income tax where they are considered as realisation of capital investment.

Similarly, the IRB applies the badges of trade (outlined in Appendix A of the Guidelines, reproduced in page 7 for reference) in determining whether the gain is capital or revenue in nature. Factors which contribute to a revenue character include investment activities which are continuous, systematic, active and are aimed at making a profit.

The gain or loss is derived from the amount received for the digital currency and the amount spent to acquire the digital currency, referred to as the adjusted basis, which include the fees, commissions and other acquisition cost.

Tax treatment for certain situations

Mere purchase and free distributions

The mere purchase of digital currencies or receipt of it as a result of free distribution/splitting is not taxable.

For example, where the purchase of digital currencies is made in order to enjoy a discount which is only available when payment for the product or service is made in digital currency, the disposal of the digital currencies in such an instance is not subject to tax.

In cases where the digital currencies is received for free as a marketing tool, or from splitting of existing digital currencies, it would not be taxable at the time of receipt. Subsequent disposals of the digital currencies may be taxable, if the gains are determined to be revenue in nature.

Exchanges of digital currencies

Where there is a conversion of one digital currency to another, any gain or loss arising from the conversion may be subject to tax, depending on whether the digital currencies was held as a capital or revenue asset.



Acquisition cost of digital currencies

Acquisition cost is to be determined in Ringgit Malaysia, and on a First-In-First-Out (FIFO) basis unless the movement of the digital currencies can be proven otherwise.

This is illustrated through the extract of Example 9 in the Guidelines below.

A company buys and sells digital currency as part of its business. It purchased the following digital currency in 2020:

Date purchased	Number of units purchased	RM per unit	Total (RM)
1 Sept 2020	500	10,000	5 million
1 Oct 2020	300	15,000	4.5 million
1 Nov 2020	700	5,000	3.5 million
Total	1,500		13 million

The company then converts 600 units of digital currency to Ringgit Malaysia when the digital currency is valued at RM20,000 per unit in January 2021. The acquisition cost based on the FIFO basis is:

$$(500 \times \text{RM}10,000) + (100 \times \text{RM}15,000) = \text{RM}6.5 \text{ million.}$$

If the company is able to prove that the units sold were those purchased on 1 November 2020, the acquisition cost would be RM 3 million (i.e. 600 x RM5,000).

Where the acquisition cost cannot be determined, the digital currency will be valued using the rate in force on the day of transaction based on the acceptable and verifiable digital currency exchanges i.e. the prevailing List of Registered Digital Asset Exchanges published by the Securities Commission Malaysia, these are (as at 17 August 2022):

1. Luno Malaysia Sdn Bhd
2. MX Global Sdn Bhd
3. SINEGY DAX Sdn Bhd
4. Tokenize Technology (M) Sdn Bhd

Record keeping

The Guidelines specify the types of records to be kept for tax purposes include those to determine the nature of transaction (including the whitepaper of the blockchain), and value of the digital currency based on online exchange.

The Guidelines are available on IRB's website www.hasil.gov.my (Legislation > Guidelines > Technical Guidelines).

Key takeaways

There are currently no specific provisions or rules under the Income Tax Act 1967 governing the tax treatment of transactions involving digital currencies. Hence, the issuance of the Guidelines is welcomed and timely due to the rise in the use of digital currencies. It is reassuring that the IRB applies general tax principles in determining the tax treatment.

It is also notable that the IRB recognises that digital currencies obtained from a business transaction could be treated as a capital investment, subject to meeting the criteria for capital gains.

The issuance of the Guidelines serves as a reminder for businesses and individuals that transactions and investments in digital currencies remain to be subject to the prevailing income tax rules. Businesses and individuals would therefore need to evaluate the opportunities and costs which come with adopting digital currencies.



Extract of Appendix A to the Guidelines

BADGES OF TRADE	EXPLANATION
Nature of subject matter	This refers to the nature of the digital currencies that is being bought and sold. The digital currencies could be regarded as the subject of trading when they are bought in large quantities.
Length of ownership	This refers to the holding period of the digital currencies. The shorter the holding period, the more likely it would be regarded as held for trading.
Frequency of transactions	High frequency of similar transactions of digital currencies is more indicative of trading than an isolated transaction
Supplementary work	This refers to additional work done on digital currencies to make it more marketable or extra effort made to find or attract purchasers. If this is done, it is more likely that the subsequent disposal would be regarded as trading.
Circumstances of the realization	Some circumstances are less likely to indicate trading (e.g. company is forced to sell the digital currencies due to compulsory acquisition, sudden urgent need of cash or threat of foreclosure by creditors).

BADGES OF TRADE	EXPLANATION
Motive	This refers to whether there was an intention to trade at the time of the acquisition of the digital currencies. If a person undertakes the activities in a business-like manner such as developing a business plan, preparing accounting records and advertising the digital currencies business, the intention is definitely to do a business of digital currencies.
Mode of financing	This refers to how the purchase of the digital currencies is being financed. Short term financing is more indicative of trading than long term financing. The company's financial position and ability to hold on to the digital currencies will also be taken into consideration.
Other factors	Other factors include whether there were any feasibility studies conducted, the availability of documentation or other evidence maintained by the company to indicate its intention regarding the digital currencies.

No single badge is a decisive pointer to the existence of a trade. It should be weighed up with all the relevant factors.

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