

Taxation and Reporting of Cryptocurrencies

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Introduction

The recent rapid emergence of cryptocurrency and blockchain technologies has outpaced the development of corresponding legal authorities. The *Income Tax Act* (Canada)¹ (**Tax Act**) and related tax jurisprudence are no exception. At the time of writing this article, the *Tax Act* has not been amended to specifically address the nature and taxation of cryptocurrencies and there is no directly relevant judicial guidance on the issue. This means that the taxation of cryptocurrencies will be informed by general principles.

Taxation of Cryptocurrencies in Canada

Nature of Cryptocurrencies – Property not Currency

The taxation of cryptocurrencies will depend on how it is characterized for purposes of the *Tax Act* – is it a currency or a property? Fundamentally, cryptocurrencies appear to have inherent qualities of both, depending on how the individual taxpayer uses the cryptocurrency. If a taxpayer uses cryptocurrency to acquire goods and services, the cryptocurrency is similar to a currency, but if a taxpayer acquires the cryptocurrency as an investment, it is similar to a property, such as a commodity (i.e. gold or silver) or a security.

In Canada, the *Currency Act*² defines "legal tender" as either coins issued under the *Royal Canadian Mint Act*³, or notes issued by the Bank of Canada pursuant to *Bank of Canada Act*⁴ intended for circulation in Canada.⁵ It is clear that cryptocurrencies do not constitute legal tender in Canada, since they are not issued by the Bank of Canada or under any specific Canadian legislation. Similarly, cryptocurrencies should not constitute foreign currency since they are not issued by the central bank of any foreign countries.

In contrast, the *Tax Act* defines "property" in a broad manner, to mean "property of any kind whatever, whether real or personal, immovable or movable, tangible or intangible, or corporeal or incorporeal and, without restricting the generality of the foregoing, includes... (b) unless a contrary intention is evident, money."⁶ Given the broad definition of "property", it is likely that cryptocurrencies can be considered property, but not "currency" or "foreign currency" for purposes of the *Tax Act*.

This conclusion is consistent with the Canada Revenue Agency's (**CRA**) current position that cryptocurrencies are to be treated as a property akin to a "commodity" instead of a "currency".⁷

Taxation of Cryptocurrency Transactions

Provided that a cryptocurrency is a property, the next question is what kind of property? A property, such as a commodity, could be held on either capital account (i.e. a capital property) or income account

¹ R.S.A. 1985, c.1. [**Tax Act**]

² R.S.C. 1985, c. C-52. [**Currency Act**]

³ R.S.C. 1985, c. R-9. [**Royal Canadian Mint Act**]

⁴ R.S.C. 1985, c.B-2. [**Bank of Canada Act**]

⁵ *Currency Act* at s. 8.

⁶ *Tax Act*, subsection 248(1)

⁷ See <https://www.canada.ca/en/financial-consumer-agency/services/payment/digital-currency.html>

(i.e. inventory or an adventure or concern in the nature of trade), depending on how the particular taxpayer deals with the property.

The criteria for determining whether a property is held on capital or income account is well established, but the application is almost always fact specific and not necessarily clear. Generally speaking, a court will look at the following factors to determine whether a taxpayer is holding the property on capital or income account:

- *The taxpayer's primary and secondary intention when purchasing the property* – if the taxpayer acquired the property to sell at a profit, it suggests income (i.e. inventory); if the taxpayer acquired the property to hold and generate income from the property, it suggests capital (i.e. a rental house). If the circumstances change regarding the use of the property, the taxpayer's secondary intention in acquiring the property may become relevant.
- *The relationship between the transaction(s) and the taxpayer's regular business* – if the taxpayer is in the business of buying and selling the particular property, it suggests income.
- *The number and frequency of transactions undertaken by the taxpayer* – the more frequently a taxpayer buys and sells the property, the more likely it is held on income account.
- *The nature of the property and the length of time that it is held* – if the taxpayer cannot obtain any income or personal enjoyment from the property and it is held for a short period of time, it suggests income treatment; if the converse is true, it suggests capital treatment.

The above rules are general in nature, and are subject to specific rules that have been developed over time in respect of certain types of property. For example, the courts have found that there is a "strong presumption" that a share of a corporation is held as capital property, which can be rebutted by sufficient evidence showing that the taxpayer was a dealer or trader in securities, or that the taxpayer was involved in an adventure or concern in the nature of trade.⁸

Even more interestingly, the CRA has published its views on when a "commodity" is to be treated on capital versus income account. In IT-346R⁹, the CRA took the view that a "speculator" may choose to report the dispositions of commodities as either on capital account or income account, provided that the taxpayer remains consistent in the particular treatment from year to year. A "speculator" for this purpose is a taxpayer who does not fall into the following three categories: (1) a taxpayer who acquires commodities or commodity futures that are connected with its business as part of its business operations; (2) a taxpayer who has access to special insider information about the commodity that it has acquired; or (3) a corporate taxpayer whose only business activity is trading such commodities. Those taxpayers that fall outside of these three categories may be able to rely on IT-346R to determine how they would like to report their dispositions of cryptocurrencies. However, care must be taken when relying on CRA administrative guidance, as such guidance is not law nor binding on a court, and may be subject to change at any time.

Generally speaking, a taxpayer that has losses in a taxation year will prefer to report the disposition on income account (which is fully deductible in the year incurred against other sources of income), whereas a taxpayer that has gains or profits in the year will prefer to report the disposition on capital account (since the disposition would be afforded capital gains treatment, instead of being included in

⁸ See *Gervais v. R.*, 2016 FCA 1, at para 33 [**Gervais**]

⁹ IT-346R (Archived) – *Commodities Futures and Certain Commodities* (Nov. 20, 1978). Note that IT-346R, despite when it was written, has been referenced by the CRA fairly recently in CRA Views 2011-0392061E5, 2010-0381521E5, and 2008-0292461E5.

income). Taxpayers relying on IT-346R should be mindful that the CRA expects consistency in reporting from year to year, so a capital gain (instead of income treatment) in one year may become a capital loss (instead of a fully deductible loss) in the next year, and vice versa.

Application to Cryptocurrency Transactions

Since cryptocurrencies can be used for a variety of purposes, the characterization of cryptocurrencies as a commodity may result in some surprising tax results, as illustrated below:

- *Cryptocurrencies used to purchase goods or services* – constitute a "barter transaction" for purposes of the Tax Act. This means that both the vendor and the purchaser may have a taxable disposition. Specifically, the vendor may be trading some of its goods for cryptocurrency, so it will generally have an income inclusion on the sale (to the extent that it is selling inventory). Similarly, the purchaser trading its cryptocurrency for goods or services will also have either a capital gain or capital loss.¹⁰ For example, if the purchaser acquired a cryptocurrency for \$100, and used that same amount of cryptocurrency to acquire \$200 of goods, then the purchaser would generally have a capital gain of \$100, \$50 of which is included in the taxpayer's income as a taxable capital gain.¹¹ Further, a barter transaction raises GST/HST implications, so that the vendor would be required to collect and remit GST/HST in respect of the sale in a manner similar to any other supply of goods or services made in the course of its business. The GST/HST would apply to the value of the consideration received for goods or services sold, which should be equal to the value of the cryptocurrency used to acquire the goods or services.
- *Cryptocurrencies that are purchased and sold* – when the taxpayer acquires a cryptocurrency, the amount paid to acquire the cryptocurrency is the taxpayer's cost in the cryptocurrency. When the taxpayer sells the cryptocurrency, the taxpayer will have a taxable event that will depend on whether the taxpayer holds the cryptocurrency on capital or income account: (1) if the cryptocurrency is held on capital account, the taxpayer will have a capital gain (or capital loss) to the extent that the proceeds on disposition exceed (or are less than) the taxpayer's cost amount in the cryptocurrency; and (2) if the cryptocurrency is held on income account, the taxpayer will have income (or a non-capital loss) equal to the amount that the proceeds on disposition exceed (or are less than) the taxpayer's cost of the cryptocurrency.

In addition to the more common scenarios above, the taxation of cryptocurrency transactions will entail further considerations: (1) the cryptocurrency was paid to a taxpayer as compensation for the taxpayer's employment; (2) the cryptocurrency was paid to the taxpayer in the course of the taxpayer's business; (3) the taxpayer is a non-resident of Canada; or (4) the cryptocurrency is held in a business entity, such as a corporation, partnership or trust, instead of individually.

Keeping Records and Reporting Requirements

Given the anonymity of cryptocurrency transactions generally, taxpayers may wonder how the CRA will identify their transactions. Notwithstanding this anonymity, a fundamental component of Canada's tax system is self-reporting by taxpayers. The onus is on taxpayers to report their income each year, and the CRA is tasked with reviewing the information provided. A failure to report income from any

¹⁰ Or business income or a non-capital loss, depending on whether the purchaser treats the cryptocurrency as being on account of capital or income.

¹¹ Or \$100 of business income, if the taxpayer treats the cryptocurrency as on account of income.

source can result in significant penalties to the taxpayer,¹² as well as significant legal fees associated with objecting to a reassessment. Further, in many cases, such as the reporting of employment income or reporting transactions involving publicly traded securities, the CRA will have the requisite information to cross reference against the information the taxpayer has reported on its tax return.

In the cryptocurrency space, it is unclear whether cryptocurrency exchanges will be sending slips to the CRA on behalf of its investors. Under the current regulations to the *Tax Act*, "every trader or dealer in securities who, in a calendar year, purchases a security as principal or sells a security as agent for any vendor shall make an information return for the year" by filing Form T5008 with the CRA in respect of the disposition.¹³ This means that, when someone purchases and sells securities that are listed on a stock exchange, the broker will generally provide the CRA with a Form T5008 identifying the transaction. This makes a failure to report a disposition much easier for the CRA to identify.

Although the plain wording of this regulation does not appear to apply to cryptocurrency transactions, the definitions are broad and encompassing. A security is defined to include, "a 'publicly traded' option or contract *in respect of any property including any commodity*..." Further, the term "publicly traded", means a security that is listed or posted for trading on a stock exchange ... or *any other exchange*". Finally, a "trader or dealer in securities" means a person who is registered or licensed under the laws of a province to trade in securities or a person who in the ordinary course of business makes sales of securities as agent on behalf of others." There is undoubtedly some uncertainty as to whether these requirements will be satisfied in respect of a cryptocurrency exchange – especially given the fact that cryptocurrency transactions have the capacity to be self executing with no need for "trader or dealer in securities". With that said, the *Tax Act* and its regulations provide the CRA with the tools required to maintain the integrity of the self-reporting system. Amending the existing rules or implementing new rules to capture cryptocurrency transactions, appears not only possible, but likely, in the future. Further, to the extent that slips are not sent to the CRA, the CRA can obtain a Federal Court requiring specific companies to disclose the taxpayer information necessary to assess whether proper tax reporting has been completed.¹⁴

The significant volume of cryptocurrency transactions are at the forefront of the news, and the CRA will be keen to ensure that the Canadian government collects its share of any profits generated from these transactions. This, combined with our self-reporting tax system, penalties for the failure to self-report and the tools in the CRA's arsenal to properly assess income tax reporting, suggests that taxpayers would be wise to keep detailed records of their cryptocurrency transactions. The onus is ultimately on the taxpayer to report its income and to prove its case.

This Bulletin is intended as general information only and is not to be taken as legal advice. If you require additional information please contact the [author](#) or any member of [BD&P's Tax Group](#).

¹² See subsection 163(1) for example, which imposes a penalty up to 10% of the unreported income if the unreported income exceeds \$500 in any two years of the previous four years.

¹³ See Reg. 230(2).

¹⁴ See for example the Federal Court order obtain in respect of PayPal - <https://www.paypal.com/ca/smarthelp/article/cra-information-request-faq3755>