FP LEGAL POST

COMMENT

Bitcoin taxation basics

VERN KRISHNA

Every new technology brings with it tax nightmares for taxpayers, and the inevitable disputes with the Canada Revenue Agency. As we approach tax filing season, Canadians who have engaged in buying or selling, or have used, cryptocurrencies must decide how to report their transactions. Virtual currencies are on the minds of tax collectors around the world, and the CRA is on a mission to increase its revenue intake. As tax litigation with the CRA is slow and arduous, taxpayers should maintain detailed evidence of their transactions for many years.

Cryptocurrencies incorporate technology, currency, math, economics and social dynamics. Australian entrepreneur Craig Wright (aka Satoshi Nakamoto) is reputed to be the shadowy creator of Bitcoin, a multi-faceted, highly technical and difficult to trace asset that may quite possibly be a pyramid scheme. The price is highly volatile and can fluctuate up and down by several thousand per cent. Bitcoin, for example, has hit over US$20,000 and as low as US$5,000 — just in 2018. The selloff of cryptocurrencies in February saw

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the market lose as much as US$100 billion in value in a single day. Such volatility triggers substantial gains and losses, which have significant tax consequences.

For tax purposes, virtual currencies are considered “property,” rather than currency. Trading a Bitcoin for another digital coin would be taxable since it would be considered a sale of property for cash, which the taxpayer then uses to buy the other cryptocurrency. Income from creating Bitcoin through the mining process would also be taxable for the producer.

How would gains and losses on cryptocurrency trading be taxed? Realized gains and losses on the currencies may be on account of capital or income, which would trigger substantially different tax consequences when a person buys or sells cryptocurrency or uses it to purchase goods and services. Depending on how taxpayers report their gains and losses, the transactions would also have a significant impact on government revenue.

The distinction between capital gains and income is superficially simple. Capital gains derive from sale or realization of the investments. Income derives from trading, or the periodic yield of an investment. The distinction is often put in the form of an analogy. Capital is likened to the tree or the land, and income to the fruit or the crop. The tree is the capital that produces a yield (the fruit), and income is the profit that derives when we sell the fruit.

However, the analogy is less than perfect. An “investment” is an asset or property that one acquires with the intention of holding it or using it to produce income. Thus, an investment is a means to an end. Where a taxpayer acquires property with an intention to trade it — that is, to purchase and resell the property at a profit — any gain or loss from the trade is business income or loss.

But the uncertainty does not stop with intention. Where a taxpayer has a secondary intention to trade, any gain or loss resulting from the trade is considered business income (or loss). Therefore, a taxpayer who claims that a gain is a capital gain must show two things: that his primary intention at the time of entering into the transaction was to make an investment; and that he had no secondary intention at that time to trade in the particular property.

Both intention and secondary intention to trade are questions of fact, and the trier of fact will draw inferences from the taxpayer’s conduct on a balance of probabilities. However, courts often use secondary intention as a surrogate for testing the taxpayer’s credibility, which is always an important issue in tax cases.

The nature of the underlying property, rather than the expectation of profit, can be important in characterizing gains and losses. All investors hope, albeit sometimes unrealistically, that their investments will increase in value. However, the mere expectation of profit is not, by itself, sufficient to characterize a transaction as on account of income or capital. Certain types of assets — typically, those that cannot possibly provide any investment yield — are suspect as “trading assets,” and any gain or loss from them would usually be income gains or losses.

These are early days for the definitive legal characterization of gains and losses from cryptocurrency transactions. Taxpayers with losses will want to claim their transactions as business losses, so that they can claim the entire loss. Taxpayers with gains will probably want to report (if they report at all) their transactions as capital gains, so that only one-half will be taxable. The determination of the character of gains and losses will be determined by the tax courts after prolonged litigation and extensive costs. We can reasonably expect the resulting disputes and litigation to extend over 10 to 12 years before we get appellate guidance on the law. Hence, at the very least, people should maintain their transaction reports from cryptocurrency exchanges or record every transaction in detail. Ultimately, the burden is always on the taxpayer to prove her case.

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CHRIS RATCLIFFE / BLOOMBERG FILES

Bitcoin, writes tax attorney Vern Krishna, is “a multi-faceted, highly technical and difficult to trace asset that may quite possibly be a pyramid scheme.” Those who trade in it should keep long-term records for tax purposes.

COMMENT

Unintended workplace consequences of #Metoo

HOWARD LEVITT
Workplace Law

The indispensable 1923 tome Reminiscences of a Stock Operator, a fictionalized account of the life of the securities trader Jesse Livermore, refers to a chap who was not like the others. He never volunteered advice or bragged of his winnings. He listened attentively, but did not seem keen to get tips. When he did get one, he always thanked the tipster very politely. If it went wrong, he never whined — so no one could tell whether he followed the lead or let it slide by.

When asked his view, he would say “You know, it’s a bull market,” as though he was giving you a priceless talisman wrapped in a million-dollar accident insurance policy. When one customer gave him a tip that had done very well, then recommended that he sell, he refused to. When the customer pressed and told him he had sold his own stake, he responded: “I hope you can repurchase your substantial concession, but it’s a bull market, you know.”

The point is, although you can try to chip away at the margins, it is tough to buck a trend. Cognizant as I am of the risk of naysaying society’s and the workplace’s biggest trend (indeed, its tsunami), the #Metoo movement, I see unintended consequences already pulling at its seams:

HIRING

In the same way that maternity leave legislation makes employers reluctant to hire women of childbearing age, or the way minimum wage leads to increased unemployment among lower-income workers, the #Metoo movement has caused many employers to think about the risks of having women in the workplace. The consequence is that women will have a more difficult time obtaining employment and promotions.

MENTORING

U.S. Vice President Mike Pence appeared a Philistinic lout when it became known that he refused to dine alone with any woman other than his wife. Some now view him as a prescient visionary. Mentoring not only means working together, it means working late together, travelling together, etc. A recent Survey Monkey poll conducted by Sheryl Sandberg, COO of Facebook and author of “Lean In,” found that 50 per cent of U.S. senior managers say they are afraid to do a common work activity with a woman, are 3.5 times more likely to have dinner with a junior male colleague than a woman colleague and five times more likely to travel with him. And because mentoring is not only formal but informal, women are now more apt to be excluded from dinners, drinks after work and other forms of socializing that could have helped develop their careers.

TEAMWORK

Many workplaces rely on camaraderie and teamwork. Dividing people based on gender and creating an environment of fear of allegations by women hampers team-building and is a serious blow to moving society to real — rather than formulaic (the type enforced by human rights tribunals) — equality.

ADVOCATES

If an employee is to get ahead in a firm, he or she needs an advocate. But many men will be reluctant to develop such a relationship with a woman if they perceive any risk.

HONESTY

A radical but vocal subsection of the #Metoo movement advocates that women making allegations of sexual predation must always be believed. The theory is that, given the historic social pressure to be silent, if a woman has the courage to come forward, she must be telling the truth. Of course, men have no monopoly on being liars or even perjurers. Some women, confident they will be believed, might well make false accusations, whether to settle old scores, obtain compensation or in response to relationships that have soured. They need not even lie. When it comes to affairs of the heart, retrospective (particularly ancient) memory is notoriously unreliable and often self-serving and revisionistic.

VALUE

Historically, companies have ignored or compartmentalized improper behaviour from an employee’s skill or value to the company. That should have been unacceptable. But now those walls have become porous. Most of the men toppled by the movement were well known to be predators yet not only survived but thrived. Just look at Bill Clinton, whose approval ratings exceeded any modern president at the end of his tenure, while Monica Lewinsky became a suicidal punchline. Will we now see the reverse where minor historic harassment, deserving of only a warning and training, will end the prospects of some companies’ strongest contributors?

FALSE ALLEGATIONS

“Due process” is the preserve of the court, not of human resources policies. However, too many companies, anxious to protect their brand from any allegations, now quickly throw the accused overboard without even the pretence of an inquiry. This not only incents false allegations but damages the trust employees have in their organizations and leads to successful lawsuits against the company. Whatever one thinks of the politician former Ontario Conservative leader Patrick Brown (and I don’t think much) it is almost impossible to recover from even a false allegation of harassment. So, as in a bull market, you don’t fight the trend — but you should be very careful not to be swept aside by false currents.

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