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The Income tax treatment of cryptocurrency trade in South Africa

by

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² Research output, in this context, is defined as a mini-dissertation, dissertation or thesis.

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ABBREVIATIONS USED

- ITA - Income Tax Act 58 of 1962
- RSA - Republic of South Africa
- SARB - South African Reserve Bank
- SARS - South African Revenue Service
- VAT - Value Added Tax
- DTA - Double Tax Treaty / agreement

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CHAPTER 1 : BACKGROUND INFORMATION AND TOPIC INTRODUCTION

1.1. Background information and Topic Introduction

The income tax treatment of cryptocurrency is a subject of great debate for private investors and governments. The nature of crypto-currencies makes it essentially difficult to regulate from a tax perspective. Among the difficulties are the fact that they are not bound by specific country borders and that they don't "fit neatly into established asset categories".¹ Recently, The South African Revenue Service (SARS) began to invest in Information Technology capabilities to analyse financial data and identify transactions in and out of crypto platforms.² What this shows is that a subject which has always caused controversy could potentially take its place at the economic forefront of South Africa as the 4th Industrial Revolution approaches. The trade of cryptocurrency is well becoming a heated topic for tax law.³ Not only in SA, but across the world. As a newly emerging form of trade, finding an effective tax regulatory framework is proving to be difficult for SA as cryptocurrency challenges economic principles regarding tax law and the exchange of money to its core. Without effective procedures regulating the tax treatment of cryptocurrency, traders of cryptocurrency, SARS and the economy stand to be adversely affected. Not only that, but it puts to question the South African Reserve Bank's (hereafter "SARB") position as the sole issuer of currency in South Africa. Cryptocurrency is not recognised as a form of currency in South Africa which already elucidates that multiple factors need to be considered for the correct income tax treatment of cryptocurrency transactions.⁴

In 2018, SARS issued a statement on the treatment of cryptocurrency for tax purposes. It was held that;

"Cryptocurrency ... is an internet-based digital currency that exists almost wholly in the virtual realm. A growing number of proponents support its use as an alternative currency that can pay for goods and services much like conventional currencies. In South Africa, the word 'currency' is not defined in the

¹ Staff Writer "SARS wants some of your cryptocurrency profits" *Businesstech*, available at <https://businesstech.co.za/news/banking/541504/sars-wants-some-of-your-cryptocurrency-profits/> [accessed 26 November 2021]. Hereinafter "SARS wants cryptocurrency profits"

² Derfoldy Marc "Cryptocurrencies and tax" *Fincor*, available at <https://fincor.co.za/cryptocurrencies-and-tax/> [accessed June 3 2021]. Hereinafter "Derfoldy".

³ Hereinafter referred to as "Crypto-assets", "cryptocurrency" unless indicated or stated otherwise.

⁴ Derfoldy 1-10.

Income Tax Act (the Act). Cryptocurrencies are neither official South African tender nor widely used and accepted in South Africa as a medium of payment or exchange. As such, cryptocurrencies are not regarded by SARS as a currency for income tax purposes or Capital Gains Tax (CGT). Instead cryptocurrencies are regarded by SARS as assets of an intangible nature. Whilst not constituting cash, cryptocurrencies can be valued to ascertain an amount received or accrued as envisaged in the definition of 'gross income' in the Act. Following normal income tax rules, income received or accrued from cryptocurrency transactions can be taxed on revenue account under gross income".⁵

This statement further elucidates the imbroglio as to whether crypto assets are revenue or capital in nature. Moosa states that *"uncertainty exists as to whether SARS correctly categorised cryptocurrencies as non-cash assets of an intangible nature capable of receipt or accrual for tax purposes".⁶*

This research, therefore, discusses the dangers of the tax treatment of cryptocurrency in the South African context. Through the lens of jurisdiction to tax, accrual and whether cryptocurrency should fall within the scope of capital or revenue for purposes of gross income, this research unpacks the various issues of cryptocurrency and considers whether South Africa is a step in the right direction for income tax purposes.

1.2. Problem statement

As stated above (**see** chapter 1.1), cryptocurrency is defined as an internet-based digital currency that exists almost wholly in the virtual realm.⁷ The regulation of cryptocurrency can become a problem that can tip the South African economy if not correctly prepared for.⁸ As cryptocurrencies challenge the foundation set by the SARB regarding economic stability, an improper tax law approach can potentially negatively affect the monetary system.

⁵ South African Revenue Service "SARS's stance on the tax treatment of cryptocurrencies", available at <http://www.sars.gov.za/Media/MediaReleases> [accessed on 14 April 2019]. Hereinafter "SARS stance".

⁶ Moosa F "Cryptocurrencies: Do they qualify as "gross income" 2019 *Journal for Juridical Science* 44 (1): 10-34. Hereinafter "Moosa".

⁷SARS stance.

⁸ Ncop Finance A guide to understanding major cryptocurrency issues and regulatory framework: NT & PBO briefing PMG 2021 <https://pmg.org.za/committee-meeting/33029/> [accessed 25 May 2022] Hereinafter "Ncop guide".

There is a need for an insight in terms of the income tax treatment of cryptocurrency transactions because virtual currencies are anonymous and affect factors for determining inclusion in gross income.

1.3. Research Questions

This dissertation addresses the following research questions;

1. What is the technology of cryptocurrency and how does it work?
2. What is the relevance of the origins of cryptocurrency in the South African context?
3. What are the different cryptocurrency trade transactions?
4. What is the trade of cryptocurrency for income tax purposes?
5. How does cryptocurrency fit into gross income?
6. What is the best way to determine the jurisdiction to tax for the trade of cryptocurrency?
7. How does the accrual of cryptocurrency take place?
8. Can South Africa learn from other countries in Africa or the rest of the world?
9. Should the trade in cryptocurrency be considered capital or revenue in nature?

1.4. Motivation for the study and an overview of literature

Taxpayers have the responsibility to submit truthful amounts received or accrued during a particular year of assessment, in case of changes in rates of tax or special provisions.⁹ SARS is obliged to ensure the adequate collection of tax.¹⁰ Cryptocurrency use comes with many potential drawbacks. There is a regulatory risk as the South African government is unable to properly monitor the trade of cryptocurrencies as, unlike widely acceptable currencies, cryptocurrency is not controlled by the SARB. Secondly, there is a very huge security risk as *“the scamming of potential investors and the hacking or theft of data or information had been common risks in the cryptocurrency market since its inception in 2009.”*¹¹

⁹ M Stiglingh (ed.) SILKE: South African Income Tax (2020) 47. Hereinafter “Silke”.

¹⁰ Ibid.

¹¹Ncop guide 2.

1.5. Methodology

The research adapts a largely descriptive and analytical study of legislation, textbooks, academic journals, publications by governmental departments and case law. From the outset I give a detailed background of cryptocurrency and trade for the purposes of income tax. I address the issues regarding the income tax treatment of the trade of cryptocurrency through critically analysing the existing gaps regarding the income tax treatment of cryptocurrency regulation.

1.6. Limitations of study

As stated above, among the difficulties are the fact that they are not bound by specific country borders and that they do not *"fit neatly into established asset categories"*.¹² The lack of specific legislation makes it essentially difficult to regulate from a tax perspective as cryptocurrency is relatively new. Many lacunas exist in terms of establishing an efficient regulatory framework.

1.7. Organization of the study

The study is divided into six chapters arranged as follows:

Chapter 1: Background information and topic Introduction, problem statement, research questions, research questions, motivation for study, overview of literature, methodology and organisation of the study.

This chapter serves as an introduction in which the background to and need for the study are examined. The research questions are defined, and the scope and, methodology and organisation of the study.

Chapter 2: An introduction to Cryptocurrency and the different Trade Transactions thereof.

This chapter discusses the cryptocurrency technology, its brief origins in the context of South Africa and the trade transactions considered. This objective also explores the different cryptocurrency trade transactions.

¹² SARS wants cryptocurrency profits.

Chapter 3: Jurisdiction to tax

This chapter explores the jurisdiction to tax in terms of income taxpayers involved in the trade of cryptocurrency. What are the implications of the “resident” and “source” based tests on the trade of cryptocurrency. It also considers the effect of VPN on jurisdiction.

Chapter 4; Accrual in terms of the trade of cryptocurrency

This chapter considers the accrual of the trade in cryptocurrency. As we are dealing with the trade of cryptocurrency, this section establishes whether cryptocurrency accrues when a taxpayer buys or sells cryptocurrency.

Chapter 5; Cryptocurrency: Capital or Revenue ?

This chapter considers whether the trade of cryptocurrency should be capital or revenue in nature. This particular chapter is essential in suggesting the best way forward for the income tax treatment of cryptocurrency. It also considers the effect of cryptocurrency market volatility for accrual purposes.

Chapter 6; Recommendations and Conclusion

In this chapter, I present the recommendations for considerations based on the current lacunas in the income tax treatment for cryptocurrencies and how these recommendations can be applied in the South African context. I bring forward suggestions for an effective income tax treatment of the trade in cryptocurrency in South Africa.

1.8. Conceptualization

The study involves a number of key concepts of which their definitions are used as contained in their respective legislation.

Commissioner: means the Commissioner for the South African Revenue Service appointed in terms of *section 6* of the *SARS Act* or the Acting Commissioner designated in terms of *section 1* of the *Act*.¹³

Cryptocurrency; a digital representation of value that is not issued by a central bank, but is traded, transferred and stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility, and applies cryptography techniques in the underlying technology.¹⁴

Taxpayer: Refers to a person liable for tax, representative taxpayer, withholding agent, responsible third party or a person who, subject to a request, provides assistance under an intentional tax agreement.¹⁵

¹³ *Section 1 of the Act.*

¹⁴ SARS “Crypto-assets & tax”, available at <https://www.sars.gov.za/individuals/crypto-assets-tax/#:~:text=A%20crypto%20asset%20is%20a,techniques%20in%20the%20underlying%20technology> [accessed 14 January 2022]. Hereinafter “Crypto-assets & tax”.

¹⁵ *Section 1 of the Act.*

CHAPTER 2: AN INTRODUCTION TO CRYPTOCURRENCY AND THE CRYPTOCURRENCY TRANSACTIONS THEREOF

2.1. Chapter overview

This chapter considers the definition of cryptocurrency in South Africa. It also discusses the different cryptocurrency transactions which exist in South Africa and the commonly used types of cryptocurrency in South Africa.

2.2. The Definition of Cryptocurrency in South Africa.

As this research focuses on the tax treatment of cryptocurrencies, the definitions to be narrowed in upon are mostly from institutions directly dealing with tax such as SARS.

As stated above, SARS defines Cryptocurrency as ;

*“An internet-based digital currency that exists almost wholly in the virtual realm. A growing number of proponents support its use as an alternative currency that can pay for goods and services much like conventional currencies. In South Africa, the word ‘currency’ is not defined in the Income Tax Act (the Act). Cryptocurrencies are neither official South African tender nor widely used and accepted in South Africa as a medium of payment or exchange. As such, cryptocurrencies are not regarded by SARS as a currency for income tax purposes or Capital Gains Tax (CGT). Instead cryptocurrencies are regarded by SARS as assets of an intangible nature. Whilst not constituting cash, cryptocurrencies can be valued to ascertain an amount received or accrued as envisaged in the definition of ‘gross income’ in the Act. Following normal income tax rules, income received or accrued from cryptocurrency transactions can be taxed on revenue account under gross income”.*¹⁶

In 2018, the Crypto Asset Regulatory Working Group (CARWG) was established to review South Africa’s position on crypto assets. The CARWG defines cryptocurrency as;

¹⁶ SARS stance.

“Digital representations or tokens that are accessed, verified, transacted and traded electronically by a community of users. Crypto-assets are issued electronically by decentralised entities and have no legal tender status, and consequently are not considered as electronic money either. It therefore does not have statutory compensation arrangements. Crypto-assets have the ability to be used for payments (exchange of such value) and for investment purposes by crypto-asset users. Crypto assets have the ability to function as a medium of exchange, and/or unit of account and/or store of value within a community of crypto asset users.”¹⁷

These varying definitions shed light on the lack of clarity in terms of the tax treatment of cryptocurrency. Whilst SARS and the SAWRG agree that cryptocurrency is digital, it is evident that financial institutions/regulators still lack requisite knowledge in terms of the trade of cryptocurrency, types of cryptocurrency, the intermediaries which facilitate cryptocurrency transactions and what is considered a “currency” by law. A critical analysis of cryptocurrencies is essential in achieving an effective and efficient income tax treatment for both; taxpayers and the regulating authorities.

2.3. Origins of Cryptocurrency in South Africa

This section briefly explores the origins of Cryptocurrency in the South African context.

I begin by regurgitating Robinson’s words;

“South Africa is one of the leading nations for cryptocurrency ownership in the world and continues to remain a major adopter of crypto and blockchain technology for everyday use. Figures shown in a 2019 report from 'We Are Social's - Global Digital Yearbook' show that 10.7 percent of internet users in South Africa own a form of cryptocurrency of some kind. This is a leading amount compared to the remaining

¹⁷ Intergovernmental Fintech Working Group, Crypto Assets Regulatory Working Group “Policy proposals for Crypto Assets” 2019 5. Hereinafter “Fintech Working Group”.

*worldwide average of 5.5 percent of internet users. This pace of adoption shows just how popular cryptocurrency continues to be in South Africa.*¹⁸

The growing presence of cryptocurrency can neither be denied nor ignored by the regulating authorities. As the popularity has been established, this research now goes back into time to outline the origins of cryptocurrency.

Cryptocurrency was first mentioned in 1989, and a few years after in 1980, American cryptographer David Chaum invented digital cash, which relied on cryptography to secure and verify transactions.¹⁹ But it was only in the early 1990s that cryptographic protocols and software began to develop towards creating a decentralized digital currency.²⁰ Later, this research shows that the quest for decentralization raises an issue for the only recognised centralized currency issuer; the SARB.

In October 2008, a paper by Satoshi Nakamoto (a pseudonym) titled “*Bitcoin: A Peer-to-Peer Electronic Cash System*” outlined a system for creating a digital currency that did not require trust in any third party. Nakamoto’s paper effectively launched the cryptocurrency revolution.²¹ This actual creation of cryptocurrency was linked to the post 2008 global financial crisis.²² Evidently , the nature of cryptocurrency as decentralized elucidates that the creators of cryptocurrency had little faith in the centralized financial institution owing to factors such as strict access requirements, low interest rates and the risk of losing one’s lifetime savings to unforeseeable events such as the abovementioned global financial crisis.

In the South African context, SARS states that the process of crypto-assets started in 2014.²³

¹⁸ Luke Robinson “The most used cryptocurrencies in South Africa” Moneytalks 2019, available at <https://www.nichemarket.co.za/blog/money-talks/most-used-cryptocurrency-south-africa> [accessed 31 May 2019]. Hereinafter “Luke”.

¹⁹ Guardian Nigeria “The idea and a brief history of cryptocurrencies” 2019 The Guardian, available at <https://guardian.ng/technology/tech/the-idea-and-a-brief-history-of-cryptocurrencies/> [accessed 26 December 2021].

²⁰ *Ibid.*

²¹ *Ibid.*

²² Ncop guide.

²³ Crypto-assets & tax.

The National Treasury (NT) issued a statement alerting the public on the risk of crypto assets. This statement held that-

“Currently in South Africa there are no specific laws or regulations that address the use of virtual currencies. Consequently, no legal protection or recourse is afforded to users of virtual currencies. Due to their unregulated status, virtual currencies cannot be classified as legal tender as any merchant may refuse them as a payment instrument without being in breach of the law. In addition, virtual currencies cannot be regarded as a means of payment as they are not issued on receipt of funds. The use of virtual currencies therefore depends on the other participant’s willingness to accept them. While virtual currencies can be bought and sold on various platforms, they are not defined as securities in terms of the Financial Markets Act, 2012 (Act No. 19 of 2012). The regulatory standards that apply to the trading of securities therefore do not apply to virtual currencies.”²⁴

As such, the lacunas present in its regulation show that there is legal uncertainty as to the position of cryptocurrencies. This uncertainty has the potential to cause serious harm to the taxpayers and regulating authorities respectively. The statement by SARS further explicates the uncertainty which exists as to whether crypto assets are revenue or capital in nature.²⁵ Furthermore, the CARWG was established in 2018 to review South Africa’s position on crypto assets as cryptocurrencies were not regulated under the current regulatory framework.²⁶ Whilst SARS and CARWG regard cryptocurrency as a form of digital money, it is not recognized as a mainstream currency because it does not satisfy the definition of currency in terms of the Act.²⁷ This research explores the great debate on the development of cryptocurrency because of its high volatility in its value and the lack of regulatory measures.²⁸

²⁴ *Ibid.*

²⁵ *See Para 1.1 above.*

²⁶ *Ncop guide.*

²⁷ *Section 1 of the Act.*

²⁸ *Ibid.*

2.4. For Income Tax purposes, three main types of crypto transactions can be identified.

2.4.1. Recognized Cryptocurrency transactions

The recognized Cryptocurrency transactions in South Africa are as follows;

- a) Cryptocurrency Mining,
- b) Trade in cryptocurrency,
- c) Cryptocurrency as a payment method.

Whilst the focus of this research is the Trade in cryptocurrency, this section briefly explores the three different cryptocurrency transactions present in South Africa. The research posits that the contextual background is important as one cannot analyse the trade of cryptocurrency without considering its sibling transactions. As a starting point, this research briefly discusses the three generations of cryptocurrencies in South Africa. For purposes of this research, the background of the aforementioned cryptocurrencies is not considered individually but is regarded holistically as cryptocurrency in any form in this research.

2.5. Types of Cryptocurrencies

An understanding of the three generations(first, second and third generation) of cryptocurrencies is important as their similarities and differences are crucial in designing regulation for cryptocurrencies.²⁹

First Generation cryptocurrencies

The first generation cryptocurrencies are made up of Bitcoin and all the coins that fork its source code and basic concepts.³⁰

(i) Bitcoin

As the first cryptocurrency, Bitcoin has become the most valuable and commonly held among the thousands of cryptocurrencies that have since been created. Its rise in

²⁹ Sadhaseevan Lucrecia “The regulation of cryptocurrencies in the context of South Africa’s financial sector” (unpublished LLM thesis, University of Kwazulu Natal, 2019) 23. Hereinafter “Sadhaseevan”.

³⁰ ELI “First, second and third generation cryptocurrencies” 2021, available at <https://crypto.bi/generations/> [accessed 2 May 2022]. Hereinafter “ELI”.

value and popularity has been steady, if not without its ups and downs.³¹ Bitcoin is defined as a “*purely peer-to-peer version of electronic cash which allows online payments to occur directly from one party to another, without relying on a trusted financial institution.*”³²

(ii) Altcoins

Altcoins is a concept which is derived from open source software development where programmers decided to take a software project and make modifications to it under a separate source code tree.³³ Essentially, Altcoins means the blockchain of a cryptocurrency has forked and followed at least two different paths forming several chains.

Harr states that ;

*“Litecoin was a famous early fork, and so was Dogecoin. These software projects simply forked the Bitcoin source code tree, changed the logo and cryptographic hash function from Bitcoin’s SHA256 to the more memory-intensive script algorithm. With these simple changes, a new cryptocurrency was born!”*³⁴

Therefore, first generation cryptocurrencies can be regarded as the spark which ignited the cryptocurrency revolution. Many more altcoins continue to develop to date which affects the income tax treatment of cryptocurrencies as a whole. Not only do financial regulators struggle to have a firm definition, but issues also arise for income tax purposes as the different cryptocurrencies are acquired in similar but different manners. This difference in nature makes it problematic to establish a regulatory framework for income tax purposes in terms of accrual.

³¹ Ryan Harr “What is Bitcoin” 2022 MinRead, available at <https://time.com/nextadvisor/investing/cryptocurrency/what-is-bitcoin/#:~:text=Bitcoin%20was%20created%20in%202009,value%20currency%2C%20comparable%20to%20gold>. [accessed 22 April 2022]. Hereinafter “Ryan”.

³² S Nakamoto ‘Bitcoin: A Peer-to-Peer Electronic Cash System’ 2018 , available at <https://www.bitcoin.org/bitcoin> [accessed on 1 March 2018].

³³ Ryan.

³⁴ Ibid.

Second Generation Cryptocurrencies

Sadhaseevan states that second generation cryptocurrencies such as Ethereum demonstrate a significant difference to first generation cryptocurrencies because they enable non-monetary transactions.³⁵

(i) Ethereum

Ethereum is a cryptocurrency which uses the blockchain to enable applications using the blockchain to generate more tokens, to represent financial instruments, the ownership of property and the development of smart contracts which encode arbitrary state transition functions allowing users to create any of the above-mentioned systems.³⁶

Govender holds that :

“It was called Ethereum and it was nothing like any of the clones that came before it. It wasn't forked from the Bitcoin source tree, it used Javascript on its front-end, it had modularized front and back ends into separate components and many more software innovations that made it very different from Bitcoin. But there was one big concept that set it apart from every other cryptocurrency from the time. Ethereum was actually a virtual machine that ran sophisticated computer programs called smart contracts.”³⁷

Third Generation Cryptocurrencies

Third generation cryptocurrencies are a concept that expands on second generation cryptos and builds further abstractions on top of them.³⁸ As this generation is relatively new, it is likely to change or evolve as it becomes more concrete within the cryptocurrency community.³⁹

³⁵ Sadhaseevan 24.

³⁶ S Govender ‘Smart Contracts vs Traditional Contracts: Same but Different’ Webber Wentzel 13 March 2019, available at <https://www.webberwentzel.com/News/Pages/smart-contracts-vs-traditional-contracts-same-but-different.aspx> [accessed on 10 July 2019]

³⁷ *Ibid.*

³⁸ *ELI.*

³⁹ *Ibid.*

(i) Cardano ADA

This is the farthest developed third generation cryptocurrency coin to date. This Cryptocurrency can be defined as follows;

“Cardano is a blockchain and ADA is the coin that powers the Cardano network. This is similar in some ways to ether and the Ethereum blockchain. Think of Bitcoin as Crypto 1.0. It’s essentially digital gold, but the system is beset with scalability issues. Then there’s Ethereum, often referred to as Crypto 2.0. Cardano, launched in 2017, is Crypto 3.0, with the goal of improving upon the functionality that Ethereum was initially missing.”⁴⁰

Evidently, cryptocurrency continues to adapt and grow to suit the dynamic cryptocurrency climate which potentially presents greater problems for the tax treatment of such currencies.

Fourth Generation Cryptocurrencies

Whilst the third generation of cryptocurrencies has not been readily developed, cryptocurrency development is ahead of its time. Fourth Generation cryptocurrencies are already a project in the pipelines and are likely to cause more tax issues than its predecessors. They are defined as *“cryptocurrencies based on metastable consensus mechanisms, such as Avalanche. In this class of consensus mechanisms, the network is never fully stable and hard set on a given consensus. Instead, it’s flexible to change as long as enough nodes believe it should change.”⁴¹*

(i) Avalanche Consensus

Avalanche is a blockchain that promises to combine scaling capabilities and quick confirmation times through its Avalanche Consensus Protocol. It can process 4,500 TPS (transactions per second). For Ethereum, that number is 14 TPS. Avalanche’s

⁴⁰ David Rodeck & Farran Powell “What is Cardano (ADA)?” Forbes , available at <https://www.forbes.com/advisor/investing/cryptocurrency/cardano-ada/> [accessed 2 May 2022].

⁴¹ ELI.

native token, AVAX, is the 10th-largest with a market cap of \$33 billion as of this writing in March 2022, according to data from CoinDesk.⁴²

Fourth generation cryptocurrencies present greater problems for institutions such as SARS as they provide extremely high transaction per second scalability, competing with VISA or MasterCard level of TPS.⁴³ This level of speed brings forward greater security and monitoring risks as transactions are almost, fully anonymous.

Cryptocurrency Mining

2.6. Background information

Cryptocurrency mining is the process of creating new cryptocurrency by solving puzzles, it consists of computing systems equipped with specialized chips competing to solve mathematical puzzles.⁴⁴ For a short time after Bitcoin was launched, it was mined on desktop computers with regular central processing units (CPUs).⁴⁵ This process was extremely slow. Technology has advanced very fast since 2008. Now the cryptocurrency is generated using large mining pools spread across many geographies, Bitcoin miners aggregate mining systems that consume massive amounts of electricity to mine the cryptocurrency.⁴⁶

2.6.1 Cryptocurrency Mining in South Africa

A stunning metaphor, cryptocurrency mining in South Africa is the process in which cryptocurrencies are unearthed.⁴⁷ This term is problematic as cryptocurrency mining exists entirely in the virtual or digital realm unlike traditional modes of mining. In a separate but concurring perspective, Mitchell posits that terms such as ‘created’ and

⁴² Coindesk “What is Avalanche?” 2022 Consensus, available at <https://www.coindesk.com/learn/what-is-avalanche-a-look-at-the-popular-ethereum-killer-blockchain/> [accessed 10 May 2022].

⁴³ ELI.

⁴⁴ Jake Frankenfield “Bitcoin Mining” 2022 Investopedia, available at <https://www.investopedia.com/terms/b/bitcoin-mining.asp> [accessed 22 February 2022].

⁴⁵ *Ibid.*

⁴⁶ *Ibid.*

⁴⁷ International Monetary Fund Discussion Note 16/03 *Virtual Currencies and Beyond: Initial Considerations* (2016) 25.

'generated' are problematic for regulation because they imply that cryptocurrencies are controlled by human intervention.⁴⁸ Cryptocurrency mining essentially entails the process by which miners unearth cryptocurrency to use as a medium of exchange to purchase goods and services for investment purposes or the sale of cryptocurrencies to other forms of exchanges.⁴⁹ Weru states that *"Strict regulations, costly electricity prices and the high cost of setting up a mining rig are some of the major reasons why the African mining community is spread so thin."*⁵⁰ Contrary to this, a growing population of South Africans are gaining access to cryptocurrency daily. Cryptocurrency mining is problematic for tax treatment purposes because digital currencies permit instant, anonymous, virtual, almost untraceable, e-payments to anyone located anywhere in the world.⁵¹

The growing presence of cryptocurrency mining in South Africa is largely due to the following factors;

- a) The South African economy is also among Africa's strongest. This strong economy makes it easier for South Africans to buy mining equipment.
- b) The availability of Bitmart stores in the country also makes it easier for residents to buy mining equipment. In most African countries, miners are forced to import components when building their rigs. South Africans have it easier.⁵²
- c) One of the world's most profitable cryptocurrency mines is located in Johannesburg, and it uses solar energy generation to power its operations.⁵³
- d) Cape town is ranked as one of the top 50 nodes in the Bitcoin network.⁵⁴
- e) The cryptocurrency platform Luno, which has seven million trading "wallets" (or accounts) in South Africa, confirms that it has seen an increase in requests from

⁴⁸ K Mitchell 'Bitcoin from the beginning' (2014) 14 *Without Prejudice* 2 62.

⁴⁹ Sadhaseevan 22.

⁵⁰ Steven Weru 'Bitcoin mining in Africa: What can be done to encourage mining?' 2019 *Bitcoin Magazine* <https://bitcoinmagazine.com/business/bitcoin-mining-in-africa-what-can-be-done-to-encourage-mining> [accessed 7 June 2019]. Hereinafter "Weru".

⁵¹ The Davis Tax Committee "First interim report: Addressing base erosion and profit shifting in South Africa", 2, available at www.taxcom.org.za (accessed on 12 April 2019). See also the DTC "Second interim report on base erosion and profit shifting in South Africa", 103-105, available at www.taxcom.org.za [accessed on 12 April 2019].

⁵² Weru.

⁵³ Myles Illidge "Joburg Mine amongst the most profitable in the world" 2021, available at <https://mybroadband.co.za/news/cryptocurrency/425860-joburg-crypto-mine-among-the-most-profitable-in-the-world.html> [accessed 4 December 2021].

⁵⁴ Sadhaseevan 30.

South Africans to download their transaction histories, presumably for tax purposes.⁵⁵

The Trade in Cryptocurrencies

2.6.2. Background information

This second type of transaction is the main focus of this research. The Trade in cryptocurrency can be defined as the act of speculating on cryptocurrency price movements via a CFD trading account, or buying and selling the underlying coins via an exchange.⁵⁶ As this research is dealing with the income tax treatment in the trade of cryptocurrency, the general tax deduction rules and formula found in the Income Tax Act are considered.⁵⁷

The general deduction formula in *sections 11(a) and 23(g)* reads as follows:

“11. General deductions allowed in determination of taxable income. —For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;”⁵⁸

Trading in cryptocurrency can be included in a taxpayer’s revenue account. A taxpayer may go long (‘buy’) if he thinks that a cryptocurrency will rise in value, or go short (‘sell’) if he thinks it will fall in value.⁵⁹ As cryptocurrencies are leveraged products, a trader may open a position for a fraction of the full value of the trade. According to IG,

⁵⁵ Staff Writer “SARS is cracking down on cryptocurrency owners” 2022 TCSA, available at <https://www.taxconsulting.co.za/sars-is-cracking-down-on-cryptocurrency-owners/> [accessed 11 May 2022]. Hereinafter “SARS crackdown”.

⁵⁶ Staff Writer “What is cryptocurrency trading” 2022 IG, available at <https://www.ig.com/en/cryptocurrency-trading/what-is-cryptocurrency-trading-how-does-it-work> . [accessed 13 May 2022].

⁵⁷ The Income Tax Act 58 of 1962.

⁵⁸ Section 11(a) of the ITA.

⁵⁹ Staff Writer “What is cryptocurrency trading” 2022 IG, available at <https://www.ig.com/en/cryptocurrency-trading/what-is-cryptocurrency-trading-how-does-it-work> . [accessed 13 May 2022].

although leveraged products can magnify profits, they can magnify losses if the market moves against a trader.⁶⁰ South Africa is one of the leading nations for cryptocurrency ownership in the world and continues to remain a major adopter of cryptocurrency and blockchain technology for everyday use. Figures shown in a 2019 report from 'We Are Social's - Global Digital Yearbook' show that 10.7 Per cent of internet users in South Africa own a form of cryptocurrency of some kind, this is a leading amount compared to the remaining worldwide average of 5.5 Per cent of internet users.⁶¹ This pace of adoption shows just how popular cryptocurrency continues to be in South Africa. Evidently, due to the high costs of cryptocurrency mining- trading in cryptocurrency makes it easier for South Africans to access cryptocurrencies at a reduced cost with minimal equipment.

The rise in the trade of cryptocurrency can largely be due to the following factors;

1. As trading does not require high start-up costs, many people are able to access popular trading platforms such as Luno.
2. Lack of regulations makes it easier to withhold funds without declaring returns for tax purposes. Luno does not provide tax certificates to users because calculating tax on bitcoin earnings requires the consideration of multiple factors and is not straightforward.⁶²
3. Bitcoin remains the most traded and popular cryptocurrency worldwide and remains the highest valued crypto coin on the market.⁶³ The fact that it is possible for South Africans to also buy Bitcoin in ZAR instead of USD continues to make it a popular cryptocurrency choice in South Africa.
4. For South African traders Ethereum is a cryptocurrency to watch, especially as its blockchain technology has attracted a lot of investment from over 150 major companies such as Mastercard and Deloitte.⁶⁴ It is also possible for South African traders to purchase Ethereum directly with ZAR.⁶⁵

⁶⁰ *ibid.*

⁶¹ *Luke.*

⁶² *SARS crackdown.*

⁶³ *Luke.*

⁶⁴ *SARS crackdown.*

⁶⁵ *ibid.*

5. Litecoin has a fairly low market cap, which makes it a good investment as cryptocurrencies like it have a reasonably high potential for coin value growth in the market.⁶⁶

2.6.3 Cryptocurrency as a payment method

The SARB states that payment methods are issued by banks to their customers to effect transactions including, among others, financial market transactions and the daily purchase of goods and services.⁶⁷ South Africa boasts cash and non-cash payment methods.⁶⁸ In 2018, the Reserve Bank said it had launched a project to test the feasibility of the National Payment System Department issuing a Central Bank Digital Currency (CBDC).⁶⁹ According to the Bank for International Settlements, 86 percent of central banks were actively researching the potential for CBDCs, Spain, Belarus, the Cayman Islands and Luxemburg saw potential in the technology behind crypto assets and were developing a cryptocurrency-friendly regulatory regime as a means to attract investment in technology companies.⁷⁰

In South Africa, *Section 14 of the SARB Act 90 of 1989* empowers the bank to issue bank notes and coins.⁷¹ This section holds that:

“ 14. (1) The Bank shall have the sole right to issue or cause to be issued banknotes and coins in the Republic: Provided that all coins which at the commencement of the South African Reserve Bank Amendment Act, 1989, were lawfully in circulation and legal tender in the Republic, shall as such remain in circulation until withdrawn from circulation in accordance with the provisions of section 19, or are no longer of the current mass prescribed in Schedule 2 in respect of the denomination in question. (2) The Bank shall not issue or cause to be issued any banknote of a denomination, in a form or of a material not approved by the Department of Finance”

⁶⁶ *Ibid.*

⁶⁷ *South African Reserve Bank National Payment System Department “Payment, clearing, and settlement systems in South Africa” (2012).*

⁶⁸ *Ibid.*

⁶⁹ *Ncop guide.*

⁷⁰ *Ibid.*

⁷¹ *SARB Act 90 of 1989, hereinafter the “SARB Act” unless indicated or stated otherwise herein.*

Evidently, cryptocurrencies are not included in this definition. As this definition contains a general and a specific provision, this research also considers the definition of payment methods given by the Finance Department of South Africa. *The Financial Intelligence Centre Act 38 of 2001* defines cash as:

“Any coin and paper money of South Africa or of another country that is designated as legal tender and circulates as, and is customarily used and accepted as, a medium of exchange in the country of issue; and (b) travellers’ cheques.”⁷²

Once again, cryptocurrencies are excluded from the ambit of this definition. To date, cryptocurrencies are not regarded as legal tender as cryptocurrency is not issued by a central bank.

2.7. Conclusion

This research shows that the definition of cryptocurrencies remains ambiguous in South Africa and finding its correct classification for income tax purposes is proving difficult for SARS and other regulating institutions such as the SARB. For an effective income tax system, this chapter sought to breakdown the definition of cryptocurrencies, the types of cryptocurrency present in South Africa and to shed light on the different kinds of cryptocurrency transactions. This background is essential as a foundation to determine how the income tax treatment of cryptocurrencies must be conducted to ensure an efficient regulatory system for income tax purposes. This research essentially concludes the following:

1. Cryptocurrency is an internet-based digital currency that exists almost wholly in the virtual realm.⁷³
2. Cryptocurrencies are decentralized (meaning they are not generated or issued by the SARB or an any other authorized authority), also, they are not considered legal tender in South Africa.
3. The trade in cryptocurrency is the most abundant cryptocurrency transaction in South Africa.
4. Cryptocurrencies do not fit the definition of money/cash.

⁷² Section 1 of the *Financial Intelligence Act 38 of 2001*, Hereinafter the “FICA Act” unless indicated or stated otherwise herein.

⁷³ *Fintech Working Group*.

5. Many people can access trading platforms such as Luno.
6. Bitcoin continues to be the most traded cryptocurrency in South Africa.
7. Cryptocurrencies exist as first-generation cryptocurrencies such as Bitcoin and Altcoins. These are used specifically to make payments and currency transactions such as investments and trading.⁷⁴
8. Second generation cryptocurrencies are largely used for investment purposes and are largely used to create cryptocurrencies and/or other tokens.
9. Third generation cryptocurrencies are a concept that expands on second generation cryptos and builds further abstractions on top of them.⁷⁵
10. Fourth generation cryptocurrencies present greater problems for institutions such as SARS as they provide extremely high transaction per second scalability, competing with VISA or MasterCard level of TPS.⁷⁶

The next chapter focuses on the imbroglio of jurisdiction to Tax.

⁷⁴ *Sadhaseevan 32.*

⁷⁵ *ELI.*

⁷⁶ *ELI.*

Chapter 3: JURISDICTION TO TAX

3.1. Chapter Overview

This chapter discusses the jurisdiction to tax in relation to the income tax treatment of cryptocurrencies. The acceleration in the globalisation of trade and investment, and the removal of barriers to the free movement of capital, have resulted in increased competition among businesses in the global marketplace and encouraged individuals, entities and multinational enterprises to increasingly develop strategies to maximise profits and reduce their global tax exposure.⁷⁷ This is explored through the ordinarily resident and physical presence tests, common law tests and the influence of VPN on the recognised tests for jurisdiction. The power to tax is one of the authorities of sovereignty, and the jurisdiction to exercise its power is conterminous with the bounds of the sovereign's jurisdiction.⁷⁸

The starting point in applying the jurisdiction to tax is determining a person's gross income.⁷⁹ The term '*gross income*' is defined as follows in *section 1* of the *ITA* as—
“ in relation to any year or period of assessment, means—
(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
(ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature.”⁸⁰

⁷⁷ M Grundy *The World of International Tax Planning* (1984) 1-2; A Ginsberg *International Tax Havens* 2 ed (1997) 5.

⁷⁸ Joseph H. Beale “Jurisdiction to Tax” 1919 *Harvard Law Review* Vol 32 6, at 6. Hereinafter “Joseph”.

⁷⁹ M Stiglingh (ed.) *SILKE: South African Income Tax* (2022), at 26. Hereinafter “Silke 2022”.

⁸⁰ *Section 1 of the ITA.*

All the requirements of the definition of 'gross income' must be complied with for an amount to qualify as gross income.⁸¹ The requirements are stated as follows:

*"In the case of a resident: there must be an amount, in cash or otherwise, that is received by or accrued to or in favour of such resident, during a year or period of assessment, excluding receipts or accruals that are of a capital nature."*⁸²

*l) in the case of a non-resident: "there must be an amount, in cash or otherwise, that is received by or accrued to or in favour of such non-resident, during a year or period of assessment, from a source within South Africa, excluding receipts or accruals that are of a capital nature."*⁸³

In general, *the Act* distinguishes between residents and non-residents. In the case of non-residents, the source principle (common law rule, or specific source rules) apply. Yet, despite these rules, cognisance must be had for the provisions in a DTA or Multi-lateral agreement where applicable. The purpose of the Act in relation to cryptocurrencies is that residents trading in cryptocurrency are taxed on a residence-based system whereas non-residents (persons who are 'not' residents, as defined), only receipts and accruals derived from sources within the Republic are subject to tax in South Africa.⁸⁴

3.2. **Residence based tests**

The main purpose of this section is an exploration of jurisdiction to tax in terms of the trade in cryptocurrency. As such, I briefly discuss the residence and physical presence tests and discuss its application in greater detail. For tax purposes, the general rule is that if a person is a resident in South Africa, the income derived from the trade of cryptocurrency, irrespective of the source must be included in the taxpayer's gross income in South Africa.⁸⁵ If a person is a non-resident, any amounts from the trade of cryptocurrencies are included in gross income if such amounts are derived from a source in South Africa.⁸⁶ Since the residence basis of taxation covers the worldwide

⁸¹ *Silke 2022, at 26.*

⁸² *Section 1 of the ITA.*

⁸³ *Silke 2022, at 26.*

⁸⁴ *Ibid.*

⁸⁵ *Ibid, at 825.*

⁸⁶ *Ibid.*

taxation of a country's residents, very few countries have the administrative capacity to cast their nets worldwide, so this basis of taxation is usually adopted by developed and net capital exporting countries.⁸⁷ South Africa as a developing African country continues to struggle to come to terms with the administration of cryptocurrency, hence the usage of more than one test for jurisdictional purposes.

The term “*ordinarily resident*” is not defined in *the Act* and the interpretation given by the courts must be followed. In *Cohen v CIR*, the taxpayer, who was a South African resident at the time was requested by his employer to work in the USA.⁸⁸ The taxpayer lived in New York for twenty months and did not return to South Africa. In establishing whether the taxpayer was ordinarily resident, the courts established three important principles:

- 1) A person’s ordinary residence would be the country to which he would naturally return from his wanderings.⁸⁹
- 2) One should not only consider the person’s actions during the year of assessment to determine whether he is ordinarily resident in a particular country.⁹⁰
- 3) Physical absence during the full year of assessment is not decisive.⁹¹

The concept of ‘residence’ is fundamental to the residence-based system of taxation. The definition of ‘resident’ distinguishes between natural persons and persons other than natural persons.⁹² This definition provides that a person is not a resident if that person is deemed to be exclusively a resident of another country in terms of a double tax treaty.⁹³ On paper, this seems simply, but as is discussed, ordinary residence is affected to a great extent by the anonymous nature of cryptocurrency. Following the ordinarily resident tests is short sighted because it is not enough for taxing authorities to rely on the honesty of tax payers who ‘declare’ ordinary residence to submit tax returns.

⁸⁷ L Olivier & M Honiball *International Tax: A South African Perspective* 5 ed (20 11) 46.

⁸⁸ *Cohen v CIR* (13 SATC 362) (1946 AD 174).

⁸⁹ *Ibid.*

⁹⁰ *Silke* 2022, at 27.

⁹¹ *Ibid.*

⁹² *Ibid.*

⁹³ *Ibid.*

3.3. Physical presence test

A brief overview of the physical presence test is essential to establishing the income tax treatment of cryptocurrency. Where an individual is not ordinarily resident in South Africa, he or she may still meet the requirements of the physical presence test and be deemed to be a resident for tax purposes. To meet the requirements of the physical presence test that individual must be physically present in South Africa for periods exceeding-

- 1) "91 days in total during the year of assessment under consideration;
- 2) 91 days in total during each of the five years of assessment preceding the year of assessment under consideration; and
- 3) 915 days in total during those five preceding years of assessment."⁹⁴

An individual who fails to meet any one of these three requirements does not satisfy the physical presence test. If the individual is neither ordinary resident, nor meets the requirements of the physical presence test, that individual is regarded as a non-resident for tax purposes. This means that the individual is subject to tax only on income that has its source in South Africa as well as the withholding of tax on the sale of immovable property as provided for in *Section 35A of the ITA*.⁹⁵ As cryptocurrency trading takes place in a virtual realm, physical presence cannot be determined accurately at face value because of the anonymous nature of cryptocurrency. As seen later in this discussion, a cryptocurrency trader may be physically present in South Africa but their geographical location on the trading platform may be outside the country-and vice versa.

3.4. Common-Law Source tests

One first has to consider the source rules in the *ITA*. Where the specific source rules do not provide for the transaction at hand, the common law rule is applied. The *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* case (referred to

⁹⁴ *Ibid.*

⁹⁵ *ITA*.

as the “*Lever Brothers case*”) dealt with the question of determining the source of interest income.⁹⁶ Lever Brothers and Unilever Ltd and Associated Enterprises Ltd, two English companies, were assessed for South African income tax for the 1940 to 1942 years of assessment on money received by them from Overseas Holdings (Pty) Ltd, a South African company.⁹⁷ As the parties had agreed that the position of Lever Brothers and Unilever Ltd and Associated Enterprises Ltd was similar and therefore one case would settle the dispute in both, the judgment referred to the two companies as “Levers” and the third company as “*Overseas Holdings*”.⁹⁸ The significance of this case set a lasting precedent in South African income tax law which establishes the basis on which the source of income earned in the form of interest should be determined and establishes a two-step test that can still be used when interrogating the source of other classes of income.

Watermeyer CJ started that the word “source” is a metaphorical expression and “*the sense in which it is used in the Act must be determined*”.⁹⁹ In arriving at the meaning of “source” in the definition of “gross income”, he referred to the two problems (or questions) that arise to determine what the source of money received by the taxpayer is

- 1) The originating cause.
- 2) The source of the income.

Watermeyer CJ further went on to state that the word “source” denotes “origin” and not “location” and concluded that “source” does not denote the quarter from which the money is received, but the originating cause of the receipt (i.e., the particular activity of the taxpayer which earns money). This seems simple but cryptocurrency trading revolves around the manipulation of location, which makes it essentially difficult to determine the source or origin.¹⁰⁰

⁹⁶ *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* 14 SATC 1, at 3.

⁹⁷ *Ibid.*

⁹⁸ *Ibid*, at 4.

⁹⁹ *Ibid*, at 8.

¹⁰⁰ *Ibid*, at 9.

3.5. **Balance between the Residency and Source based tests**

South Africa is regarded as a country which has not done much to develop in terms of dealing with cross border transactions.¹⁰¹ When dealing with a transaction in terms of which a right to tax is difficult to establish, the importance of an effective cross border transaction tax treatment is essential to achieving an efficient income tax treatment system. As such, this research re-emphasizes that its purpose is not to discuss effective ways of tax regulation or enforcement, but rather how such tests affect a taxpayer's income tax returns when trading in cryptocurrency. The *Katz Commission Report* stated that *“in order to protect South Africa's tax base, over the years, the ITA deviated from a pure source basis and a hybrid system was adopted whereby the source basis of taxation was applied on active income and various deeming provisions (which were essentially based on the residence principle) were applied on passive income.”*¹⁰²

Oguttu states that;

*“With the gradual phasing out of exchange controls, the introduction of a residence basis of taxation was inevitable. The tax authorities were convinced that the introduction of the residence basis of taxation would significantly broaden South Africa's tax base, limit the opportunities for offshore tax avoidance and also bring South Africa's tax system into line with international best practice. Thus from the years of assessment commencing 1 January 2001, the residence-based system of taxation was introduced in South Africa, ushered in by the Revenue Laws Amendment Act 59 of 2000, which amended the Income Tax Act. Currently, the principles that underlie the basis of taxation in South Africa are laid out in the definition of ‘gross income’ in section 1 of the Income Tax Act.”*¹⁰³

South Africa's income tax laws shows that there is no clear policy on where the country ought to be on the broad spectrum that runs from a pure worldwide system to a pure

¹⁰¹ Annet Wanyana Oguttu “Ensuring a right balance in applying the residence and source bases of taxation” 2016 JUTA 246. Hereinafter “Oguttu”.

¹⁰² Katz Commission Report (n 4) paras 2.1.2 and 2.1.5.

¹⁰³ Oguttu 274.

source/territorial system.”¹⁰⁴ This is problematic when dealing with the trade of cryptocurrency as it is largely anonymous and not border or source specific. The greater application of the income tax consequences is discussed considering VPN in the next section.

3.6. The impact of VPN on the residency tests ; Ordinarily resident, physical presence & common law tests

The principles of jurisdiction to tax are discussed through the analysis of VPN. An insight on VPN is essential as it is the most direct cause affecting income tax treatment. Through the lens of VPN, the anonymous nature of cryptocurrency emphasizes the shortcomings for purposes of determining jurisdiction over tax. As cryptocurrency can be traded anywhere, it is important to discuss the impact of VPN to the jurisdiction to tax. Apart from being used as a traditional currency, cryptocurrencies can also be used for trading and there are numerous-markets across the world which allow the trade in cryptocurrencies.¹⁰⁵ It is important to keep in mind the country the VPN originates from and where it operates, most of the top VPN providers come from countries without any mass surveillance programmes, like the British Virgin Islands, Switzerland, Panama and Cayman Island.¹⁰⁶ This is due to blockchain technology (**see** chapter 1.1). As already stated earlier, blockchain technology keeps cryptocurrency in a decentralized market which is unregulated by anyone (**see** chapter 1.1.). It’s decentralization bears risks of potential losses and loss of privacy.¹⁰⁷ Traders take advantage of the transactions being irreversible and untraceable.¹⁰⁸ The anonymous nature of the transaction does not take away the right to tax. The right to tax is established in terms of the *ITA*. However, the anonymity may hinder the enforcement of the right to tax. The enforcement is a tax administration issue that does not impact on the right to tax. In other words, the discussion here does not deal with the right to tax.

¹⁰⁴ *Ibid.*

¹⁰⁵ Alexiei Zahorski “You Absolutely Need a VPN to Avoid Cryptocurrency Theft” MUO, available at <https://www.makeuseof.com/why-you-need-a-vpn-cryptocurrency/> . [accessed 10 May 2022].

Hereinafter “Zahorski”

¹⁰⁶ *Zahorski.*

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*

VPN allows a taxpayer to protect its online data through encryption and protection of identity.¹⁰⁹ The benefit of VPN lies in VPN allowing a taxpayer to secure traffic through the masking of public IP addresses and hiding of the taxpayer's original location by redirecting the traffic to another place that could be hundreds of miles away.¹¹⁰ This in turn makes it impossible for anyone to keep track of online activities. The main issue with cryptocurrencies is that it goes against the principles of jurisdiction to tax as transactions are anonymous and can be done from anywhere.¹¹¹ Unlike stocks, people can trade at any time and time zone.¹¹² Therefore, A South African can be present in South Africa whilst their location is anywhere outside of South Africa.¹¹³ Nakamoto states that, *"one person could hold multiple addresses, and in theory, there would be nothing to link those addresses together, or to indicate that the person owned them."*¹¹⁴ Cryptocurrencies are essentially borderless and can be traded from anywhere in the world. A transaction is anonymous because a cryptocurrency trader can hold a crypto address without revealing anything about his/her personal identity in that address. Despite this, The residence test is not affected. The taxpayer is either a resident or not. The source rules are difficult to apply where there is no specific deeming rules, the common law source rule is inconclusive, the DTA/Multi-lateral agreement does not provide for deeming source rules/ the rules are subject to the common law rule that yields inconclusive results.

In 2021, South Africa's Financial Sector Conduct Authority (FSCA) issued a public warning that Binance Group, the owner of the world's largest cryptocurrency exchange, is *"not authorised to give any financial advice or render any intermediary services in terms of the Financial Advisory and Intermediary Services Act."*¹¹⁵ To which Binance quickly responded: *"We don't recognize your authority anyway."*¹¹⁶ A

¹⁰⁹ *Ibid.*

¹¹⁰ *Ibid.*

¹¹¹ *Silke 2022, at 27.*

¹¹² *Zahorski.*

¹¹³ *Ibid.*

¹¹⁴ Staff Writer "How anonymous is Cryptocurrency" 2020 *Accuant*, available at

<https://www.acuant.com/blog/how-anonymous-is-cryptocurrency/> [accessed 9 December 2020]

¹¹⁵ Jeff Benson "Binance Tells South Africa Regulator it Doesn't Have Jurisdiction Over Crypto" 2021 *Decrypt*, available at <https://decrypt.co/80219/binance-tells-south-africa-regulator-it-doesnt-have-jurisdiction-over-crypto> [accessed 4 September 2021].

¹¹⁶ *Ibid.*

complete discussion of the enforcement mechanisms of SARS falls outside the scope of the study, this research simply highlights the difficulty of the right to tax created by the anonymity factor as a result of VPN. Thus, it is established that, if the income complies with the definition of gross income, it is taxed in South Africa (save, for any DTA provisions).

The greatest relief afforded for the income tax treatment of trade in cryptocurrencies is the misconception of VPN and its anonymity. A common misconception is that cryptocurrencies provide complete anonymity to the user, but that is not entirely true because hackers and foreign governments can track a taxpayer through public IP addresses.¹¹⁷ Whilst this may seem helpful, its application proves difficult or virtually impossible to implement because traders can trade outside the country whilst using South Africa as a VPN and vice versa. SARS states that the many users present in South Africa use the following, main platforms :

*“The most trustworthy crypto exchange platform in South Africa that have been tested and are reliable with bitcoin trading are Luno, Binance, Coinbase, etc. These exchange platforms accept deposits from your bank account or card payments. Once the money is confirmed, you can buy or sell bitcoins through the exchange immediately.”*¹¹⁸

The cryptocurrency platform Luno, which has seven million trading ‘wallets’ in South Africa confirmed that it has seen an increase in requests from South Africans to download their transaction histories.¹¹⁹ Luno further stated that it does not share customer information with SARS on a routine or ongoing basis.¹²⁰ Contrary to what many traders and investors believe, cryptocurrency bank transfers by a taxpayer to a trading platform can be traced.¹²¹ To this end, Zahorski states that an internet service provider may not know how much bitcoin you bought or sold, but they can tell what trading platform you use and when you logged in.¹²² He further states that if you use

¹¹⁷ Zahorski.

¹¹⁸ SARS crackdown.

¹¹⁹ *Ibid.*

¹²⁰ *Ibid.*

¹²¹ *Ibid.*

¹²² Zahorski.

a VPN, your ISP only sees the IP address of the VPN server you use instead of the crypto website.¹²³ This essentially means that the VPN encrypts all data online, and the ISP cannot manipulate your connection. It is difficult to determine a taxpayer's location accurately. One could argue that information from these trading platforms can be used to determine jurisdiction, however, this is dismissed because a VPN hides IP addresses meaning that a trading platform can never know the geographical location and, cannot prevent a taxpayer from trading on the site. This essentially means that whilst the information is there, only the law provides the right to tax. However, enforcing the law is problematic. Taxing authorities can only rely on returns declared by taxpayers (accurate or not) as the trading platforms have no obligation to disclose confidential client information.

Krok v CSARS

The residence basis of taxation has also been strengthened in the context of South African residents' investments in offshore trusts.¹²⁴ With the continuous relaxation of the Exchange Control Regulations, which began in 1997, there has been a tendency of South African residents to invest in offshore trusts.¹²⁵ South African residents have been known to transfer assets to offshore trusts by means of donations, especially by parents resident in South Africa who desire their children who are resident in other countries to be able to inherit their wealth.¹²⁶

A classic example of this is found in the *Krok v CSARS* case.¹²⁷ This case dealt with the correctness of granting a preservation order under a double tax agreement in respect of alleged tax debt owed to Australia by a South African expatriate.¹²⁸ In 1999, South Africa and Australia concluded a double taxation agreement (the DTA) for the avoidance of double taxation and the prevention of fiscal evasion with respect to income tax.¹²⁹ The Australian tax office made requests to SARS under the agreement in January 2012 and February 2013 for income tax plus interest amounting to

¹²³ *Ibid.*

¹²⁴ *Oguttu, at 246.*

¹²⁵ *Ibid.*

¹²⁶ *Ibid.*

¹²⁷ *Krok v CSARS (20230/2014 AND 20232/2014) 2015 ZASCA 107 [20 August 2015].*

¹²⁸ *Ibid.*

¹²⁹ *Ibid.*

R235 705 169.19 due by Mr Krok for the income period from 30 June 2004 to 30 June 2009.¹³⁰ The Relevance of this case is the facts not the judgment. Mr Krok inherited capital assets valued at R71 713 807 in February 2003. Prior to emigrating to Australia, Mr Krok sought tax advice on the tax implications relating to the assets which led to him setting up an elaborate scheme to avoid adverse exchange control implications.¹³¹ The scheme involved him vesting beneficial interests in both the assets and the income in a British Virgin Islands company through a series of agreements. Mr Krok essentially ceded all his South African income and assets to a company which made it impossible to tax as there was no double tax agreement.

This case is a classic example of how a taxpayer can channel a transaction to a tax haven or low tax jurisdiction. This case recognises that a DTA overrides the domestic law in the case where multiple jurisdictions have the right to tax the same transaction. Also, this case helps to explain how the common law rules of determining jurisdiction to adjudicate a dispute can be used to apply the common law test.

The *Fidelity & Columbia Trust Co. V Louisville* case held that a bank deposit might be included in the tax laid upon the depositor at his domicile.¹³² This means cognisance must be had to the provisions of a double-tax or multi-lateral agreement where the income so derived is taxable in multiple jurisdictions. In applying the ordinarily resident test, specific focus is put on the fact that a trader makes a deposit on the trading platform through his bank. Jurisdiction in tax is not a big deal if a taxpayer is a South African Citizen. The source rules are efficient but the issue is whether the taxpayers are compliant. A person who trades in an entity other than a natural person (e.g. through a trust), that trust exists in a cloud or is registered in a foreign place where SARS has no double tax treaty, technology allows the taxpayer to circumvent the jurisdiction rules. This is done via channelling the income to a tax jurisdiction which is considered a tax haven.

The importance of the *Krok vs CSARS* case is evinced by the overriding nature of a DTA or multilateral agreement which has a far reaching effect of overriding the

¹³⁰ *Ibid.*

¹³¹ *Ibid.*

¹³² *Fidelity & Columbia Trust Co. V Louisville* 245 US 54 (1917).

domestic law where multiple jurisdictions have the right to tax the same transaction. Beale states that the fact that property within the jurisdiction has paid a tax for the same year to another Sovereign does not in any way affect the right of the former sovereign to tax it, nor does an exemption granted by another sovereign withdraw the subject of taxation from his power.¹³³ Secondly, as the right to tax can be interpreted generally in the context of the *ITA* and/or DTA or multilateral agreement, taxing authorities cannot pick and choose which section to use to determine the right to tax. Whilst *section 11(a) of the ITA* gives the basis for general deduction, a DTA has far reaching effects for jurisdictional purposes. This shows that the purpose of jurisdiction to tax is not a denial of the existence of jurisdiction as per the *ITA* or common law source tests- which generally takes place the moment the ordinarily resident or physical presence, originating cause and source tests are met.

3.7. CONCLUSION

This research concludes that the right to tax may be difficult to establish because of the reasons provided above. This research also concludes that a complete discussion of the enforcement mechanisms of SARS falls outside the scope of the study. This Research also shows the difficulty which arises from applying the right to tax due to the anonymity factor. This Research shows that the residence and source based tests for jurisdiction cannot be accurately applied due to the anonymous nature of trading in cryptocurrency. Only Residents and sources who are present in South Africa and using South Africa as their geographical location are obliged to submit returns for income tax purposes. This geographical lacuna means that South African authorities have limited jurisdiction over the trade in cryptocurrency and can only rely on returns declared by tax-payers in gross income. Even though limited jurisdiction is there, if a taxpayer complies with either the Resident or Source rules, the taxpayer is obliged to submit tax returns as it comes with the enforcement of the right to tax. SARS has certain powers in terms of the *Tax Administration Act* to get a hold of third party information, but because these traders are not registered in a specific jurisdiction with which South Africa has exchange of information agreements, the power to gather information and enforce tax compliance is limited. In these cases, SARS mainly relies

¹³³ *Joseph, at 6.*

on the honesty of taxpayers which is not enough. A DTA or Multilateral agreement overrides the domestic law in the case where multiple jurisdictions have the right to tax the same transaction. It is submitted that someone who trades in cryptocurrency might have/likely has the intention to trade under the radar so as to avoid being taxed in any jurisdiction. The anonymity with which crypto currencies are traded aids the taxpayer to avoid taxes altogether. However, some traders in crypto currencies are tax compliant. Research further shows that taxing authorities have limited jurisdiction because cryptocurrencies are not recognised as legal tender. SARS has limited jurisdiction as under their media release, SARS declared that the gains and losses from the use of cryptocurrencies have income tax consequences(**see** chapter 1.1.). This research also shows the obvious importance of VPN cryptocurrency trading and demonstrates that taxpayers need a VPN to properly hide IP addresses and have the freedom to operate on platforms in different countries. Another benefit, which is to the detriment of taxing authorities, is the limited jurisdiction as taxpayers can geographically manipulate their location.

CHAPTER 4 : ACCRUAL IN THE TRADE OF CRYPTOCURRENCY

4.1. Chapter Overview

For many years, the debate about the meaning of the word “*accrual*” has caused great controversy. For income tax purposes, should it mean ‘entitled to’ or ‘immediately due and payable’. Accrual in terms of cryptocurrency presents another imbroglio for its income tax treatment. The trade of cryptocurrency is defined above as the act of speculating on cryptocurrency price movements via a CFD trading account, or buying and selling the underlying coins via an exchange.¹³⁴

Moosa states that:

*“The SARS media release underscores the importance for taxpayers to disclose transactions denominated in cryptocurrency. The problem is that uncertainty exists as to whether SARS correctly categorised cryptocurrencies as non-cash assets of an intangible nature capable of receipt or accrual for tax purposes. This gives rise to the research question forming the subject of this article: Can a cryptocurrency be included in “the total amount, in cash or otherwise, received by or accrued to” a taxpayer for gross income purposes under the ITA?”*¹³⁵

This chapter briefly touches on the meaning of received by / accrued to and the timing and valuation of receipts or accrual for background purposes. The last requirement, being non-monetary receipts and accrual are given greater weight for the purposes of this research because SARS classified cryptocurrencies as non-cash assets of an intangible nature capable of receipt or accrual for tax purposes.¹³⁶

For income tax purposes, this research considers accrual in the hands of the taxpayer (who can either be a buyer and/or seller) on the various cryptocurrency trading platforms such as Luno, Binance.¹³⁷ As the definition of gross income has been discussed in the last chapter, this research determines the basic transactional rules in

¹³⁴ Staff Writer “What is cryptocurrency trading” 2022 IG, available at <https://www.ig.com/en/cryptocurrency-trading/what-is-cryptocurrency-trading-how-does-it-work> . [accessed 13 May 2022].

¹³⁵ Moosa.

¹³⁶ *Ibid.*

¹³⁷ *Ibid.*

terms of trading cryptocurrency and applying rules of accrual to state whether a contingent liability arises or is it an unconditional right the moment a sale takes place or is the sale of cryptocurrency suspended until a later date. (**see** chapter 3) The terms 'accrued to' , 'received by' or 'in favour' as they appear in the definition of 'gross income' are an indication that the definition applies to both of them.¹³⁸

4.2. Received by / accrued to

The *CIR v People's Stores* case stated, *"that an amount accrues to a taxpayer when he becomes unconditionally entitled to it."*¹³⁹ The *Lategan v CIR* dealt with an issue where in addition to the amount received by the taxpayer, what other amount accrued to him during the year of assessment in question.¹⁴⁰

Watermeyer J, in his judgment said the following:

*"In my opinion the words in the Act 'has accrued to' or 'in favour of any person' merely mean to which he has become entitled. So far as a debt is concerned which is payable in the future and that in the year of assessment, it might be difficult to hold that the cash amount of the debt has accrued to the taxpayer in the year of assessment...but he has acquired a right to claim payment of debt in future. According to what has been stated above, the value of this right must in my opinion be included in the taxpayer's gross income for taxation purposes...but something must be deducted from their face value to allow for the fact that they were not payable at the close of year of the assessment."*¹⁴¹

The critical issue in this case is whether the amount accrues to the taxpayer when it is 'due', that is when he becomes entitled to it, or when it is only due and payable. Accrual can take place only after the obligations have been complied with, or the conditions fulfilled. Until these events take place the taxpayer is not entitled to claim payment. The meaning of the term 'accrued to' was extended to unconditionally

¹³⁸ Jiyane Nonhlanhla Gillian *"'Received' by and 'accrued to'"* (unpublished LLM thesis, University of Kwazulu-Natal, 2008) 6.

¹³⁹ *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd (244 of 1988) [1990] ZASCA 1 (22 February 1990).*

¹⁴⁰ *Lategan v CIR 1926 CPD 203, 2 SATC 16.*

¹⁴¹ *Ibid.*

'entitled to' in *Mooi v SIR* where it was submitted this represented the correct meaning of 'accrued to'.¹⁴²

Another case which is relevant is the *Pyott Ltd v CIR* case.¹⁴³ This case dealt with accrual in terms of deposits. It is essential here for timing of accrual because taxpayers who trade in cryptocurrencies make deposits on the various trading platforms. The taxpayer here was a biscuit manufacturer who sold biscuits but charged a refundable extra fee when the tin container was returned in perfect condition.¹⁴⁴ Here, “*the taxpayer then deducted an amount from its gross income as a provision for containers still to be returned.*”¹⁴⁵ Also, the court ruled, “*that the taxpayer was not entitled to exclude the amount as it was still going to refund customers from its gross income.*”¹⁴⁶ The *Pyott* case shows us that a deposit can be included gross income as it accrues to the owner. This would hint at the fact cryptocurrency trading platforms are merely a middleman between the taxpayer and other cryptocurrency traders on the platform. The greatest burden to declare tax therefore falls on the taxpayer who is the buyer/seller.

4.3. Accrual in terms of the Transaction

A typical cryptocurrency transaction in South Africa consists of a taxpayer essentially depositing money into an account with any one of the various trading platforms. The taxpayer then uses the balance to buy and sell cryptocurrency and then, later withdraws the amount after speculating. Does accrual take place when a taxpayer withdraws from the fund(sell) or does it accrue the moment a profit is made at the end of a year of assessment?

Example

During the 2022/2023 year of assessment, a taxpayer opened an account with Luno and invested R100 000 in a cryptocurrency named Bitcoin during July 2022. The

¹⁴² *Ibid.*

¹⁴³ *Pyott Ltd v CIR (13 SATC 121) (1945 AD 128).*

¹⁴⁴ *Ibid.*

¹⁴⁵ *Ibid.*

¹⁴⁶ *Ibid.*

market value of Bitcoin increased although he did not sell it at the end of or during the year of assessment. His investment of R100 000 appreciated and the market value became R120 000. For income tax purposes, does that mean the R20 000 accrues to the taxpayer or is it a mere investment and accrual takes place when the taxpayer has withdrawn it?

Contingent liability or not?

Due the anonymous and unquantifiable nature of cryptocurrency, *section 24M* of the *ITA* becomes important as cryptocurrencies cannot necessarily be quantified due to limited jurisdiction.¹⁴⁷ The reliance on the honesty of a taxpayer further reflects that quantifying cryptocurrency is virtually impossible.

To this end, *Section 24M* states that :

“Incurral and accrual of amounts in respect of assets acquired or disposed of for unquantified

amount.—(1) If a person during any year of assessment disposes of an asset for consideration which consists of or includes an amount which cannot be quantified in that year of assessment, so much of that consideration as—

(a) cannot be quantified in that year must for purposes of this Act be deemed not to have accrued to that person in that year; and

[Para. (a) substituted by s. 34 of Act No. 31 of 2005 (English only).]

(b) becomes quantifiable during any subsequent year of assessment must for purposes of this Act be deemed to have been accrued to that person from that disposal in that subsequent year.

(2) If a person during any year of assessment acquires an asset for consideration which consists of or includes an amount which cannot be quantified in that year of assessment, so much of that consideration as—

(a) cannot be quantified in that year must for purposes of this Act be deemed not to have been incurred by that person in that year; and

¹⁴⁷ *Section 24 of the ITA.*

*(b) becomes quantifiable during any subsequent year of assessment must for purposes of this Act be deemed to have been incurred by that person in respect of the acquisition of that asset in that subsequent year.*¹⁴⁸

The court's interpretation of "actually incurred" in the *Edgars Stores v Commissioner for Inland Revenue (1988 (3) SA 876 (A))* judgment, held that, "for expenditure to be deductible in a specific tax year, there had to be an unconditional legal liability to pay the expenditure within that year."¹⁴⁹ Also, "this requirement would be met even where the amount of the obligation was subject to some uncertainty."¹⁵⁰ Cryptocurrency trading by nature is uncertain and deposits made by taxpayers are not an accurate manner to determine the accrual. The Court in *Edgars Stores 1988 vs CSARS* held that there is a "clear distinction between the case where the liability was contingent and accordingly not incurred in the tax year in question; and the case where the liability was unconditional and established within the tax year in question, although the amount was unquantified at the tax year-end, in which event the liability was regarded as having been incurred in the tax year in question."¹⁵¹

For purposes of income tax, the treatment of cryptocurrency should be one regarded similar to shares and/or immovable property.¹⁵² Because when the value increases, it does not mean that the amount accrues, it accrues when a taxpayer disposes of it. Therefore, estimates of contingent (uncertain) liabilities are not expenditure actually incurred. This is justifiable by the ability of a taxpayer to incur an unconditional legal liability (the moment a deposit is made on a cryptocurrency trading platform and the value appreciates/depreciates) but cannot be quantified (the moment a tax payer keeps his investment in an account which is inaccessible to taxing authorities) but must be estimated based on available information claimed in that tax year after a taxpayer makes withdrawals (the honesty of a taxpayer).

¹⁴⁸ *Ibid.*

¹⁴⁹ *Edgars Stores v Commissioner for Inland Revenue (1988 (3) SA 876 (A))*

¹⁵⁰ *Ibid.*

¹⁵¹ *Ibid.*

¹⁵² Section 24 of the ITA.

4.4. Non-monetary receipts or not?

This section begins by re-iterating the media release by SARS in 2018 (see chapter 1.1.). To this day, uncertainty exists as to whether SARS correctly categorised cryptocurrencies as non-cash assets of an intangible nature capable of receipt or accrual for tax purposes”.¹⁵³ This gives rise to the research question whether trading in cryptocurrency can be included in “*the total amount, in cash or otherwise, received by or accrued to*” a taxpayer for gross income purposes under the *ITA*?¹⁵⁴

The importance of SARS’s classification of cryptocurrencies as assets and not as currency is evident from an analysis of the term “asset” as used in, for example, the *Eighth Schedule* to the *ITA*.¹⁵⁵ Paragraph 2 thereof stipulates that CGT may arise on the disposal of “any asset of a resident “and of listed “assets of a person who is not a resident”.¹⁵⁶ Paragraph 1 of the *Eighth Schedule* defines an “asset “ as including “(a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding [...] and (b) a right or interest of whatever nature to or in such property”.¹⁵⁷

Accordingly, cryptocurrency can also give rise to capital gains in terms of the *Eight Schedule*. Following normal income tax rules, income received or accrued from cryptocurrency transactions can be taxed on revenue account under gross income.¹⁵⁸

A taxpayer may object to an appeal against a decision by SARS to levy CGT on a gain made on the disposal of cryptocurrency held as an investment.¹⁵⁹ A taxpayer may also challenge a decision by SARS to levy income tax on a receipt or accrual of cryptocurrency regarded as trading stock or other form of revenue.¹⁶⁰ An application of these abovementioned principles to the trade of cryptocurrency certainly means that cryptocurrency can be included in the gross income of a taxpayer. However, certain limitations apply. The SARS’ media release is not part of domestic law, as such, a taxpayer can object to a finding by SARS about the nature of cryptocurrency

¹⁵³ *Moosa, at 14.*

¹⁵⁴ *Ibid.*

¹⁵⁵ *Eighth Schedule to the ITA.*

¹⁵⁶ *Moosa, at 14.*

¹⁵⁷ *Emphasis added.*

¹⁵⁸ *SARS stance.*

¹⁵⁹ *Moosa, at 14. See also Chapter 9 (Part B) of the Tax Administration Act 28/2011.*

¹⁶⁰ *Ibid.*

transactions. Whilst a blockchain ledger can be regarded as a document in terms of the TAA, the right offered to SARS to retain any information for Tax administration purposes is restricted by enforcement powers (**see** chapter 3). Unfortunately, the honesty of taxpayers seems to be the only reliable information which SARS can rely on for assessment purposes. In general, if cryptocurrency is received or accrued as a revenue asset, its value in South African Rands on the date of such receipt or accrual, whichever occurs first, is subject to inclusion in the recipient taxpayer's gross income under the ITA.¹⁶¹

4.5. CONCLUSION

Due to the anonymous nature of cryptocurrency, this research shows that determining accrual also poses great obstacles as taxing authorities generally cannot access information to cryptocurrencies due to limited jurisdiction (**see** chapter 3). The fact that the value of an asset has increased over-time does not mean that the value should be included in its owners gross income(emphasis added).¹⁶² This research establishes that if cryptocurrency is received or accrued as a revenue asset, its value in South African Rands on the date of such receipt or accrual, whichever occurs first, is subject to inclusion in the recipient taxpayer's gross income under the ITA. As such, trading in cryptocurrency creates an unconditional right the moment a sale takes place for income tax purposes. This research also shows that SARS' was likely correct in classifying cryptocurrency as non-cash assets of an intangible nature capable of receipt or accrual for tax purposes. Taxing authorities still face the difficulty of accurately determining timing of accrual because taxpayer withdrawals are not an accurate indicator of expenditure traded in a year of assessment for timing of accrual purposes.

¹⁶¹ *Ibid*, at 22.

¹⁶² *Silke 2022*, at 38.

Chapter 5: CAPITAL VS REVENUE?

5.1. Chapter overview

This Chapter establishes whether the trade in cryptocurrency should be regarded as capital or revenue in nature for income tax purposes. If the trade in cryptocurrency constitutes revenue, it is included in the gross income of a tax-payer. On the other hand, the finding that a cryptocurrency disposal is capital in nature triggers capital gains tax. To explore this, this research explores the following factors; the nature of the taxpayer, intention of the taxpayer, holding period of cryptocurrency before disposal, the frequency of transactions which took place and the circumstances which led to the sale to determine if the sale is part of gross income.

5.2. Background to Cryptocurrency Volatility

The factors for determining gross income or capital gains are directly affected by cryptocurrency volatility. As all determining factors are affected by volatility, this research sheds an insight of what constitutes volatility to avoid a repetition of facts on each determining factor. In the trade of cryptocurrency, there is two extremes; it is either a taxpayer makes a profit or makes a loss. To this end, Bitcoin has seen its fair share of ups and downs over the past 10 years, and these price swings are explained by something called volatility.¹⁶³ Therefore, it is possible to talk to two taxpayers who have both invested in cryptocurrency, but one has lost money and the other gained a profit. Whether you win or lose can depend largely on timing.¹⁶⁴ This is because cryptocurrency is an incredibly topsy-turvy investment; all cryptocurrencies experience huge fluctuations in their valuation—a quality known on Wall Street as volatility.¹⁶⁵ Generally, traders buy when the price of cryptocurrency goes down. Likewise, a trader sells when the cryptocurrency price shoots up. As stated above, Bitcoin remains the most traded and popular cryptocurrency worldwide and remains the highest valued

¹⁶³ Staff writer "Protect your Wealth in a volatile market" 2021 *BusinessTech*, available at <https://businesstech.co.za/news/industry-news/505610/protect-your-wealth-in-a-volatile-market/> [accessed 13 July 2021].

¹⁶⁴ Nicole Lapin "Explaining Crypto's volatility" 2021 *Forbes*, available at <https://www.forbes.com/sites/nicolelapin/2021/12/23/explaining-cryptos-volatility/?sh=10f251cb7b54> [accessed 23 December 2021].

¹⁶⁵ *Ibid.*

crypto coin on the market (**see** chapter 2.5).¹⁶⁶ This research discusses the effects of cryptocurrency through the lens of Bitcoin.

BusinessTech states that :

*“If we use spot Gold (16% 90-day vol), JP Morgan (24% 90-day vol), and Tesla (70% 90-day vol) as a proxy for Gold, Banking, and Tech, we can see that Bitcoin (95% 90-day vol) clearly has superior volatility. So based on historical volatilities investors now know that the returns of Bitcoin fluctuate by approximately 95% quarter-over-quarter (90-day vol).”*¹⁶⁷

When looking at past Bitcoin volatility, we use ‘Historical Volatility’ to paint us a picture of how risky the asset is, Historical volatility is an indicator to show the extent at which a price may diverge from its average value in a given period.¹⁶⁸ Hence, increased price fluctuation results in a higher historical volatility value.¹⁶⁹ This in-turn, has ripple effects on the nature, intention, frequency of transactions, holding period and circumstances of sale regarding the taxpayer.

5.3. Nature of the taxpayer

When we consider the nature of the taxpayer, one must be a trader by nature for purposes of inclusion in a taxpayer’s gross income. This is to ensure taxpayers with profit-making intentions are rightfully taxed by taxing authorities. As cryptocurrency is a very volatile market, there exists a taxpayer who is a trader by nature. Secondly, there is a taxpayer who is not a trader by nature, but exploits a favourable market. In the first scenario, the right to tax is easily established and becomes revenue in nature as the person constitutes a trader in terms of the *ITA*. This is not in dispute. Issues arise in the second instance because Bitcoin only becomes favourable to a taxpayer when the price shoots up. As such, a taxpayer can only trade and take advantage of the market when the value of Bitcoin is high. The general rule is *“that a taxpayer is entitled to realize his property to his best advantage.”*¹⁷⁰ A taxpayer can, therefore,

¹⁶⁶ Luke.

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.*

¹⁷⁰ *John Bell & Co Ltd v Commissioner for Inland Revenue 1946 AD 1957, 13 SATC 354 165.*

sell cryptocurrency at his best advantage if it is not a profit-making scheme, which would be the likely case where a taxpayer who is not a trader by nature trades indefinitely. In cases where Taxing authorities determine the nature of a taxpayer is that of a trader, the onus rests on the taxpayer to prove otherwise. This position was emphasized in the *CIR v Nussbaum* case, where a secondary profit-making intention was established because the purpose of the sale of assets was found to be revenue in nature.¹⁷¹

5.4. **Holding Period**

Holding period is largely determined by the value of Cryptocurrency at any given point. As stated earlier, volatility affects the length of time an asset is held as a taxpayer is likely to sell when the market is favourable. As the regulation and enforcement of cryptocurrency falls outside the scope of this study (emphasis added), this research does not determine what constitutes a justifiable holding period in the form of months or years. This research only briefly touches on the effects of the holding period on the right to tax. The holding period might not be an accurate indicator because it is largely affected by the influence of volatility on the value of Bitcoin. In terms of holding period, The *CIR vs Nel* case states that “a mere decision to sell an asset originally held as an asset is not to be regarded as a transformation of the profits from a capital nature to a revenue nature.”¹⁷² Accordingly, where a taxpayer keeps cryptocurrency for a long time, but due to an unforeseeable event, decides to realize his property, his reasons can be regarded as legitimate and not profit in nature.

5.5. **Change of Intention**

To consider the intention of a taxpayer, one must look at the intention of a trader in cryptocurrency at the time of realization compared to the taxpayer’s intention at initial acquisition. If a taxpayer did not intend to keep Bitcoin for investment purposes and immediately sells it when the market is favourable, the intention is profit in nature. To this end, the *COT Levy* case states that “where the purposes of a taxpayer are mixed, one should give effect to the dominant factor that induced the taxpayer to acquire the asset”.¹⁷³ For insight purposes, when the sale of fixed property is considered, and a

¹⁷¹ *CIR v Nussbaum* 1996 (4) SA 1156 (A), 58 SATC 283.

¹⁷² *CIR V Nel* 59 SATC 349 37.

¹⁷³ *COT v Levy* 1952 (2) SA 413 (A), 18 SATC 127.

sale takes place within a short period after its acquisition, it is indicative of speculation as fixed property is generally held as an investment. When shares or cryptocurrency are considered, it is common for someone to dispose of cryptocurrency to protect his investment to prevent losses in a volatile market. So, for example, where the taxpayer disposes cryptocurrency shortly after acquiring it simply to mitigate losses does not mean that the taxpayer's transactions are profit in nature. Yet, where the taxpayer is a broker in shares or venture capital, the disposal may be considered speculation in crypto assets rather than the mitigation of losses.

5.6. Similar and frequencies of transactions

A consideration of similar and frequent transactions shows that a taxpayer who trades cryptocurrency must engage in frequent trades. The *Stott* case holds that a taxpayer is “entitled to realize an asset to his best advantage to accommodate the exigencies of the market”.¹⁷⁴ Furthermore, The *Natal Estates v CIR* case posits, “that a decision to sell an investment does not amount to a change of intention.”¹⁷⁵ The determining formula for frequency of transactions is an enforcement task which falls outside of the scope of this study. However, it is evident that a taxpayer is likely to include proceeds from frequent cryptocurrency transactions in its gross income.

5.7. Conclusion

This chapter shows that volatility affects all the factors which determine whether the trade in cryptocurrency is capital or revenue and that, the factors for capital vs revenue can only be applied accurately to a limited extent for income tax purposes because of the volatility factor. This research concludes that a taxpayer, can, therefore sell cryptocurrency at his best advantage if it is not a profit-making scheme, which would be the likely case where a taxpayer who is not a trader by nature trades indefinitely. In cases where taxing authorities determine the nature of a taxpayer is that of a trader, the onus is on the taxpayer to prove otherwise. This research concludes that where a sale of cryptocurrency takes place within a short period after its acquisition, it is indicative of speculation. In considering the effect of volatility on cryptocurrency, it is common for someone to dispose of cryptocurrency to protect his investment to prevent

¹⁷⁴ *CIR v Stott* 1928ad 252, 3 SATC 253 87.

¹⁷⁵ *Natal Estates Ltd v SIR* 1975 (4) SA 177 (A), 37 SATC 193 .

losses. The time within which a disposal takes place is not an accurate indicator of profit-making intentions. However, If the taxpayer is known in venture capital and in shares, then it is more likely that he is speculating. This research concludes that the holding period might not be an accurate indicator because it is largely affected by the influence of volatility on the value of Bitcoin. Therefore, where a taxpayer keeps cryptocurrency for a long time, but due to an unforeseeable event, decides to realize his property, his reasons can be regarded as legitimate and not profit in nature.

CHAPTER 6: RECOMMENDATIONS AND CONCLUSION

6.1. Chapter Overview

The main objective of this research is to study, analyse and provide an insight on the income tax treatment of trading in cryptocurrency in South Africa. This research identifies that the recognized cryptocurrency transactions in South Africa are as follows; Cryptocurrency mining, trade in cryptocurrency and cryptocurrency as a payment method. This research solely focuses on the trade of cryptocurrency, as such, any recommendations in this chapter are limited to the trade of cryptocurrency. The previous chapters sought to apply the factors considered for the nature of trading in cryptocurrency, namely; jurisdiction to tax, capital vs revenue and accrual. From an analysis of these findings, this final chapter suggests possible ways to ensure that South Africa is in the right direction when the trade in cryptocurrency is concerned.

6.2. Main Findings

It is established that cryptocurrency is not recognised as legal tender in South Africa. Regardless, this research still affirms that cryptocurrency is an internet-based digital currency which exists almost wholly in the virtual real but cryptocurrency holders can purchase goods and services in the real world via cryptocurrency. In line with this, uncertainty still remains whether taxing authorities correctly classified cryptocurrencies as non-cash assets of an intangible nature capable of receipt or accrual for tax purposes.¹⁷⁶

Chapter 2 concludes that uncertainty still exists regarding the definition, and this contributes to the anonymous nature of cryptocurrency. Whilst SARS recognizes cryptocurrency as a digital based currency, other institutions such as the SARB still lack a clear definition. To create clarity regarding the definition, chapter 2 explores the nature of cryptocurrency by discussing the different types of cryptocurrencies, the different kinds of transactions, and identifying the cryptocurrencies which are largely used in South Africa (namely Bitcoin). The research also establishes that the subject of this research (trade in cryptocurrency), remains the most abundant cryptocurrency transaction in South Africa. It is found that cryptocurrencies are essentially

¹⁷⁶ Moosa, at 14.

decentralised currencies which operate and exist entirely on the virtual realm, and its core elements are as follows:

- a) Cryptocurrency is an internet-based digital currency that exists almost wholly in the virtual realm. (see chapter 1.1.) This means that cryptocurrencies can be exchanged for real currencies and therefore, used as a payment method for goods and services.
- b) Cryptocurrencies are decentralized (meaning they are not generated or issued by the SARB or any other authorized authority).
- c) Cryptocurrencies are not recognized as legal tender in South Africa.
- d) Blockchain technology keeps cryptocurrency in a decentralized market which is anonymous and unregulated by anyone.

The greatest benefit of cryptocurrencies is its anonymous nature, which has been largely demonstrated by the different kinds of cryptocurrencies. They are all different, but their anonymous nature remains the same. First-generation cryptocurrencies such as Bitcoin are specifically used to make payments and currency transactions such as investments and trading. Second generation cryptocurrencies are also used for investments purposes but are also largely used to create cryptocurrencies and other tokens. Third generation cryptocurrencies essentially expand on second generation cryptocurrencies. Fourth generation cryptocurrencies provide high transaction per second scalability.

The anonymous nature above demonstrates that transactions can take place without central regulation from authorities such as the SARB. Transactions take place wholly between a buyer and a seller without any government or authority intervention, where intervention exists- It always leads to limited enforcement as seen in the earlier chapters.

Chapter 3 critically analyses the jurisdiction to tax in relation to the income treatment of cryptocurrencies. It determines that the starting point to determine jurisdiction to tax is the definition of gross income.¹⁷⁷ If an individual is treated as resident in South Africa, any income derived from trading in cryptocurrency is included in gross income

¹⁷⁷ Section 1 of the ITA.

where a taxpayer is a non-resident, such amounts must be derived from a source in South Africa to be included in gross income.¹⁷⁸ The physical presence test only apply where an individual is not ordinarily resident as long as the requirements of the physical presence test are met. These requirements are summarised as a taxpayer being physically present in South Africa for periods exceeding 91 days during a year of assessment, and 91 days during each of the five years of assessment preceding the year of assessment under consideration and 915 days in total during those five preceding years of assessment. The greatest factor preventing the proper application of the residence or physical presence test is the anonymous nature of cryptocurrency as a trader in cryptocurrency can manipulate their location. The common law test was also introduced and heavily relies on the originating cause or the source of the income, which echoes some of the tests recognised by the *ITA*. Bearing similar characteristics to the residence and physical presence test, cryptocurrency trading revolves around geographical location manipulation which also makes it difficult to determine the source of origin.

For purposes of determining jurisdiction to tax in terms of the *ITA*, it is found that:

- 1) The concept of 'residence' is central to the residence-based system of taxation.
- 2) The definition of 'resident' distinguishes between natural persons and persons other than natural persons.
- 3) Ordinary residence is affected to a great extent by the anonymous nature of cryptocurrency.
- 4) A cryptocurrency trader can be physically present in South Africa but their geographical location on the trading platform may be outside the country or vice versa.
- 5) The residence and source-based tests for jurisdiction cannot be accurately applied due to the anonymous nature of trading in cryptocurrency.
- 6) Only residents and sources who are present in South Africa and using South Africa as their geographical location are obliged to submit returns for income tax purposes.
- 7) South African authorities have limited jurisdiction over the trade in cryptocurrency and can only rely on returns declared by taxpayers in gross

¹⁷⁸ *Silke 2022, at 26.*

income. Even though limited jurisdiction is there, if a taxpayer complies with either the Resident or Source rules, the taxpayer is obliged to submit tax returns as it comes with the enforcement of the right to tax.

The South African stance regarding the treatment of cryptocurrency for jurisdictional purposes establishes that a right to tax exists on a resident or source basis. This jurisdictional lacuna arises from the fact that the income tax system is a self-assessment system. This means technology allows transactions to go undetected. If a taxpayer does not declare accurate returns, then an audit is not likely to reveal such concealment. The self-assessment system somewhat gives taxpayers a privilege to manipulate tax returns for income tax purposes. With regards to creating a balance between the residency and source-based tests, the extent to which South Africa remains underdeveloped when dealing with cross border transactions falls outside of the scope of the study. However, this research has shown the shortcomings of South African income tax law. These shortcomings are essentially discussed considering VPN.

This research establishes that VPN is the greatest factor affecting tax compliance. VPN brings a better understanding of the anonymous nature of cryptocurrency. The blockchain is shown to be key to VPN enhancement because blockchain ensures that cryptocurrency is kept in a decentralized market which is unregulated by anyone. To this end, traders continue to take advantage of VPN as it makes transactions irreversible and untraceable leaving behind no visible trail in general. It is also established that the anonymous nature of cryptocurrency does not take away the right to tax. The right to tax is based on the residence status or the source principle. As stated above, it is not always possible for SARS to identify and locate transactions during an audit. Thus, SARS relies on the taxpayer to declare the income honestly. This means that it can affect enforcement, but enforcement is not part of the scope of the research.

Whilst cryptocurrency anonymity is a major factor to consider, there is still a lot that traders are unaware of. Cryptocurrency does not provide complete anonymity because

hackers and foreign governments can track a taxpayer via IP addresses.¹⁷⁹ Regardless, the benefits are minimal because this misconception only provides minimal jurisdiction. An analysis of the VPN factor linked to anonymity has shown that transactions are entirely decentralized. Recognized financial institutions are limited in terms of regulating the transactions.

It has also been established that the various trading platforms such as Luno and Binance are not obliged to declare information to taxing authorities. The various trading platforms function like banks, in fact, they take over the role of traditional banks when it comes to cryptocurrency trading, thus, they contradict the decentralized concept of cryptocurrencies.¹⁸⁰ The research also shows that while information on trading platforms can be used to determine jurisdiction, not even a trading platform can prevent a taxpayer from trading on their site. Another interesting perspective elucidated by chapter 2 is the ability of taxpayers to invest offshore and use DTA treaties to circumvent domestic law. The *Krok v CSARS* case is an example of the overriding nature of a DTA or multilateral agreement over domestic law. To this end, whilst the information is there and taxpayers can also take advantage of DTA treaties, taxing authorities have limited jurisdiction over the trade of cryptocurrency. (emphasis added)

Chapter 4 critically analyses the accrual of trading in cryptocurrency and focuses on the SARS stance because its classification is a good measuring stick for research purposes. Based on the SARS' media release, it is found that the only essential element of accrual is cryptocurrencies being regarded as being non-monetary assets of an intangible nature capable of receipt or accrual for tax purposes. The research concludes that the treatment of cryptocurrencies should be treated as similar to shares and/or immovable property, because valuation does not necessitate accrual. The deciding factor is the disposal of cryptocurrency.

¹⁷⁹ *Zahorski*.

¹⁸⁰ *Sadhaseevan, at 83*.

For purposes of determining accrual, it is found that;

- 1) Estimates of contingent (uncertain) liabilities are not expenditure actually incurred.
- 2) The treatment of cryptocurrency should be one regarded similar to shares and/or immovable property.
- 3) If cryptocurrency is received or accrued as a revenue asset, it is subject to inclusion in the recipient taxpayer's gross income under the *ITA*.

To this end, chapter 4 supports SARS' classification of cryptocurrencies as non-monetary assets and accrual takes place the moment a sale takes place.

Chapter 5 concludes that the factors for determining gross income or capital gains is directly affected by cryptocurrency volatility. It is established that cryptocurrency is an incredibly topsy-turvy investment and experiences high fluctuations due to volatility. In terms of the nature of a taxpayer, if a taxpayer trades indefinitely, he can be allowed to sell cryptocurrency at his best advantage if it is not a profit-making scheme. If a taxpayer is a trader, then the onus is on such a taxpayer to prove otherwise (emphasis added).

It is established that volatility determines the holding period. To this end, holding period is not an accurate indicator because volatility affects the value of cryptocurrency. The intention of a taxpayer requires a pragmatic approach because practical factors influence a sale of cryptocurrency. Intention is not an accurate indicator where volatility has an overreaching effect on a sale of cryptocurrency. However, chapter 5 makes it clear that if a taxpayer is known in venture capital, it is more likely that he is speculating. The frequency of transactions falls outside the scope of this study because it is an enforcement issue. Regardless, a taxpayer who engages in frequent transactions is obliged to submit all cryptocurrency transactions in his tax returns.

6.3. Recommendations

a) A Clear definition of cryptocurrency and/or crypto assets

Owing to the ambiguous nature of cryptocurrency, it is crucial for taxing authorities, legislation and/or financial institutions to provide a clear definition of cryptocurrencies and any issues regarding its classification, as it directly impacts the manner in which cryptocurrencies are classified and regulated.¹⁸¹ This research establishes that cryptocurrencies share the same characteristics as traditional currencies. The focus is not whether cryptocurrency is recognised as legal tender or not, the focus is rather on the far-reaching nature of cryptocurrencies. Chapter 2 proposes that uncertainty exists in terms of determining the nature of cryptocurrencies. To this end, this research questions whether SARS correctly classified cryptocurrencies as non-monetary assets of an intangible nature. The biggest issue with the definition given by the CARWG is that it neglects the biggest factors affecting gross income - especially when establishing jurisdiction to tax (emphasis added).

This research re-iterates the definition by CARWG ;

“Crypto-assets are digital representations or tokens that are accessed, verified, transacted and traded electronically by a community of users. Crypto-assets are issued electronically by decentralised entities and have no legal tender status, and consequently are not considered as electronic money either. It therefore does not have statutory compensation arrangements. Crypto assets can be used for payments (exchange of such value) and for investment purposes by crypto asset users. Crypto assets have the ability to function as a medium of exchange, and/or unit of account and/or store of value within a community of crypto asset users.” (see chapter 2.2)

Given the socio-economic climate of South Africa as a developing country, this definition captures SARS’ concerns about cryptocurrency being recognised as intangible assets. Elements of this definition fail to recognise the key issues mentioned above. Firstly, the words “issued” and “decentralized” are problematic because cryptocurrencies are not issued by a recognised authority and/or financial institution

¹⁸¹ Intergovernmental Fintech Working Group, *Crypto Assets Regulatory Working Group Consultation Paper on Policy Proposals for Crypto Assets (2019)* at 8.

such as the SARB. It is likely that entities such as Luno and Binance can take over the role of financial institutions in terms of the regulation of currencies.

As this research deals with the income tax treatment of trading in cryptocurrency, it is proposed that the definition of cryptocurrencies should be revised to read as follows:

“Cryptocurrencies are virtual assets with an ascertainable value. Cryptocurrency transactions are facilitated by non-regulated intermediaries/entities. Cryptocurrencies are not recognised as security, legal tender and/or commodities, however, they may be used to purchase goods and services in the real economy. Whilst not recognised as legal tender, cryptocurrencies can be valued to ascertain an amount received or accrued as envisaged in the definition of ‘gross income’ in the Income Tax Act. Following normal income tax rules, income received or accrued from cryptocurrency transactions can be taxed on revenue account under gross income”.

b) Cryptocurrency Regulatory Authority to establish jurisdiction

Chapter 2 shows that cryptocurrencies are not issued by decentralized entities. Entities such as Luno only operate as intermediaries between buyers and sellers of cryptocurrency. In simple terms, they facilitate transactions on the respective trading platforms. To this end, it is proposed that a central regulating authority be established to oversee and carry out an exchange of information with popular trading entities such as Luno because such intermediaries have information regarding targeted taxpayers. The power of such intermediaries can rise if cryptocurrency usage surges in the years to come. The ripple effect of this can negatively impact taxing authorities.

Generally, the functions and purpose of the FSCA is defined in the *Financial Sector Regulation Act*.¹⁸² Financial Institutions must disclose certain transactions to SARS. They must also hand over their client information to SARS when so requested. When crypto trade is regulated in SA, crypto platforms must register as financial service providers, and have the same reporting duties as other financial service providers. But that solves the issue only in respect of domestic service providers. International

¹⁸² *Financial Sector Regulation Act, No. 9 of 2017, Hereinafter referred to as the “FSRA” unless indicated or stated otherwise.*

platforms are not subject to the same rules. The FSCA's mandate is to further continue to supervise financial institutions. It further oversees self-regulatory organisations such as securities exchanges particularly the Johannesburg Stock Exchange, central securities depositories and clearing houses.¹⁸³ Trading in cryptocurrency should be dealt with in a similar manner. The biggest problem for taxing authorities is the anonymous nature of cryptocurrency and limited jurisdiction. The present legislation has shown that regulating cryptocurrency goes beyond creating mere legislation. It is a very pragmatic issue, making a regulatory authority a key factor in encouraging the transparency of cryptocurrency transactions.

The most efficient regulatory authority to establish in the given circumstances is a self-regulatory organisation ("SRO"). This is because SROs are a well-known and implemented concept in SA. Currently, SRO status has already been established by the JSE Limited and the central securities depository.¹⁸⁴ To this end," the *concept of self-regulation does not mean that the SRO is regulating itself, but rather that it is tasked with regulating the market it services.*"¹⁸⁵ This is key because it has been shown that taxing authorities are always affected by limited jurisdiction because, "*these organisations are permitted to regulate the affairs of the market which it services by creating rules, supervision protocols and disciplinary mechanisms.*"¹⁸⁶

The National Treasury has shown that a self-regulatory organisation can be applied as a good step forward for cryptocurrencies.¹⁸⁷ Currently in South Africa, "*exchanges and CSDs (and notably not clearing houses) are given the status of SROs through the SSA... these bodies are expected to perform regulatory functions on behalf of the Registrar, under his or her supervision.*"¹⁸⁸ These functions include the licensing and supervision of market participants, including investigations into alleged regulatory

¹⁸³ Sadhaseevan, at 97.

¹⁸⁴ Staff Writer 'How Bitcoin can be regulated in South Africa' Business Tech 21 August 2017, available at <https://businesstech.co.za/news/finance/193632/how-bitcoin-could-be-regulated-in-south-africa/>, [accessed on 21 August 2017].

¹⁸⁵ *Ibid.*

¹⁸⁶ *Ibid.*

¹⁸⁷ South African National Treasury "Reviewing the regulation of financial markets in South Africa: Policy document explaining the Financial Markets Bill" 2011, at 13-14.

¹⁸⁸ *Ibid.*, at 12.

breaches.¹⁸⁹ Furthermore, “each member of the controlling body of an SRO owes a fiduciary duty as well as a duty of care and skill to the SRO.”¹⁹⁰

In its earlier submissions, this research shows that taxing authorities have limited power to access confidential information from trading intermediaries such as Luno. As members to an SRO are bound by its rules and regulations, South African authorities can now use an SRO for trading in cryptocurrency which mostly focuses on encouraging intermediaries to disclose transactions by taxpayers. As is established earlier, the greatest relief afforded for the income tax treatment of trade in cryptocurrencies is the misconception of VPN and its anonymity. Since Hackers and foreign governments can track a taxpayer through public IP addresses, an SRO can help establish jurisdiction by determining the geographical location of a taxpayer.¹⁹¹ As the purpose of this research is not to address administrative or enforcement tasks, the information submitted by intermediaries is likely to help taxing authorities to double-check the honesty of taxpayers and to also carry out effective assessments (see chapter 3). This same body is essential when applying the capital vs revenue test because access to information from intermediaries can more accurately determine the frequency of transactions done by a taxpayer.

c) Holding period for accrual and Capital vs Revenue purposes

The biggest issue for accrual purposes is whether transactions should be amount drawn or time drawn? The former test would simply require a threshold amount to be established, this obliges a taxpayer to become liable to declare any amounts exceeding the threshold. The latter test involves an ageing rule with a threshold attached to it too **e.g.**, if a taxpayer holds cryptocurrency for more than 3 years, it is indicative of cryptocurrency being an investment. On the other hand, if a taxpayer holds and further disposes cryptocurrency in less than 3 years, his/her actions indicate speculation. This means that if a trader holds cryptocurrency for a certain period, then that should be indicative of speculation or investment.

¹⁸⁹ *Ibid.*

¹⁹⁰ *Ibid.*

¹⁹¹ *Zahorski.*

The accrual of cryptocurrencies must not infringe the cryptocurrency investor (capital gains) or the crypto trader (gross income) as well as not to disenfranchise the government at a facilitation level as they are the motherboard for regulating money. A line must be drawn. As stated earlier, the treatment of cryptocurrency is regarded as similar to shares and/or immovable property (**see** chapter 4.1). It is important to keep in mind that an increase in cryptocurrency value does not indicate accrual, because accrual only takes place when a taxpayer disposes of cryptocurrency. Whilst the enforcement of cryptocurrency is outside the scope of this research, the ageing rule seems to be the most effective manner for taxing authorities to determine accrual. This is essential because factors such as market exigencies can cause the untimely disposal of cryptocurrency, and to this end the best advantage rule can protect a taxpayer to the detriment of taxing authorities. A failure to acknowledge such factors can result in unnecessary administrative burdens- especially when taxing authorities consider that cryptocurrencies have no effective regulatory framework for taxing authorities to act upon. It is already established that taxing authorities have limited jurisdiction, resulting in the benefits of the ageing rule because regardless of a taxpayer's nature or jurisdiction, such a taxpayer is liable for tax for holding cryptocurrency for a certain period. This research suggests that the ageing rule is a more effective manner for taxing authorities to establish factors such as jurisdiction, intention of taxpayers, and the overreaching duty of taxpayers to be honest towards taxing authorities because taxing authorities save on expenditure which can be directed to other easily regulated commodities such as shares, precious metals and /or immovable property.

6.4. Conclusion

To a large extent, cryptocurrency proves its extended abilities of circumventing any possible legislation targeted at its decentralization and/or regulation. To date, the biggest issue with regulation is the decentralisation of cryptocurrencies. To this end, South African taxing authorities should consider the following central issues;

1. Whether the current definition of accrual is suitable for application regarding cryptocurrency transactions;
2. Whether or not a regulatory authority is essential to circumvent the anonymous nature of cryptocurrencies for jurisdictional purposes;

3. Whether amended legislation (e.g. interpretation notes) is required to accommodate the regulation of cryptocurrencies for capital or revenue transactions.

This research shows the difficulty for taxing authorities when it comes to determining factors such as jurisdiction to tax, accrual and capital vs revenue for gross income purposes. This research proposes a contextual approach to assist taxing authorities when handling the income tax treatment of trading in cryptocurrencies. It is essential for a self-regulating authority to be established as it would bring South Africa a step closer to efficient cryptocurrency treatment for income tax purposes. Not only does it increase transparency, but it also allows taxing authorities to audit the “*duty of honesty*” principle which is central to self-assessments. Another key takeaway is reducing administrative burdens regarding governmental resources in cases where jurisdiction to tax or accrual cannot be easily determined.

Due to cryptocurrency being a new form of exchange, classifying it as revenue or capital for purposes of gross income requires utmost research as the best possible solution can only be found through constant monitoring and implementation of effective regulations. There is a need for an insight in terms of the income tax treatment of cryptocurrency transactions because virtual currencies erode South Africa’s tax base, because they permit instant, anonymous, virtual, almost untraceable, e-payments to anyone located anywhere in the world.¹⁹²

¹⁹² *The Davis Tax Committee “First interim report: Addressing base erosion and profit shifting in South Africa” 2019 2, available at www.taxcom.org.za [accessed 12 April 2019]. See also the DTC “Second interim report on base erosion and profit shifting in South Africa” 2019 103-105, available at www.taxcom.org.za [accessed on 12 April 2019].*

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