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A critical analysis of the effectiveness of taxation regulation of cryptocurrencies in mitigating the facilitation of tax evasion in South Africa

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Supervisors: Dr Lee Swales and Professor Shannon Bosch

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DECLARATION

I, Pratista Singh declare that:

A. The research reported in this dissertation, except where otherwise indicated, is my original research.

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Preliminary Note: The submissions made in this dissertation are based on research which includes regulations and legislation up to an including the month of May 2021. Any legislative or academic developments after such date have not been addressed herein accordingly.

ABSTRACT

In finance, law and technology, change is an inevitable result of development. Whilst governments, legal authorities and financial regulatory bodies may be sceptical or hesitant to accept the natural progression of technology, the digital revolution will not regress, but merely continue to thrive against a background of hostility. Thus, the importance of regulatory structures which effectively standardise digital innovations is reflected through the necessity thereof. It is submitted therefore, that it is wise to mitigate the consequences of the ineffective regulation of digital innovations. One such innovation which has been exponentially gaining traction in the field of technology is that of cryptocurrency.[1]

This research explores the need for effective cryptocurrency regulation by examining the necessity of a solid legal regulatory foundation upon which it may be integrated into the financial sphere in South Africa.[2] Submissions will be made that it is insufficient to merely impose superficial legal regulations on cryptocurrency without accounting for various factors of consideration where the novelty of cryptocurrency is concerned in relation to the nature thereof. In SA specifically, taxation authorities[3] have been implementing regulations regarding cryptocurrency, which will be analysed and evaluated through this research.

In the likely event of cryptocurrency becoming a primary medium of transacting, the taxation regulations thereof must be effective to mitigate any negative effects (of insufficient and ineffective regulation) for taxpayers and the *fiscus*. It is imperative that regulatory bodies such as the legislature and the South African Revenue Service,[4] ensure that the regulation of cryptocurrency in SA is effective so that any *lacunae* in existing legislation which could yield negative consequences for taxpayers and/or the *fiscus* are adequately addressed and effectively mitigated.

From a taxation perspective, it is submitted that one of the main negative consequences of the lack of effective regulation of cryptocurrency is the potential of tax evasion. Tax evasion in

[1] See footnote 308 for an explanation of the terminology used in this research in respect of both 'cryptocurrency' and 'crypto assets' respectively. In terms of the abstract specifically, the term 'cryptocurrency' will be used as it is the general term which this digital innovation is referred to as and the use thereof thus provides a cohesive background before both terms and the respective contextual use thereof are explored and discussed.
[2] Hereinafter referred to as 'SA.'
[3] The South African Revenue Service as well as the South African Reserve Bank will collectively be referred to as 'taxation authorities.' Where only one of these bodies are referred to, they will be referred to as 'taxation authority' in context of the content being discussed. The South African Reserve Bank may also be referred to as 'financial authority' where the context refers to it as such.
[4] Hereinafter referred to as 'SARS.' SARS is SA's tax collecting authority and is responsible for the administration of the taxation system in SA.

relation to cryptocurrency will be analysed and discussed in this research based on the nature of cryptocurrency. The lack of cryptocurrency regulation is also cause for concern among taxpayers who use cryptocurrency without surety of how the proceeds therefrom will be taxed. Recommendations will thus be made regarding the implementation of a legislative definition of cryptocurrency to provide preliminary regulatory clarity on the taxation of cryptocurrency.

This research envisages that the lack of understanding and effective regulation of cryptocurrency in SA should also be addressed by advisory, regulatory and authoritative bodies insofar as these bodies taking active steps to resolve the confusion surrounding the categorisation of cryptocurrency is concerned. The effectiveness of taxation regulations (or rather, the lack thereof) of cryptocurrency in SA will therefore be examined through this research, by analysing existing plans, proposed policies and new legislation as well as criticising the *lacunae* in the law which exist in cryptocurrency regulation. Furthermore, this research aims to prove that cryptocurrency regulation in SA is inadequate and ineffective. This issue will be explored in a holistic sense in order to assert that the lack of adequate cryptocurrency regulation is in fact a global issue. The legislation addressing the taxation of cryptocurrency in SA will be evaluated in order to ascertain whether the relevant legislative provisions will be sufficient in addressing the issues related to the taxation of cryptocurrency and tax evasion specifically, and subsequently used to prove that cryptocurrency regulation is in fact insufficient.

In addressing the issues explored through this research, it is proposed that the nature of cryptocurrency must be considered as the foundation upon which the legislature constructs cryptocurrency regulations. From a practical perspective, it is proposed that a formal definition of cryptocurrency be implemented in legislation (in order to provide further clarity on the taxation treatment thereof) and a provision be inserted in legislation addressing the taxation treatment of cryptocurrency. It is also recommended that the UK and Germany be looked towards for cryptocurrency regulation in terms of SARS implementing an interpretation note thereon as well as ensuring that the content of the interpretation note/position paper is formulated in accordance with the UK government's position paper on the taxation treatment of crypto assets. This research proposes that authoritative bodies must ensure cohesion regarding the categorisation of cryptocurrency as well as regulation thereof in order to provide clarity on cryptocurrency regulation as well as ensure the effective regulation thereof.

CHAPTER 1

INTRODUCTION AND GENERAL BACKGROUND

1.1. INTRODUCTION AND GENERAL OVERVIEW

Cryptocurrencies[5] have been at the epicentre of debates, disagreements and much confusion in financial, digital and legal spaces.[6] Not only has there been an historic misconception of what cryptocurrency actually is,[7] but it is submitted that professionals in all fields have not successfully converged in order to reach holistic solutions to the issues that are faced by virtue of cryptocurrency transactions. The financial sphere is progressing rapidly and the way in which people transact is deviating from the normalcy of cash payments and even credit card payments.[8] Due to the increase in technological advancements, payment methods are undoubtedly changing concurrently through the development of financial technology.[9] This evolution in payment methods can be seen in SA specifically, due to the South African Reserve Bank's[10] approach to the national payment system.[11] As illustrated by SARB in its strategy report, the willingness of the South African financial authority to keep up with global economic change is present, as the South African economy needs growth.[12]

[5] See footnote 308. It must be noted that for the purposes of chapter 1, the term 'cryptocurrency' will be used predominantly in order to lay the foundation for the rest of the research as well as to establish the basis on which this digital innovation has been formulated so as to create cohesion before the specific issue of the categorisation of cryptocurrency is discussed (in chapter 2 of this research), which involves (largely) an examination of the various classifications of cryptocurrency. Since a considerable aspect of this research is focused on the lack of regulatory clarity in respect of cryptocurrency taxation regulation, and in further consideration of the fact that one of the reasons as to why this is so is due to the lack of cohesion in the classification of cryptocurrency, the term must be referred to in its original form so as to examine the variations thereof (in the initial chapters of this research).

[6] The Law Library of Congress, Global Legal Research Center 'Regulation of Cryptocurrency in Selected Jurisdictions' (2018) Law report.

[7] Kevin Roose 'Think Cryptocurrency Is Confusing? Try Paying Taxes in It' available at *https://www.nytimes.com/2018/03/21/technology/think-cryptocurrency-is-confusing-try-paying-taxes-on-it.html*, accessed on 13 March 2020.

[8] Dana van der Merwe et al *Information and Communications Technology Law* 2 ed (2016) 218.

[9] Ryan Browne 'Everything you've always wanted to know about Fintech' available at *https://www.cnbc.com/2017/10/02/fintech-everything-youve-always-wanted-to-know-about-financial-technology.html*, accessed on 14 March 2019.

[10] The South African Reserve Bank is the central bank of SA and regulates the financial sector in SA on the background of ensuring economic growth and financial stability. The South African Reserve Bank is hereinafter referred to as 'SARB.'

[11] South African Reserve Bank *The National Payment System Framework and Strategy – Vision 2025* (ND) 1-2.

[12] Ibid at 1-2.

In terms of the rapid development of technology,[13] it is submitted that economic growth may only take place when governments are open to the merging of technology and finance. The willingness of the South African government to ensure the progression of financial technology[14] may be indicated by the establishment of the Presidential Commission on the Fourth Industrial Revolution.[15] The PC4IR has been established in order to facilitate the socio-economic progression of SA in light of what has been referred to as the digital industrial revolution.[16] The formulation of the PC4IR and its objectives of facilitating economic growth in SA through modernisation illustrates that the South African government has recognised that in order to be a global contender, SA must embrace the integration of technology and digital systems into existing systems, in order to improve SA's socio-economic prospects.[17] Even though the South African government indicates its readiness for the influx of financial technology into the financial sector,[18] the lack of progressive measures taken to regulate cryptocurrency shows the government's reluctance in terms of integrating cryptocurrency (specifically) into the financial sphere.[19] The use of cryptocurrency as a medium for financial transactions has been the subject of speculation in the legal and financial worlds as there are various theoretical approaches to the legal regulation of cryptocurrency.[20] Cryptocurrency itself has been misunderstood due to its complex nature.[21] It is submitted that governments are hesitant to accept the rise of financial technology, as this progression in payment systems may lead to unforeseen consequences.[22] Whilst the global platform for technological advancements

[13] Ryan Browne 'Everything you've always wanted to know about Fintech' available at *https://www.cnbc.com/2017/10/02/fintech-everything-youve-always-wanted-to-know-about-financial-technology.html*, accessed on 14 March 2019.
[14] See 1.2.6. below for a definition of 'financial technology.'
[15] Department of Communications and Digital Technologies notice in GN 591 GG 43834 of 23 October 2020. The Presidential Commission on the Fourth Industrial Revolution is hereinafter referred to as 'PC4IR.'
[16] Ibid.
[17] Ibid.
[18] South African Reserve Bank *The National Payment System Framework and Strategy – Vision 2025* (ND) 1-2.
[19] This reluctance is shown through the meager information provided by SARS on cryptocurrency as well as the ineffectiveness of the Draft Taxation Laws Amendment Bill of 2018 in terms of the cryptocurrency provisions. (Discussed below at 3.4.).
[20] Irina Cvetkova 'Cryptocurrencies legal regulation' (2018) 5 *BRICS LJ* 2 at 133-137.
[21] Kevin Roose 'Think Cryptocurrency Is Confusing? Try Paying Taxes in It' available at *https://www.nytimes.com/2018/03/21/technology/think-cryptocurrency-is-confusing-try-paying-taxes-on-it.html*, accessed on 13 March 2020.
[22] These include general consequences such as money laundering, the circumvention of exchange control regulations as well as the purchasing of illegal goods and services through the dark web, for example. It must also be noted that governments have adopted a cautious approach in respect of cryptocurrency and the development of digital systems due to the fact that they remain (largely) unregulated or that the regulation in respect thereof is severely lacking.

is expanding,[23] law enforcement, governments and financial institutions do not know how to deal with the rapid growth of financial technology in regard to the regulation thereof.[24]

The lack of regulation of cryptocurrency specifically, spans across the globe and is not only an issue being faced in a South African context.[25] There are many users of cryptocurrency (the most popular cryptocurrency being Bitcoin), as it is an ever-growing modern method of accumulating wealth[26] and moving wealth across boarders easily and efficiently. This indicates not only the progression of alternative means of exchange and financial systems,[27] but the fact that currencies which operate on a virtual space may have a permanent place in the financial world, may also be inferred. In terms of taxation regulation specifically, despite efforts on the parts of SARS[28] as well as lawmakers, the lack of cryptocurrency regulation in SA has not been fully remedied. In a global sense, due to the fact that 'the existence of cryptocurrencies has been a threat to current financial institutions…',[29] the lack of cryptocurrency regulation serves as a conundrum for governments.

Since cryptocurrency transactions are based on decentralised[30] systems and anonymity among users,[31] the reasons as to why cryptocurrency taxation regulations are lacking in the legal sphere will be addressed. This will therefore solidify the necessity of further cryptocurrency regulation. It is imperative that the regulation of cryptocurrency in SA is sufficient and effective enough to curb any problems the legal sector might face regarding this digital system.

The taxation of cryptocurrency is a focal point as it is a prevalent legal issue in the field of tax and cyber law.[32] The lack of cryptocurrency regulation proves to be an issue for the enforcement of tax laws relating to income and the main problem which is faced in the legal

[23] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1979-1980.
[24] Marina Chudinovskikh and Victor Sevryugin 'Cryptocurrency regulation in the BRICS countries and the Eurasian Economic Union' (2019) 6 *BRICS LJ* 1 at 64.
[25] Ibid at 63.
[26] Irina Cvetkova 'Cryptocurrencies legal regulation' (2018) 5 *BRICS LJ* 2 at 129.
[27] Ibid at 129.
[28] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.
[29] Christian Partanen *The viability of cryptocurrency in relation to the response of financial institutions and governments* (bachelor of business administration thesis, Helsinki Metropolia University of Applied Sciences, 2018) 0.
[30] See definition of 'decentralised' below at 1.2.5.
[31] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 1-2.
[32] Omri Marian 'Are cryptocurrencies 'super' tax havens?' (2013) 112 *UF Law Scholarship Repository* at 40-45.

sphere in this regard is potential tax evasion.[33] This will be discussed extensively as a consequence of the lack of cryptocurrency regulation.

Whilst cryptocurrency has been included in taxation legislation,[34] it is submitted that this minimal regulation is insufficient in adequately addressing cryptocurrency as it relates to taxation. This will be explored extensively through this research. With specific focus on the lack of taxation regulation of cryptocurrency,[35] it must be noted that if the relevant authorities do not find alternative ways to address the consequential issues,[36] the financial sphere will be faced with an array of problems.[37]

One such issue that is closely associated with the lack of cryptocurrency regulation is the possibility of tax evasion. While tax evasion is a serious offence in SA,[38] the potential of the act of a person not declaring their cryptocurrency earnings (as part of their income) constituting tax evasion must be examined. It is submitted that the tax evasion potential related to cryptocurrency is confusing due to the lack of certainty, knowledge and consequently, the taxation regulation of cryptocurrency. This is reflected in the lack of an effective legal regulatory framework (in respect of the regulation of cryptocurrency) in SA.[39]

Current taxation legislation classifies cryptocurrency as a financial instrument,[40] which causes uncertainty relating to the taxation consequences of cryptocurrency earnings. The issue of whether cryptocurrency should be taxed in terms of normal tax in accordance with the definition of gross income[41] is yet another factor that has not been addressed adequately and needs to be discussed in order to ascertain whether not declaring one's cryptocurrency earnings can in fact constitute tax evasion. A further consideration in this regard would be the issue of whether the proceeds from the 'disposal' of cryptocurrency would be considered as a capital gain for the purpose of capital gains tax[42] or whether the proceeds therefrom would be considered as income in nature.

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[33] Ibid at 40-45.
[34] Taxation Laws Amendment Act 23 of 2018 and the Taxation Laws Amendment Act 23 of 2020.
[35] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1988.
[36] These issues include tax avoidance, potential tax evasion as well as money laundering.
[37] Omri Marian 'Are cryptocurrencies 'super' tax havens?' (2013) 112 *UF Law Scholarship Repository* at 38-39.
[38] Tax Administration Act 28 of 2011: s 235(1). In terms of this section, if a taxpayer is guilty of evading, assisting another to evade or obtains an undue refund in regard to their taxable income, they may be subject to a fine or imprisonment for a period not exceeding five years, upon conviction.
[39] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1989.
[40] Taxation Laws Amendment Act 23 of 2018: s 1. This classification remains relevant in terms of the Taxation Laws Amendment Act 23 of 2020.
[41] Income Tax Act 58 of 1962: s 1.
[42] In other words, if cryptocurrency is to be considered as an asset for the purpose of capital gains tax. See point 3.3.2. below for a discussion on capital gains tax in relation to cryptocurrency.

If there is no adequate legislation addressing the treatment of cryptocurrency earnings, (taking into account the anonymity and decentralised nature of cryptocurrency transactions) attaching an offence as serious as tax evasion to the non-inclusion of cryptocurrency earnings in a person's gross income may be a frantic attempt by authorities to enforce regulations in order to curb any related offences. It is submitted therefore, that governments, tax authorities, lawmakers as well as experts in the digital and financial sectors should work in unison to seek alternative means of regulating cryptocurrency. When dealing with new methods of exchange (and specifically the issues associated therefrom), an unconventional approach may be necessary.[43]

The lack of legal regulatory clarity in respect of cryptocurrency among government bodies, lawmakers as well as financial institutions may be illustrated (with specific focus on SA) in the inconsistent categorisation of cryptocurrency by different authoritative bodies and academics.[44] This paves the way for the lack of future progressive regulatory measures relating to cryptocurrency. This must be considered in addition to the fact that payment methods, methods of exchange and financial systems are constantly changing and if there is no radical attempt to remedy the insufficient taxation regulation of cryptocurrency, governments, lawmakers and centralised financial institutions will be faced with extensive regulatory hardships.

The regulation of cryptocurrency, however, is coupled with the limitations thereof. The financial technology sphere is rapidly progressing and there are new innovative technological systems that are being developed in order to keep up with the everchanging digital sphere.[45] Therefore, it is important not only to possess an in-depth knowledge of systems which may overtake traditional financial systems, but most importantly, to be able to comprehend the limits of such systems. In a legal sense, lawmakers have to make sure that they are aware of these progressive financial systems, as they need to regulate them. It is submitted that merely incorporating cryptocurrency into existing regulatory systems (which were formulated specifically for other types of traditional financial systems) is indicative of the ineffective regulation thereof.

[43] Yuval Noah Harari *21 lessons for the 21st century* (2018) 31-32.
[44] The categorisation of cryptocurrency in SA will be discussed below at 2.3.
[45] Jason de Mink 'The rise of Bitcoin and other cryptocurrencies' available at *http://www.derebus.org.za/rise-bitcoin-cryptocurrencies/*, accessed on 14 March 2019.

Cryptocurrency as a means of financially transacting, as well as the issues which are related to the complex digital system upon which cryptocurrency has come to exist, are concepts which are relatively new to the financial and legal sectors.[46] Due to the fact that any financial system needs to be legally regulated, this new and complex payment system proves to be an issue in the legal sector as well.[47] Due to the fact that there is very little which academia has to offer to lawmakers in regard to their efforts to regulate the use of cryptocurrency, it is submitted that one of the main pitfalls which the legal sector is faced with is a lack of information. This lack of information surrounding cryptocurrency is a direct consequence of both the novelty of this digital system as well as the complexity thereof.

Due to these reasons, it becomes exceptionally difficult to find sound academic sources from which one can synthesise information and deduce an opinion on the topic. This is especially true in the South African context, as there is minimal development where cryptocurrency is concerned.[48] Whilst it may be argued that this lack of development is due to the complex nature of cryptocurrency and the fact that when attempting to regulate it, governments are constantly at an impasse due to its decentralised nature, it must be borne in mind that more effort needs to be made in attempting to regulate cryptocurrency.

Whilst cryptocurrency has been recently included briefly in taxation legislation,[49] it is submitted that there is still no cohesive and unified understanding of cryptocurrency across each sector which may be affected by cryptocurrency transactions. It is accepted that advancements in technology are aimed at making everyday life more convenient for human beings. However, it is submitted that with the convenience, comes the burden of potential threats and unforeseen consequences.[50]

These consequences account for the importance of this particular research project. As a decentralised financial system,[51] cryptocurrency poses certain challenges in both the financial and legal fields.[52] The fact that the system is based on user anonymity has been a global issue. Most significantly, however, is the issue of the lack of effective and thorough taxation

[46] Based on the construction that the development of cryptocurrency and integration into the financial market thereof only occurred in 2009, along with Bitcoin, as mentioned at 1.1.1.
[47] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 17-23.
[48] Ibid at 17.
[49] Taxation Laws Amendment Act 23 of 2018 and the Taxation Laws Amendment Act 23 of 2020.
[50] Jason de Mink 'The rise of Bitcoin and other cryptocurrencies' available at *http://www.derebus.org.za/rise-bitcoin-cryptocurrencies/*, accessed on 14 March 2019.
[51] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 1-2.
[52] Ibid at 5-6.

regulation of cryptocurrency.[53] This is why the study is crucial – to illustrate the *lacunae* in the law where cryptocurrency is concerned and to propose regulatory measures or merely more effective solutions in that regard. This study will not only improve the holistic knowledge of cryptocurrency (with specific reference to the taxation thereof), but also aim to contribute valuable submissions to the fields of tax and cyber law.

1.2. DEFINITIONS

1.2.1. Bitcoin

Bitcoin is categorised as a type of cryptocurrency.[54] It is a '… "currency" and a "payment system."'[55] It is used to retain value as well as facilitate commercial and cryptocurrency transactions. Erlank argues that Bitcoin is a '… form of virtual property.'[56] Bitcoin may also be categorised further as a 'decentralised convertible virtual currency'[57] as it is does not form part of traditional centralised banking systems. Bitcoin was supposedly[58] founded in 2009 by one or many anonymous developers and researchers and does not operate based on any centralised system or authority.[59] This means that the users of Bitcoin are virtually anonymous, unlike with traditional financial and banking/ payment systems, where users may be traced.[60] Users are allowed to send as well as receive Bitcoin and use the Bitcoin to trade or transact.[61] Delving into the technicalities of Bitcoin, it must be added that it '… relies on digital signatures to ensure the correct validation of ownership…' and '… uses a unique cryptographic system to verify transactions…' which are irreversible due to the nature of the digital system upon which it operates.[62] Many writers have referred to Bitcoin as an alternative payment method in relation to traditional financial transactions which may take place via central banking systems.[63]

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[53] Ibid at 6.
[54] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.
[55] Ibid at 2.
[56] Wian Erlank 'Introcuction to virtual property: lex virtualis ipsa loquitur' (2015) 18 *PER/PELJ* 7 at 2542.
[57] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1980.
[58] The reason for the global uncertainty in regard to when Bitcoin was founded is due to the lack of knowledge of the actual identity of the founder as well as the date on which Bitcoin was actually developed and ready for integration into the financial world.
[59] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1986.
[60] Ibid at 1986.
[61] Ibid at 1986.
[62] Cian Healy *The Role Decentralised Non-Regulated Virtual Currencies Play in Facilitating Unlawful Financial Transactions* (Master of Sceince Thesis, KTH Industrial Engineering and Management, 2016) 4.
[63] Ibid at 4.

1.2.2. Blockchain

Blockchain is a '…foundational technology'[64] on which cryptocurrency is based and is the digital structural component which cryptocurrency is built on.[65] Blockchain technology does have the potential to serve the purpose of a digital structural component for economic as well as social systems.[66] This development is referred to and described as a 'digital ledger' which regulates virtual currency transactions.[67] This is a form of a database and is not completely anonymous.[68] Even though users of cryptocurrency are anonymous, cryptocurrency transactions may be 'traced' via the blockchain technology 'ledger' as it does have an account of the transactions, but not an account of the identity of the users.[69] Blockchain allows for the recording of virtual currency activities and serves as a 'data structure' which can display cryptocurrency transactions, as it may be considered to be an informal and unregulated 'intermediary.'[70]

1.2.3. Crypto Assets and Virtual Currency

According to the Intergovernmental Fintech Working Group,[71] cryptocurrency (which is referred to as crypto assets by the IFWG)[72] is synonymous with 'virtual currencies'[73] and is based on decentralised[74] systems.[75] Crypto assets[76] may serve the purpose of being a

[64] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 5.
[65] Ibid at 5.
[66] Ibid at 5.
[67] Cian Healy *The Role Decentralised Non-Regulated Virtual Currencies Play in Facilitating Unlawful Financial Transactions* (Master of Science Thesis, KTH Industrial Engineering and Management, 2016) 0.
[68] Ibid at 4.
[69] Ibid at 16.
[70] Oanh Truong *How Fintech industry is changing the world* (Thesis, Centria University of Applied Sciences, 2016) 22.
[71] See 2.3.4. below for a brief explanation on the nature and purpose of the Intergovernmental Fintech Working Group. The Intergovernmental Fintech Working Group will hereinafter be referred to as 'IFWG.'
[72] For the purposes of this subheading, 'cryptocurrency' will be referred to as 'crypto assets' for the purpose of illustrating the meaning which the IFWG assigns thereto. In this regard, it is of relevance to this research to note that cryptocurrency had been historically referred to as such but is now being referred to as 'crypto assets' and was referred to as 'crypto assets' by the IFWG before any formal legislative provisions to that effect had been formulated. Furthermore, the IFWG refers to virtual currencies specifically, but then refers to cryptocurrency as 'crypto assets,' which terms are all essentially interchangeable in this context. It is submitted that the IFWG referring to cryptocurrency as 'crypto assets' may have been a preemption on the part of the IFWG or may merely infer the intention of the government in respect of the regulation of cryptocurrency. See 2.3.4., 3.3.2. and 3.7. below for various discussions on the different points of consideration in terms of cryptocurrency as 'crypto assets' for taxation purposes and the possible capital gains tax considerations associated therewith accordingly.
[73] See below for a definition of 'virtual currency.'
[74] See 1.2.5. below for a definition of 'decentralised.'
[75] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 3-8.
[76] It must be noted that 'crypto assets' will be referred to interchangeably with 'cryptocurrency' from chapters 3-5, where the context requires that either one or the other be referred to in relation to the source in question or the

'…medium of exchange…' as they are used to digitally transact.[77] 'Crypto assets' as an all-encompassing term, gives rise to what IFWG call 'crypto asset tokens' which have different uses (such as facilitating exchange or payment, affirming ownership or entitlement and providing access to products or services) in the digital sphere.[78] It is submitted that crypto asset tokens are means of assigning value to crypto assets as they are used in order to accomplish transactions. It is an established fact that crypto assets are not regarded as legal tender or traditional representations of currency and monetary value.[79]

The term 'virtual currency' is synonymous with the term 'cryptocurrency' and refers to a decentralised '… digital representation of value' and is not synonymous with other currency which is tangible and issued by banks or regulated by government authority. [80] Virtual currency facilitates online transactions insofar as cryptocurrency is concerned and may act as '…an alternative to money'.[81] Virtual currency comprises of '…online payment systems…'[82] which users can operate on in order to transact using values which are purely generated digitally.[83]

1.2.4. Cryptocurrency

Cryptocurrency is built upon a digital database system called 'blockchain.'[84] It is submitted that when one considers the world of virtual currencies, 'cryptocurrency' may be seen as an 'umbrella term.' Therefore, Bitcoin is a type of cryptocurrency and is viewed under this 'umbrella term.'[85] Cryptocurrency (of which there are over 700 different types, according to Reddy and Lawack) is a 'decentralised virtual currency' and was created via the internet in order to provide a mode of online transactions.[86] In order to create cryptocurrency, '…open-source software on a peer-to-peer network…' is used by developers.[87] The prevalence of cryptocurrency in SA as well as the consideration that there are various cryptocurrencies which

content under the relevant chapter headings. This consideration in terms of the use of the relevant terminology is explained below at footnote 308.

[77] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 8.

[78] Ibid at 8-9.

[79] Ibid at 9.

[80] Cian Healy *The Role Decentralised Non-Regulated Virtual Currencies Play in Facilitating Unlawful Financial Transactions* (Master of Sceince Thesis, KTH Industrial Engineering and Management, 2016) 0.

[81] Ibid at 0.

[82] Omri Marian 'Are cryptocurrencies 'super' tax havens?' (2013) 112 *UF Law Scholarship Repository* at 38.

[83] Ibid at 38.

[84] Discussed above at 1.2.2.

[85] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.

[86] Ibid at 2.

[87] Ibid at 2.

have been developed merely proves that the rise and growth of cryptocurrency in the financial sphere is indeed increasing.

1.2.5. Decentralised

This term refers to systems which are devoid of regulatory authority to the extent that no official government bodies have direct control over such systems.[88] With specific reference to cryptocurrency, the decentralised nature thereof denotes the fact that there is no involvement on the part of the government or banks in cryptocurrency transactions.[89] The decentralised nature of cryptocurrency enables users to transact without the approval or regulation of any financial institutions, but a consequence of decentralisation may be that centralised financial systems cease to exist in the future.[90] This illustrates the very nature of 'decentralisation' as a term.

1.2.6. Financial Technology

This general term may be used to describe payment systems which are relatively not traditional and deviate from the normal methods of payment such as cheques or physical cash.[91] More specifically, this term alludes to the use of technological advancements, systems and devices in order to transact through online banking or cryptocurrency platforms (among other forms of digital transaction methods).[92] Truong cleverly notes that even the printing press and telegraph were financial technological inventions as they were closely associated with the process of transacting at the time.[93] Electronic systems are also forms of financial technology as they were developed in order to make the process of transacting easier.[94] A payment method such as the popular 'PayPal' is one such example of an online transacting development.[95] 'PayPal' is an example of a financial technological system as it does not involve the physical exchange of

[88] Cian Healy *The Role Decentralised Non-Regulated Virtual Currencies Play in Facilitating Unlawful Financial Transactions* (Master of Sceince Thesis, KTH Industrial Engineering and Management, 2016) 4.
[89] Ibid at 4.
[90] Ibid at 7.
[91] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.
[92] Oanh Truong *How Fintech industry is changing the world* (Thesis, Centria University of Applied Sciences, 2016) 1.
[93] Ibid at 4. This shows that financial technology is developing as human knowledge and needs develop in terms of financial systems.
[94] Ibid at 5.
[95] PayPal 'How PayPal works' available at *https://www.paypal.com/za/webapps/mpp/personal*, accessed on 24 June 2021.

cash for an item or service.[96] This financial technology has made it easier for international transactions without the burden of a financial institution having to facilitate the transaction.[97] As these systems have developed over time under the general term of financial technology, more complex systems such as cryptocurrency came to the fore of the financial and digital spheres as a form of financial technology.[98]

1.3. RESEARCH QUESTIONS

The main research question is 1.3.1. which will be followed by and explored via the sub-questions[99] which appear below it.

1.3.1. How effective is SA's tax regulation of cryptocurrency in mitigating tax evasion?

1.3.2. What is SA's legal position and stance on cryptocurrency?

1.3.3. Why is the regulation of cryptocurrency a challenge for law enforcement?

1.3.4. Is the taxpayer's failure to include their cryptocurrency earnings in their gross income tantamount to tax evasion?

1.3.5. How is tax evasion facilitated through the use of cryptocurrency?

1.3.6. How have other countries attempted to regulate cryptocurrency and would any international model be viable in a South African context?

1.4. RESEARCH METHODOLOGY

This research project will be a desktop study. It will include a black letter analysis in that it will provide a legalistic standpoint and will comprise of doctrinal research. Legal regulations, policies and proposed structures to regulate cryptocurrency will be analysed. The current legal standpoint on cryptocurrency will be evaluated and synthesised in order for sound recommendations to be made. Analysis is crucial in terms of a black letter law approach, which is exactly what this particular research project aims to achieve. Deductive reasoning will also be made use of in this context as well as expository research.

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[96] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.
[97] Ibid at 2.
[98] Ibid at 20-21.
[99] 1.3.2. – 1.3.6.

To a lesser extent, a comparative element will be used in this research project. Even though the study is not entirely a comparative study, there will be elements within the research project which will focus on how other countries have attempted to regulate cryptocurrency. This will merely be referred to for perspective and will not be the sole focus of the research project. The reason as to why this comparative element is needed in this research project is due to the fact that there is no cohesive international model for dealing with the taxation of cryptocurrency and the transacting thereof affects users internationally due to the very nature of cryptocurrency.

1.5. RATIONALE

The importance of this study lies primarily in the fact that there is a scarcity of knowledge, sound academic sources as well as regulations in regard to cryptocurrency in general.[100] Due to this lack of adequate cryptocurrency regulation in SA,[101] this study will serve the purpose of solidifying the need for a structured regulatory plan to be put into place by law enforcement and government. Another reason as to why this study is relevant is due to the fact that in order for any meaningful change to occur in terms of the regulation of cryptocurrency, more knowledge thereon needs to be available in the academic space. The taxation of cryptocurrency will be examined specifically due to the fact that this is an issue which is at the forefront of the cryptocurrency regulation debacle.[102] This study is crucial in order to prompt the development of thorough taxation regulations in relation to cryptocurrency. The legal field comprises of a diverse set of rules and regulations which are ever-growing due to the progressive society it operates in. It is submitted that the legal sphere needs to develop in conjunction with technological and societal advancements in order to provide authority on the issues[103] which are inadvertently coupled with the digital age in which people are living. Furthermore, considering the unprecedented situation with which the economy is faced,[104] it is submitted that alternative methods of payment will become more prevalent. Therefore, the lack of cryptocurrency knowledge and legal regulation provides a foundation upon which the

[100] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1989.
[101] Ibid at 1989.
[102] Omri Marian 'Are cryptocurrencies 'super' tax havens?' (2013) 112 *UF Law Scholarship Repository* at 41-45.
[103] Those relating to the lack of cryptocurrency regulation, which will be discussed in the chapters below.
[104] This refers to the emergence of COVID-19 and the effect it has had on the economy in regard to traditional payment methods. It is commonly accepted that people are less inclined to use cash as a means of payment, due to the fact that people are encouraged to remain at home so as to protect themselves. Furthermore, people are having to seek new methods of generating income as many have lost their livelihoods as a consequence of not being able to go to their place of work. It is submitted that this time of uncertainty will give rise to more cryptocurrency transactions, as people are looking to alternative options to generate an income.

importance of this study is based. It is submitted that if there is no effective and adequate legal regulation of cryptocurrency in the near future, the much-needed convergence between the legal and digital worlds will begin to rupture.

1.6. STRUCTURE/LAYOUT OF THE DISSERTATION

Chapter 1: This chapter will focus mainly on introducing the topic of the legal regulation of cryptocurrency and the lack thereof. Taxation regulation of cryptocurrency will also be introduced in order to illustrate the need for development in the area of law where legal regulations converge with this complex digital platform. Importantly, this chapter will provide definitions of terms that will be used throughout the dissertation in order to afford the reader an in-depth understanding of terms that may not be readily understood.

Chapter 2: The nature and mechanics of cryptocurrency will be discussed in this chapter. This will serve as a foundation to understanding how cryptocurrency works, before examining the legal categorisation of cryptocurrency in SA. The classification of cryptocurrency in SA will then be examined and emphasis will be placed on analysing whether the various categorisations are coherent and effective. This will thus serve as a basis for determining the taxation implications of cryptocurrency transactions and provide a foundation for determining whether cryptocurrency taxation regulations are effective.

Chapter 3: This chapter will extensively examine why cryptocurrency is challenging to regulate, and more specifically, in terms of taxation regulation. The focal point of this chapter will be on the characteristics of cryptocurrency and how they attribute to the lack of taxation regulation thereof. Taxation principles will be examined in conjunction with cryptocurrency and an attempt will be made (through this research) to determine how cryptocurrency is treated in SA from a taxation perspective. Furthermore, international regulations of cryptocurrency will be considered briefly in order to determine the taxation treatment of cryptocurrency in a global context. This serves the purpose of establishing a foundation for possible legislative solutions to the taxation of cryptocurrency in SA.

Chapter 4: The issue of potential tax evasion relating to the taxpayer's failure to include their cryptocurrency earnings in their gross income (for purposes of determining their normal tax liability) will be discussed. This is the crux of the dissertation as the aim is to explore tax evasion and tax avoidance in relation to cryptocurrency. From this investigation into tax evasion and tax avoidance, analyses will be made regarding whether the failure of a taxpayer

to include their cryptocurrency earnings in their gross income is tantamount to tax evasion or tax avoidance, given the nature of cryptocurrency as well as the lack of regulation thereof.

Chapter 5: This chapter will serve in part as a reflective chapter. The ideas, information and deductions from previous chapters will be consolidated. Furthermore, recommendations will be made regarding the way forward in respect of the taxation regulation of cryptocurrency.

CHAPTER 2

CRYPTOCURRENCY MECHANICS AND SOUTH AFRICA'S LEGAL POSITION ON CRYPTOCURRENCY

2.1. OVERVIEW

Cryptocurrency[105] is founded on a complex technological system, which makes it difficult to regulate.[106] Not only is the regulation of cryptocurrency an issue in SA, but it is of global concern.[107] Due to uncertainty, lack of knowledge as well as the lack of enforcement capacity (on the part of governmental, legal and financial authorities) of cryptocurrency regulations,[108] the scope for the legal regulation thereof is currently limited. This chapter will encompass two main focus areas in order to establish the foundation for the rest of the research. The first component of this chapter will focus on the nature and mechanics of cryptocurrency in an effort to illustrate how cryptocurrency functions. The second component of this chapter involves an analysis of the current stance on cryptocurrency in SA and serves the purpose of outlining the current cryptocurrency regulations (and the lack thereof). This chapter discusses cryptocurrency mechanics and regulation, whilst the deductions therefrom (in terms of a taxation perspective) will be explored further in Chapter 3 of this research. This chapter will function in conjunction with Chapter 3 as it serves to explore the classification of cryptocurrency as well as the current legal regulation thereof generally, whilst Chapter 3 will focus on the taxation regulations and implications of cryptocurrency classification in SA.

[105] See footnote 308. In respect of this chapter specifically, the term 'cryptocurrency' will be used (primarily) as a general term as this is necessary for the examination of the very issue of the lack of cohesion in the categorisation/ classification of cryptocurrency. Thus, the general/standard term ('cryptocurrency') will be used contextually when comparing the general classification to other classifications thereof. The use of the general term 'cryptocurrency' (as opposed to 'crypto assets') also serves to illustrate the historic development thereof in conjunction with the specific sources which refer to cryptocurrency as opposed to crypto assets, which is in itself a relatively new reference/ term which cryptocurrency is only currently being referred to as. Furthermore, the headings in this chapter will also include the term 'cryptocurrency' so as to adhere to the context of the respective source which is being examined/discussed accordingly.

[106] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 3.

[107] Ibid at 3.

[108] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 3.

2.2. THE NATURE AND MECHANICS OF CRYPTOCURRENCY AND HOW THESE FACTORS INFLUENCE THE REGULATORY POTENTIAL OF CRYPTOCURRENCY

The nature of cryptocurrency as well as the way in which it functions are factors which are crucial to understand. Before attempting to analyse the effectiveness of legislation or determine how cryptocurrency should be regulated and taxed, the mechanics of cryptocurrency need to be examined. It is submitted that even though the mechanics of cryptocurrency and the technical nature thereof are rooted in computer science, in order to legally regulate a system which is non-traditional and has unknown variables, lawmakers must obtain an in-depth understanding of cryptocurrency. Due to the operational complexities posed by cryptocurrency and the technology which it is founded upon, (blockchain technology)[109] only once it is fully understood can it be regulated effectively. This part of the research does not serve to categorise or classify cryptocurrency,[110] but rather, to analyse the foundational mechanics thereof.

2.2.1. Cryptography and blockchain technology as the foundational mechanisms of cryptocurrency

In order to ascertain the true nature of cryptocurrency, it is necessary to analyse the foundation thereof. Blockchain technology[111] may be seen as a foundational technology on which cryptocurrency is based. However, before examining the intricacies of blockchain technology, the underlying principle which is a driving force behind blockchain technology must be investigated. This underlying force which enables the existence of cryptocurrency in general is cryptography.[112] Cryptography is indicative of 'secret communications' (one of the modern-day equivalents would be recognised as encryption)[113] and is defined by the Oxford Learner's Dictionary as 'the art of writing or solving codes.'[114] This science is important to analyse and relevant to cryptocurrency as it illustrates the very origin thereof. In a holistic sense, cryptography exemplifies the basal principles which are responsible for the existence of cryptocurrency. It is submitted that once these foundational principles are identified,

[109] See 1.2.2. above for the definition of 'blockchain.'
[110] See 2.3. for the categorization of cryptocurrency in South Africa.
[111] See 1.2.2. above for the definition of 'blockchain.'
[112] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 5.
[113] Ibid at 5.
[114] Oxford University, 'Oxford Learner's Dictionary' available at *https://www.oxfordlearnersdictionaries.com/definition/english/cryptography?q=cryptography*, accessed on 28 July 2020.

cryptocurrency may be understood more effectively. This will inadvertently improve the understanding of cryptocurrency in a legal context and more specifically, (in relation to this research) in the context of tax law for the purpose of the effective regulation of cryptocurrency.

Cryptographic practices in general can be dated back to Ancient Greece,[115] which attests to the ubiquitous nature of encryption in society. Due to technological developments, (in regard to computer science specifically) the way in which people began to practice this science of secret communication changed accordingly.[116] The protection of data and information via encryption became increasingly prevalent and the amalgamation of computer science with mathematical theory in order to create algorithms to ensure confidentiality created a modern cryptographic practice.[117] Due to the potential of cryptography to protect user information, there were attempts (which may be dated as far back as 1982) to create cryptographic money (E-cash) in order to enable anonymous transactions (as opposed to transactions which may be tracked due to the fact that a user's personal details are attached thereto).[118] This cryptographic technology which enabled the encryption of 'digital coins' served to anonymise transactions, therefore there was no link to the user of such 'digital coins.'[119] This method of anonymising transactions is the basis for the anonymous nature of cryptocurrency transactions.

Further attempts were made to introduce 'digital cash' into the economy, however they proved to be unsuccessful.[120] That is, until the emergence of cryptocurrency and specifically, the popular cryptocurrency known as Bitcoin.[121] The foundational technology (which is the underlying technology of Bitcoin)[122] known as blockchain technology must thus be analysed in order to determine the mechanics of cryptocurrency as it operates in a practical sense. The purpose of progressing from a discussion on cryptography to that of blockchain technology is merely to illustrate the various levels of the creation and establishment of cryptocurrency. The mechanics of blockchain must therefore be analysed to further the investigation into the nature of cryptocurrency.

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[115] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 5.
[116] Ibid at 5.
[117] Birgit Friederike Kortekaas *Internet-based electronic payment systems* (Master of Science thesis, University of South Africa, 2001) 51.
[118] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 5.
[119] Ibid at 6.
[120] Wei 'Bmoney' available at *http://www.weidai.com/bmoney.txt*, accessed on 24 June 2021.
[121] See 1.2.1. above for the definition of 'Bitcoin.'
[122] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017).

The titling of 'blockchain technology' as an innovation was second to the innovation of Bitcoin.[123] This may seem peculiar, as blockchain technology is the foundational technology in the development of Bitcoin (cryptocurrency), therefore Bitcoin only exists due to the existence of blockchain technology. However, blockchain technology being referred to as the 'second innovation'[124] to Bitcoin is merely a matter of semantics. Blockchain technology as a concept was only established as a separate entity after it was discovered that it could be separated from Bitcoin and used as underlying technology for other cryptocurrency systems.[125] A paper which was written by the founder of Bitcoin[126] (at the time it was founded) explaining the functioning thereof makes no mention of what is termed today as 'blockchain technology.' The absence of the term in the paper solidifies the fact that blockchain technology was not termed as such when it was used to develop Bitcoin, as it was not yet discovered that it could be separated therefrom. Even though blockchain technology (as an underlying technology of Bitcoin) was not so titled when it was created, it will be referred to as blockchain technology in this research, as it is now known and established as such.

Until blockchain technology was invented, transactions could not be verified without the parties thereto having to rely on centralised banking/ financial authority to regulate such transactions.[127] In a practical sense, the bank acted as an intermediary between two parties who wanted to transact. Computer science was relied on to determine whether there was a way in which central authority (such as banks) would not need to be used by parties in order to facilitate their transactions.[128] The issue arose as to how computers could possibly make decisions without the reliance on central authority in order to protect users against cyber-attacks.[129] These attacks may cause what is referred to as 'double spending' and entails an attacker spending a coin which was already spent by another user.[130] The person receiving the value will not be aware of the fact that the coin has already been spent.[131] Thus, having a centralised banking system as an intermediary would mitigate this type of attack insofar as

[123] Vinay Gupta 'A brief history of blockchain' available at *https://hbr.org/2017/02/a-brief-history-of-blockchain*, accessed on 28 July 2020.
[124] Ibid.
[125] Ibid.
[126] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[127] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 10.
[128] Ibid at 10.
[129] Ibid at 10.
[130] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[131] Ibid.

traditional transactions are concerned. The issue of double spending is, *inter alia*, what blockchain technology addresses.[132]

In a practical sense, this issue may be represented by a problem question – how would an inanimate object (computer) enable users to transact within a framework of protection and privacy without third party regulation?[133] In order to address this question, blockchain technology utilises principles of probability.[134] Since data moves constantly through a network of computers in the context of blockchain technology, transparency is increased and attackers are less likely to corrupt a distributed/shared database with fake information relating to the transaction in question.[135] Blockchain is thus a series of blocks (containing mathematical equations) which are digitally connected and store data about the transactions users make.[136] Khudnev describes the blockchain as '…a chronological database of transactions, which are recorded into blocks and checked/ verified by other computers in the blockchain network.'[137] A public ledger of transactions which have been approved is referred to as the 'blockchain.'[138] However, the fact that there are records of every transaction does not mean that the users of blockchain technology (and thus, cryptocurrency) can be identified. Users of blockchain technology therefore remain anonymous.[139]

No confidential or personal data is required from a user in order for blockchain to function and be used (no email addresses, contact details, names or other personal information is collected from users), which affirms their anonymity and privacy whilst using blockchain technology and systems which operate thereon.[140] It is submitted that user anonymity in terms of blockchain technology is one of the main issues regarding the regulation of cryptocurrency. If users are to remain anonymous, (for the most part)[141] there will be no real-world link between

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[132] Ibid.
[133] This issue is commonly referred to as the 'Byzantine Generals Problem' and is explained by Khudnev on page 10 of the source and as referred to above at footnote 129.
[134] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 11.
[135] Aaron Wright and Primavera De Filippi *Decentralized blockchain technology and the rise of lex cryptographia* (Legal academic paper, Yeshiva University – Benjamin N. Cardozo School of Law, 2015). Provided that the 'attacker' does not own majority of the computational power associated with the network in question.
[136] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 11.
[137] Ibid at 11.
[138] Ibid at 12.
[139] Ibid at 28.
[140] Ibid at 28.
[141] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14. Only certain cryptocurrency, such as Luno require a user's personal information in order for them to transact using that specific type of cryptocurrency. However, most cryptocurrency do not require any personal user information.

them and the transactions they make. This is one of the main issues in terms of the effective regulation of cryptocurrency and will be discussed in more detail below.[142]

Another important function of blockchain technology is the process of 'mining.'[143] The block may be mined, which is a process that involves recording new transactions on the public ledger which contains the approved transactions.[144] Blockchain technology serves as a function which approves facts (and inadvertently, authenticity) of transactions as they take place on the network.[145] Mining involves miners expending computational power in order to solve digital mathematical puzzles in order to have their mined block accepted by other members on the network.[146] This requirement of solving mathematical puzzles to enable the acceptance of mined blocks is referred to as 'proof of work' and is a consensus mechanism.[147] Cryptocurrency relies on this mechanism of 'proof of work' as a basis for the decentralised nature thereof[148] and most importantly, to simplify the verification of payments.[149] The incentive used to encourage miners to expend computational power on mining is a reward system which involves cryptocurrency as a possible reward.[150] The miner who solves the mathematical puzzle first will receive an amount of cryptocurrency.[151]

Even though the mechanics of blockchain technology are exceptionally intricate and complex, blockchain technology is used to develop cryptocurrency, which is why the understanding thereof is relevant to this research. Blockchain technology has paved the way for hundreds of various cryptocurrencies which operate differently to the original cryptocurrency Bitcoin.[152] All cryptocurrency which are not Bitcoin are known as alternative cryptocurrencies,[153] but still contain the same conceptual and mechanical framework as that of Bitcoin due to the use of cryptography through blockchain technology. However, since Bitcoin was the '…first and most widely used cryptocurrency…'[154] the technical aspects thereof must be analysed in order

[142] See 2.2.2. for a discussion on user anonymity.
[143] When Bitcoin was first developed and released, the concept of mining was not yet discovered, however, currently, 'mining' is a popular function of blockchain technology.
[144]Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 12.
[145] Ibid at 13.
[146] Ibid at 13.
[147] Ibid at 13.
[148] Ibid at 14.
[149] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[150] Ibid.
[151] Ibid.
[152] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 7.
[153] Ibid at 6.
[154] Ibid at 6.

to gain an understanding of how other cryptocurrency function. This will improve the prospect of ensuring the effective legal regulation of cryptocurrency and thus provide a foundation for understanding how the taxation regulation of cryptocurrency may be improved in conjunction with the principal aspects of cryptocurrency mechanics.

2.2.2. Bitcoin: the first cryptocurrency and how it functions

Due to the fact that cryptocurrency has the same fundamental functioning as Bitcoin, (the first cryptocurrency)[155] the mechanics and processes involved in Bitcoin transactions must be determined. The relevance of this investigation to this research is to provide an accurate account of cryptocurrency mechanics as illustrated by the very founder of Bitcoin. It is submitted that any information provided by a person who is responsible for developing cryptocurrency is of high academic worth when conducting research thereon. The founder of Bitcoin (who identifies themselves under the pseudonym Satoshi Nakamoto – in order to remain anonymous) released a paper explaining how the system functions. Even though most of the paper includes scientific and computational mathematic deductions and explanations, the various components of Bitcoin (as a cryptocurrency) are discussed thoroughly. It is submitted that since the underlying mechanics of Bitcoin function the same way as other cryptocurrency (as blockchain technology forms the basis thereof), even though there may be some slight differences therebetween, the information on the functioning of Bitcoin will apply to that of cryptocurrency in general.[156]

Nakamoto introduces Bitcoin as an '…electronic system based on cryptographic proof instead of trust, allowing any two willing parties to transact directly with each other without the need for a trusted third party.'[157] The need for Bitcoin is reflected through the fact that a shortfall of traditional financial systems is that they operate through financial institutions (which act as trusted third parties in the facilitation of electronic transactions) which rely on the principle of trust to validate authenticity.[158] Another shortfall in regard to traditional financial systems is

[155] Ibid at 6.
[156] Please note that where information and explanations apply to Bitcoin, these will also be relevant in terms of cryptocurrency in general, unless stated otherwise. Furthermore, the term 'blockchain technology' will not be used due to the fact that at the time of the development of Bitcoin, it was not yet discovered that blockchain technology could be separated therefrom and used independently. However, it must be borne in mind that blockchain technology (as formally titled only after the creation of Bitcoin) forms the basis of Bitcoin (and thus, all cryptocurrency) in any event.
[157] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[158] Ibid.

the costs involved in transacting through centralised financial institutions.[159] Disputes may arise in relation to traditional payment systems as transactions may need to be reversed (due to fraud) and reviewed by centralised financial institutions.[160] This process as well as the fees involved in regard to using centralised financial services (such as that of banks) involves added costs.[161] Furthermore, centralised financial institutions require a plethora of user information before it becomes possible for such user to transact electronically via the financial institution.[162] It is submitted that this issue is prevalent in terms of centralised banks in that they require an abundance of personal information from a user in order to identify them as well as verify their eligibility for the use of the bank as an intermediary. This can become cumbersome, especially in the event of a user merely needing to make casual transactions.[163] Whilst these shortfalls of using centralised financial institutions to transact may be avoided by solely using physical cash to transact, this is not practical or feasible considering the fact that electronic payment methods have become integrated into the financial sector to the point where the use of physical cash is at a decline.

Thus, the proposed solution would be a system based on cryptographic proof rather than trust.[164] The element of fraud would be mitigated due to the fact that Bitcoin transactions are impractical to reverse (considering the computational elements associated with the mechanism of the blockchain system) which means that sellers thereof would be protected. Furthermore, escrow mechanisms may be implemented to protect buyers.[165] The nature of cryptocurrency allows for the avoidance of double spending, in terms of which the value of a unit of such digital currency is spent twice due to the fact that there is no intermediary to facilitate the transaction.[166] This issue of double spending is solved by the use of a peer-to-peer distributed timestamp server which will result in computational proof of the order in which the transactions in question took place.[167] This would ensure the authenticity of the transactions as the first one

[159] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 35.
[160] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[161] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 35,39 and 43.
[162] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[163] Ibid.
[164] Ibid.
[165] Ibid.
[166] Ibid.
[167] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 18. Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.

would inadvertently be the original one. This is how the system tracks and records facts about cryptocurrency transactions.

Bitcoin transactions are essentially made up of a chain of digital signatures by various owners of electronic 'coins'[168] which are constantly being transferred to the next owner via such digital signatures.[169] The signatures may be verified by the person receiving the coin, however they may not be able to ensure that one of the owners further up in the chain of ownership did not double-spend the coin.[170] In terms of a traditional financial system, this issue would be inadvertently mitigated (and thus not be a point of contention) by central authority as centralised financial institutions verify and oversee each transaction. However, due to the fact that Bitcoin is not regulated by centralised authority, the payee needs to be assured via the system that the previous owner of the coin did not 'sign' any previous transactions.[171] This is accomplished by the transactions being available publicly on a ledger, which enables the earliest transaction (which is the only significant transaction as it will verify *when* the coin has been spent) to be tracked, thus eliminating the possibility of double spending.[172] The method of recording each transaction chronologically on a public ledger and thus verifying the authenticity thereof is achieved via a timestamp server, which proves the existence of each transaction's data as and when it exists in the chain of transactions.[173]

Even though the transactions are recorded publicly, this does not mean that users of Bitcoin (and other decentralised cryptocurrency) can be identified. Public keys in Bitcoin transactions are kept anonymous as the nature of the system is based on user anonymity.[174] Users as well as the public can see when and if someone is sending an amount/funds to someone else, but no information is provided which links the transaction to anyone.[175] Thus, the transactions are recorded in their entirety, but the users who transact using Bitcoin (or another cryptocurrency) remain anonymous. This proves to be an issue in terms of the regulation of cryptocurrency in general as the users of the systems and owners of the coins (in the case of Bitcoin) cannot be

[168] In other words, Bitcoin units.
[169] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[170] Ibid.
[171] Ibid.
[172] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 12 and 21.
[173] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[174] Ibid.
[175] Ibid.

identified.[176] More specifically, (and in the context of this research) the element of anonymity will inadvertently create friction for taxation authorities in relation to tax evasion, money laundering and fraud.[177]

Khudnev affirms the fact that the element of user anonymity merely provides society with a moral challenge in terms of ensuring that cryptocurrency is used in the correct way.[178] It is submitted that human nature has proven to be erratic, destructive and self-serving, which is why a mere moral obligation will not suffice in terms of ensuring the regulation and proper use of cryptocurrency. It is submitted further that if users are relied on to exercise integrity and honesty when transacting via cryptocurrency (and accounting for or declaring their cryptocurrency earnings in order for the application of general legal and taxation regulations thereto), the system would inadvertently continue to be misused. Herein lies the importance of the regulation of cryptocurrency. Even though users of most cryptocurrency remain anonymous,[179] (which makes the system exceptionally difficult to legally regulate) efficient and effective regulations still need to exist in order to mitigate the volume of incidents of misuse of the cryptocurrency system.[180]

It is submitted that there will always be inherent issues with any financial system, (whether such system is traditional or not) which will allow for misuse thereof as well as fraud related thereto, however, this does not preclude such systems from being legally regulated effectively. Physical cash may be stolen, yet it is still legally regulated. Computers may be hacked, consequently affecting internet banking and user security, however, this traditional financial technology system is still widely used and regulated. Thus, it is evident that all financial

[176] It must be noted however, that if users of cryptocurrency are registered to or download applications (which are indicative of cryptocurrency platforms) where user information is required in order to use these cryptocurrency platforms, the user may be identified as their information is stored on the platform in question. An example of such platform is the popular application Luno, which requires users to submit their personal information (including their email addresses, for example) in order to use the platform.

[177] The issues presented to taxation authority by cryptocurrency and the nature thereof relating to user anonymity will be discussed thoroughly in Chapter 3 and Chapter 4 of this research.

[178] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 23.

[179] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14.

[180] It must be noted that even though users of cryptocurrency may remain anonymous, this would depend largely on the platform which they use in order to facilitate their cryptocurrency transactions. Whilst the digital innovation of blockchain technology ensures anonymity from a mechanical perspective, it is widely accepted that some users of cryptocurrency will have to disclose their information if they use certain platforms/applications in order to trade or facilitate cryptocurrency transactions. In this regard, (and in light of this research) user anonymity is discussed as a potential threat to the regulation of cryptocurrency and a reason upon which the cautious attitude of governments towards cryptocurrency is based. This is due to the fact that the foundation of cryptocurrency (in other words, blockchain technology) is formed upon a system which, by its very nature, operates on user anonymity.

systems are not without their shortfalls and inherent dangers. The nature of cryptocurrency affects the regulatory potential thereof, but with insight, collaboration between authoritative bodies as well as innovative approaches to the regulation of cryptocurrency, it may be possible to impose effective and reasonable legal regulation thereon.

2.3. CATEGORISING CRYPTOCURRENCY IN SOUTH AFRICA

Blockchain technology[181] has been part of the digital and financial sectors since 2008.[182] Since this technology forms what may be characterised as the foundational digital structure of cryptocurrency,[183] it must be noted that the integration of cryptocurrency into the financial sphere has been constantly and rapidly increasing. It is submitted therefore, that considering the fact that cryptocurrency has been part of the financial world for over ten years, there should be more development regarding the regulation thereof. However, to date, the only formal regulatory efforts in terms of cryptocurrency relates to the taxation thereof.[184] It is submitted that the provisions relating to cryptocurrency in the Taxation Laws Amendment Act 23 of 2018[185] are inadequate.[186] Cryptocurrency is not currently recognised as legal tender in any jurisdiction in South Africa.[187] Therefore, the regulation which applies to legal tender (imposed by centralised banking systems) does not apply to cryptocurrency.[188] This means that central banking systems have not assigned legal recognition to cryptocurrency in terms of the payment and investment potential thereof. However, in SA, cryptocurrency is not banned or classified as an illegal payment method, means of exchange or investment.[189]

Even though Reddy and Lawack indicate that cryptocurrency is not recognised as legal tender by centralised banking systems,[190] they neglect to mention the taxation developments regarding

[181] See 1.2.2. for the definition of 'blockchain.'
[182] Evgenii Khudnev *Blockchain: foundational technology to change the world* (Bachelor of Business Administration thesis, Lapland University of Applied Sciences, 2017) 5.
[183] Ibid at 5.
[184] The taxation of cryptocurrency was formalised primarily through the Taxation Laws Amendment Act 23 of 2018.
[185] Taxation Laws Amendment Act 23 of 2018. The Taxation Laws Amendment Act 23 of 2018 will hereinafter be referred to as the 'Tax Amendment Act 2018.'
[186] The grounds for the inadequacy of the provisions therein will be discussed in detail in Chapter 3 of this research, which deals with the taxation of cryptocurrency.
[187] South African Reserve Bank position paper number 02/2014 *Virtual Currencies* (2014) 2.
[188] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2-3.
[189] This is evident in the fact that cryptocurrency has not been formally banned by any authoritative or legal body in South Africa and all authoritative bodies indicate the acceptance of cryptocurrency into the South African economic space. This notion is supported further by the existence of cryptocurrency taxation regulation.
[190] Which contention, it must be noted, the SARB confirms. South African Reserve Bank position paper number 02/2014 *Virtual Currencies* (2014) 2.

cryptocurrency.[191] Even though cryptocurrency has been formally classified by taxation legislation,[192] other sectors which influence cryptocurrency viability in SA have yet to regulate or formally classify cryptocurrency.[193] Whilst the categorisation of cryptocurrency in relation to taxation regulations is the focus of this research, it is important to gauge the general approach to cryptocurrency in the financial sector as taxation law is not the only element which will affect cryptocurrency transactions. Furthermore, other approaches have to be considered holistically in order to determine if the current categorisation by taxation legislation is sufficient and effective in comparison thereto.

The central issue of the classification of cryptocurrency by various sectors and authoritative bodies thus arises.[194] Since it is not recognised as legal tender,[195] but is not an illegal financial technology system, authoritative bodies do not have a coherent and unified view in terms of how cryptocurrency is to be categorised.[196] The lack of consistent and coherent understanding and categorisation of cryptocurrency as well as the lack of regulation thereof across various sectors which are affected by cryptocurrency inadvertently affects the regulatory potential thereof within each sector concerned. Therefore, it is important to ascertain the different interpretations of cryptocurrency and the potential categorisation thereof by various authorities in order to determine the potential effectiveness of these stances. This in turn provides a primary point of consideration where the taxation of cryptocurrency is concerned due to the fact that the classification thereof plays a crucial role in its effective regulation.

2.3.1. The general classification of cryptocurrency

The general definition of cryptocurrency was discussed in Chapter 1 of this research briefly,[197] however, an in-depth analysis of the general classification of cryptocurrency must be undertaken in order to fully ascertain the functioning and implications thereof. This will serve as the foundation for the analysis of more specific categorisations[198] of cryptocurrency by

[191] It must be noted that even though Reddy and Lawack's journal article was written in 2019 and addressed the taxation of cryptocurrency as well as the IFWG paper on crypto assets, (which was released in 2019) the journal article makes no mention of the Draft Taxation Laws Amendment Bill of 2018, which did include provisions relating to the taxation of cryptocurrency.
[192] Taxation Laws Amendment Act 23 of 2018.
[193] Annamart Nieman 'A few South African cents' worth on Bitcoin' (2015) 18 *PELJ* 5 at 1988.
[194] It must be noted that SARS' categorisation/ classification of cryptocurrency will be discussed thoroughly at 3.3. below, thus it is omitted in the scope of chapter 2 accordingly so as to avoid repetition.
[195] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2-3.
[196] The inconsistent categorisation of cryptocurrency by South African authoritative bodies will be discussed below and reflected through the exposition of content at 2.3.1-2.3.5.
[197] See 1.2.4. above for the general definition of 'cryptocurrency'.
[198] These categorisations will be discussed below, from 2.3.2. onwards.

authoritative bodies and academics. It must be noted that in SA specifically, there exists no formal and independent definition of cryptocurrency in any legislation to date.[199] It must be noted further that, internationally, there are various regulations which pertain to cryptocurrency that may be more extensive, but in SA there is less growth in terms of cryptocurrency regulation. The lack of a formal legislative categorisation[200] of cryptocurrency attests to this. The South African perspective on the categorisation of cryptocurrency must be analysed primarily, in order to ascertain SA's stance on cryptocurrency so that the regulation thereof may be effective. If the South African stance on cryptocurrency is properly analysed, it may serve as an indication of how much development the country needs in terms of understanding cryptocurrency so that it may be regulated effectively.

Cryptocurrency is understood to be an alternative payment system and categorised generally as a type of financial technology.[201] Cryptocurrency is a financial technology innovation[202] which operates in the digital realm and facilitates a variety of transactions such as (but not limited to) the buying and selling of goods and services, investment and the storing of value.[203] Even though cryptocurrency is not part of a traditional financial system, the use thereof has the potential to affect the economy.[204] It is submitted that this is due to the fact that cryptocurrency is widely used to transact and acts as a conduit for the exchange of value, which is primarily what traditional financial systems are used for. Thus, by rapidly integrating cryptocurrency into a society which functions on the growth of economies via traditional financial systems and regulated financial technology systems, the use of cryptocurrency as an alternative method of payment or investment will inadvertently affect traditional financial services.

Cryptocurrency may be used in the facilitation of the exchange of value as well as the storage of value.[205] In this regard, cryptocurrency may be transferred between users through virtual transactions.[206] Whilst different authoritative bodies have various interpretations and classifications of cryptocurrency,[207] it is generally accepted that cryptocurrency may be bought,

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[199] Lucrecia Sadhaseevan *The regulation of cryptocurrencies in the context of South Africa's financial sector* (LLM thesis, University of KwaZulu-Natal, 2019) 19.
[200] Ibid at 19.
[201] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.
[202] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 4.
[203] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.
[204] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 4.
[205] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 2.
[206] Ibid at 2.
[207] These various classifications will be discussed below, from 2.3.2. onwards.

sold and invested in by users.[208] Even though South Africans do not generally use cryptocurrencies to pay for goods and services,[209] it must be noted that the fact that users may use cryptocurrencies for this purpose indicates that even though cryptocurrency is a unique system, it may in any event fulfil the purposes for which traditional payment systems are used. It is submitted that this alludes to the fact that cryptocurrency will, in future, be integrated into the financial sector progressively and used widely in a capacity which is not merely supplementary to traditional financial systems, but parallel thereto.

2.3.2. The categorisation of cryptocurrency in terms of legislation

Any legislative categorisation of cryptocurrency must be referred to first in order to gain a holistic perspective in terms of the progress SA has undergone (and is still to undergo) in terms of regulating cryptocurrency. Currently, the only legislation which addresses cryptocurrency relates to the taxation thereof, as is evident in the Tax Amendment Act 2018,[210] where the taxation regulation of cryptocurrency first arose. Whilst the purpose of this chapter is to analyse the categorisation of cryptocurrency as well as the uses and functioning thereof, the Tax Amendment Act 2018[211] must be mentioned as it provides a more formal indication of how cryptocurrency is categorised for taxation purposes specifically.[212] This may indicate further how cryptocurrency is to be treated in terms of other areas of law, however, to date, no other major legislative developments in this regard have been made.

A detailed analysis of the cryptocurrency provisions in the Taxation Amendment Act will be discussed in Chapter 3, however, the categorisation of cryptocurrency as it appears therein must be mentioned in this chapter as it is of relevance in accordance with the South African stance on cryptocurrency. According to the Taxation Amendment Act, cryptocurrency is categorised as a 'financial instrument.'[213] The classification of cryptocurrency as a financial instrument will have consequences[214] in terms of the taxation of cryptocurrency specifically.

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[208] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 16.
[209] Ibid at 16.
[210] Taxation Laws Amendment Act 23 of 2018.
[211] Ibid.
[212] The Tax Amendment Act 2018 is discussed as the preliminary taxation regulation of cryptocurrency, as it has since been amended by virtue of the Taxation Laws Amendment Act 23 of 2020, which is discussed throughout Chapter 3 of this research. The Tax Amendment Act 2018 is however, still relevant in that the basis of cryptocurrency taxation regulation as it exists therein remains the basis upon which the Taxation Laws Amendment Act 23 of 2020 operates.
[213] Ibid at s 1(1) (*f*).
[214] Some of the implications of the classification of cryptocurrency as a 'financial instrument' include: the consideration of section 22(1) of the Income Tax Act 58 of 1962 (which relates to closing stock) in conjunction

2.3.3. The South African Reserve Bank's categorisation of cryptocurrency

A prevalent issue to consider in terms of the classification of cryptocurrency is which authoritative body should have the capacity to regulate and classify cryptocurrency.[215] Reddy and Lawack contend that cryptocurrency is in direct competition with and an opposing force to legal tender as cryptocurrency is a decentralised system and only central banks have the authority to decree legal tender status.[216] Even though cryptocurrency is not formally recognised as legal tender,[217] it is submitted that due to the fact that cryptocurrency may be used legally to transact, deeming it an opposing force to legal tender may not be a true reflection of the nature of cryptocurrency. Cryptocurrency may be used for trading purposes as well as buying goods,[218] which is exactly what legal tender may be used for. Therefore, labelling cryptocurrency as a system which is in direct opposition to legal tender is largely inaccurate. This therefore brings the issue of which authoritative body will have the power to formally classify and regulate cryptocurrency to the fore. If cryptocurrency is not considered to be legal tender but is also not technically an opposing force to legal tender, then it may be possible for centralised banks to contribute to the regulation of cryptocurrency in future. This is why SARB's position (and other authoritative bodies, such as SARS) is vital and must be analysed in order to gain a holistic understanding of cryptocurrency, thus determining any possible involvement of centralised banks in terms of the regulation of decentralised financial systems.

In terms of chronology, SARB's position must be considered first as it released a position paper on cryptocurrency in 2014. This particular position paper may only be analysed in retrospect due to the fact that it was released in 2014 and since then, there have been developments in regard to cryptocurrency and the rapid integration thereof into the economic sector. In the paper, SARB maintains that even though it will not regulate cryptocurrency, it categorises virtual currency as a digital representation of value which may be used as a medium of exchange, unit of account and a digital system with value-storing potential.[219] This notion of

with the fact that discrepancies will arise between income and expenses when calculating taxable income, and the consideration of whether CGT may apply when considering the fact that cryptocurrency is to be accounted for as a financial instrument. (The second consideration includes the point of contention regarding the lack of clarity surrounding CGT and cryptocurrency, which is discussed bellow at 3.7.) The meaning as well as implications of this categorisation as it relates to cryptocurrency will be expanded upon in detail in Chapter 3 of this research. (See 3.4.1. below for a discussion on the taxation of cryptocurrency as a financial instrument)

[215] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 3.

[216] Ibid at 2-3.

[217] Ibid at 2-3.

[218] Ibid at 22.

[219] South African Reserve Bank position paper number 02/2014 *Virtual Currencies* (2014) 2.

cryptocurrency being a digital representation of value has paved the way for various interpretations of the classification of cryptocurrency across various sectors.

SARB acknowledges that cryptocurrency does not function in conjunction with traditional banking and payment systems, but also notes the fact that virtual currencies may either be centralised or decentralised, and convertible or non-convertible.[220] Bitcoin is an example of a decentralised and convertible virtual currency, as it can be valued in terms of actual currency as well as exchanged for real currency values.[221] Centralised and non-convertible virtual currencies are less popular and cannot be exchanged for real currency values.[222]

These preliminary facts within SARB's position paper are important to note due to the fact that they are factors which determine the way in which SARB views cryptocurrency and the challenges it envisages in regard to the regulation thereof. In this regard, SARB recognises the inherent dangers in cryptocurrency, given their decentralised nature. Another issue which SARB mentions briefly is the price volatility of cryptocurrency, which inadvertently creates a high risk for users investing therein.[223] Even though this issue is brought to light, the potential for growth of cryptocurrency in the financial sector is (to a small extent) affirmed by SARB, which indicates that it acknowledges the possibility for cryptocurrency to be formally integrated into SA's economy.

By referring to the issue of legal tender and the relation between cryptocurrency and the exclusive capacity of centralised banks to manage legal tender, it can be seen that a similar analysis is evident in SARB's position paper. Only SARB is allowed to issue legal tender which may be offered to a creditor in terms of the payment used to discharge an obligation.[224] Furthermore, the paper indicates that decentralised cryptocurrency should not be used as payment in order to discharge an obligation in a manner which '… suggests they are perfect substitute of legal tender.'[225] This indicates the fact that SARB is not willing to recognise cryptocurrency as legal tender (to date). This, however, does not mean that cryptocurrency does not contain value or cannot be used legally to transact in a digital sense.

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[220] Ibid at 2.
[221] Aaron Wright and Primavera De Filippi *Decentralized blockchain technology and the rise of lex cryptographia* (Legal academic paper, Yeshiva University – Benjamin N. Cardozo School of Law, 2015) 9.
[222] South African Reserve Bank position paper number 02/2014 *Virtual Currencies* (2014) 2. Interestingly, an example of such centralised and non-convertible virtual currency is World of Warcraft Gold, which exists digitally and cannot be exchanged in terms of existing currency.
[223] Ibid at 2.
[224] Ibid at 4-5.
[225] Ibid at 5.

Since SARB outlines and explains the risks of cryptocurrency thoroughly,[226] it seems as if the Bank is sceptical in regard to the nature of cryptocurrency as well as the way in which virtual currencies may be used. It is acknowledged that cryptocurrency will reduce costs associated with centralised banks but asserts the fact that cryptocurrency systems may serve as vehicles for problems such as money laundering, the financing of terrorism as well as the possible disruption of the financial system.[227] Furthermore, the fact that there is a lack of legal infrastructure supporting and regulating cryptocurrency systems, users thereof do not have as much protection as users of traditional banking systems or even traditional financial technology systems have.[228] The wording used by SARB in discussing the risks inherent in cryptocurrency systems is indicative of a warning to users as it is indicated that users of cryptocurrency must be aware of the possibility of them losing their money.[229] This immediately portrays a notion of caution in regard to the use of cryptocurrency, which adds to the determining factors of SARB's stance thereon.

Furthermore, when addressing the issue of the financial stability of cryptocurrency in conjunction with the country's financial system, SARB seems to maintain its reservations. This is reflected not only in the cautious tone of the paper, but specifically in the wording used when the discussion of financial stability transpires. SARB maintains that the financial instability of virtual currencies lies in the disruption of the functioning of traditional payment systems by such virtual currency systems.[230] It is submitted that even though cryptocurrency is an alternative method of payment and transacting, there is little evidence which suggests that cryptocurrency directly affects the smooth functioning of traditional payment systems. Cryptocurrency may be in 'competition' with traditional payment systems, however, it is submitted that cryptocurrency itself does not disrupt the operational or technical aspects of traditional financial systems. SARB points out that the link between the real economy and cryptocurrency would stimulate the financial instability of (specifically decentralised) virtual currency.[231] It is submitted in this regard, that if cryptocurrency is regulated in its own capacity, this supposed link between cryptocurrency and traditional payment systems (which causes

[226] These risks include: the exploitation of the cryptocurrency system for illegal purposes, the legal uncertainties associated with cryptocurrency use in conjunction with the risk regarding the price volatility of cryptocurrency, the safety of cryptocurrency payment systems, the credit and liquidity risks associated with cryptocurrency, the potential risk of money-laundering and financial terrorism and the long-term financial stability of cryptocurrency.
[227] South African Reserve Bank position paper number 02/2014 *Virtual Currencies* (2014) 5.
[228] Ibid at 6.
[229] Ibid at 6.
[230] Ibid at 12.
[231] Ibid at 12.

financial instability) would inadvertently be broken. This is due to the fact that risks facing traditional financial systems would be mitigated by the effective regulation of cryptocurrency. This would mean that traditional financial systems would be protected (insofar as the financial system in general is concerned) by virtue of the fact that cryptocurrency would be legally regulated.

SARB affirms the fact that it does not '… oversee, supervise or regulate the VC[232] landscape…'[233] and goes on to mention that whilst virtual currencies do not pose a significant risk, SARB will monitor any related developments.[234] It is submitted that even though it is clearly stated that virtual currencies do not pose significant risks, the contents of the position paper and cautious stance SARB adopts suggests otherwise. Even though SARB distances itself from the regulation of cryptocurrency as it mentions that it does not have a responsibility to regulate it,[235] it is submitted that the Bank should play a more active role going forward in terms of cryptocurrency as it affects the country's national payment system. Even though the position paper is merely a source of information about virtual currencies, it may be referred to in order to reflect on SARB's position in relation to the regulation of cryptocurrency. This further attests to the general South African stance on cryptocurrency and the regulation thereof.

In a separate document released by SARB,[236] the Bank seems to adopt an optimistic tone in regard to financial technology in general. The need for regulation and change in financial, legal and digital sectors is identified by SARB in the national payment strategy vision it released which addresses the need for development in these areas in an attempt to curb economic challenges[237] emerging therefrom.[238] This solidifies SARB's efforts to address economic challenges going forward. It is submitted that this identification of the need for economic development and reform is closely linked to the potential for cryptocurrency regulation. Even though cryptocurrency is not mentioned specifically in the document, it is mentioned that SARB's vision includes '…extend[ing] the availability of digital payment services to all sectors of society…'[239] One of the goals of SARB in this regard is to promote flexibility and adaptability in the financial sector.[240] This therefore illustrates SARB's readiness to develop

[232] Virtual currency.
[233] South African Reserve Bank position paper number 02/2014 *Virtual Currencies* (2014) 12.
[234] Ibid at 12-13.
[235] Ibid at 12.
[236] South African Reserve Bank *The National Payment System Framework and Strategy – Vision 2025* (ND).
[237] These challenges include poverty, inequality and the need for economic growth in South Africa.
[238] South African Reserve Bank *The National Payment System Framework and Strategy – Vision 2025* (ND) 1-2.
[239] Ibid at 3.
[240] Ibid at 4.

the financial sector in a way which will be beneficial to economic growth in the country.[241] There is no evidence of an attempt by SARB to regulate cryptocurrency and the position paper it released on virtual currencies reflected the Bank's cautious stance thereon. But the Bank's openness to change and innovation in the financial and digital sectors (in regard to financial technology in general) indicates that there is indeed a need for reform where the regulation of cryptocurrency is concerned. Furthermore, in consideration of the strong link between SARB and SARS in terms of administrative regulation where transactions, currency, legal tender and other financial facets are concerned, it is submitted that SARB's stance will influence the taxation regulation of cryptocurrency to a large degree. It is submitted further, that since one of the IFWG's purposes is to analyse and implement the objectives of these authoritative bodies, its stance will also influence the taxation regulation of cryptocurrency accordingly.

2.3.4. The Intergovernmental Fintech Working Group's categorisation of cryptocurrency

An advisory body, the IFWG, has a more specific analysis on the categorisation of cryptocurrency. The IFWG is a South African group of 'financial sector regulators'[242] which was formed in order to address this issue of inconsistency regarding the understanding of financial technology (including cryptocurrency) as well as the lack of cohesion regarding the categorisation of cryptocurrency by the various sectors which influence cryptocurrency transactions.[243] The IFWG aims to provide a space to encourage the advancement of innovation as well as experimentation in regard to financial technology in conjunction with the regulation thereof.[244] The National Treasury, the Financial Intelligence Centre, the Financial Conduct Authority, the National Credit Regulator, SARB as well as the SARS are authoritative bodies which collaborate with the IFWG in order to address the integration of financial technological innovation within the financial sector and the regulation thereof.[245] The primary aim of the IFWG is to assess the ways in which financial technology can be regulated effectively.[246] It is submitted that the development of this group in SA is a progressive step towards ensuring the regulation of financial technology. The position paper which the IFWG released on crypto

[241] Ibid at 3.
[242] Intergovernmental Fintech Working Group 'About us' available at *https://www.ifwg.co.za/about-us/*, accessed on 2 August 2020.
[243] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020).
[244] Intergovernmental Fintech Working Group 'About us' available at *https://www.ifwg.co.za/about-us/*, accessed on 2 August 2020.
[245] Ibid.
[246] Ibid.

assets reflects not only a collaborative stance on cryptocurrency (as other authoritative bodies have collaborated with the IFWG in terms of assessing the regulation of cryptocurrency) but also the lack of a cohesive understanding of cryptocurrency by South African financial authority.

The IFWG uses the term 'crypto assets'[247] assuredly when referring to cryptocurrency.[248] This illustrates the classification of cryptocurrency immediately, as it assigns this specific term to cryptocurrency in order to define it. In this regard, it is submitted that classifying cryptocurrency is important since this creates certainty regarding the treatment thereof in terms of the law. It is submitted further that this categorisation of cryptocurrency by the IFWG would allow SARS to effectively implement their taxation regime. This is due to the fact that categorising cryptocurrency as 'crypto assets' is favourable to SARS' categorisation[249] thereof in that SARS has indicated that it considers cryptocurrency as intangible assets.[250] It is submitted however, that this categorisation ought to be explored and formalised via legislation.[251]

The IFWG categorises crypto assets as financial technology innovations which also function as mediums of exchange which have digital value.[252] This is similar to SARB's categorisation in that cryptocurrency is considered as a medium of exchange by both authoritative bodies. However, the IFWG delves further into the categorisation of cryptocurrency as it indicates three types of crypto asset tokens,[253] which make up crypto assets.[254] Classifying crypto assets

[247] 'Crypto asset' is defined above at 1.2.3.
[248] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 3. This change in terminology from 'cryptocurrency' to 'crypto assets' may be explained when considering the fact that, according to the IFWG, central banks have been hesitant to refer to this digital innovation as 'currency' since cryptocurrency is not considered as legal tender. It is submitted that the IFWG took this into consideration when deciding to formally refer to 'cryptocurrency' as 'crypto assets.' It may also be inferred that the IFWG took the taxation implications of 'cryptocurrency' being referred to as 'crypto assets' into consideration in terms of the potential capital gains tax liability associated with the disposal of assets. This contention (relating to cryptocurrency as assets for the purposes of capital gains tax) however, is discussed below at 3.3.2. and 3.7.
[249] SARS' stance on cryptocurrency will be discussed thoroughly in Chapter 3 of this research, which deals specifically with the taxation of cryptocurrency.
[250] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.
[251] Even though the Tax Amendment Act 2020 refers to cryptocurrency as 'crypto assets,' the legislation is silent as to what this means in terms of the possible CGT implications and whether merely refering to cryptocurrency as 'crypto assets' constitute sufficient grounds for users of cryptocurrency to assume that the disposal of their cryptocurrency will be subject to CGT if they make a capital gain on the proceeds of the cryptocurrency transactions. See 3.3.2. and 3.7. below for a discussion on cryptocurrency and CGT in conjunction with the general CGT principles and the Tax Amendment Act 2020 respectively.
[252] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 8.
[253] Elements of crypto assets which indicate the different uses thereof.
[254] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 8.

into tokens merely indicates the various uses of cryptocurrency. The token names symbolise the different uses of crypto assets but are not physical sub-divisions thereof.[255] These three tokens are: exchange or payment tokens, security tokens and utility tokens.[256]

Exchange tokens represent how crypto assets may be used as a means of payment for buying goods and services or investing and security tokens are representative of ownership rights, rights to the repayment of money and entitlements to future profits.[257] Utility tokens may be used for access to certain products or services which are provided to users by way of the use of a DLT[258] platform.[259] These three tokens may be seen as sub-categories of crypto assets or cryptocurrency. By separating the uses of crypto assets by these three tokens, the IFWG sets out clearly the financial categories which cryptocurrency may fit in to. It is submitted that this will improve the regulation potential of cryptocurrency, as the specificity of the categorisation thereof brings SA closer to classifying cryptocurrency formally across all sectors.

However, the IFWG's position paper on crypto assets does not categorise cryptocurrency in the same way as the Tax Amendment Act 2018[260] in the sense that it makes no mention of cryptocurrency being formally categorised as a financial instrument[261] by this Act.[262] It is submitted that (at the point when the IFWG paper was released) an analysis of the Tax Amendment Act 2018[263] or even the Draft Taxation Laws Amendment Bill of 2018[264] would be useful, considering the fact that the IFWG was formed in order to create a unified understanding of financial technology across various sectors. The fact that the paper makes no mention of taxation legislation which came into effect in 2019[265] (considering the fact that the IFWG paper was released in 2020) is a shortfall in terms of the group's aim of providing a

[255] Ibid at 8.
[256] Ibid at 9.
[257] Ibid at 9.
[258] Distributed ledger technology.
[259] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 9.
[260] Taxation Laws Amendment Act 23 of 2018.
[261] The Taxation Laws Amendment Act will be discussed thoroughly in Chapter 3 of this research, which deals specifically with the taxation of cryptocurrency.
[262] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020). Even though it may be contended that this is merely a matter of 'semantics' as financial instruments are indicative of the nature of assets in general, it is submitted that there should not be a lack of cohesion in the terminology used by the IFWG and the authoritative bodies which it endeavours to represent. This lack of cohesion (as discussed throughout chapter 2 above) contributes to the lack of effective regulation of cryptocurrency.
[263] Taxation Laws Amendment Act 23 of 2018.
[264] Draft Taxation Laws Amendment Bill of 2018. The Draft Taxation Laws Amendment Bill of 2018 will hereinafter be referred to as the 'Draft Tax Bill.'
[265] Taxation Laws Amendment Act 23 of 2018.

cohesive and unified stance (in collaboration with other authoritative financial bodies) on financial technology.

Even though the paper makes no mention of taxation legislation which classifies cryptocurrency as a 'financial instrument,'[266] it does mention the possibility of cryptocurrency being used as a financial instrument. The paper indicates that crypto assets may be classified as an underlying asset of a derivative instrument.[267] A derivative instrument may be a financial instrument or contract which '… creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event.'[268] This approach would support the Tax Amendment Act 2018[269] to a certain extent, as it places crypto assets in the realm of financial instruments, even though the IFWG does not define crypto assets as such.

Furthermore, the IFWG makes a recommendation that initial coin offerings[270] should be regulated in terms of financial instrument regulation.[271] Even though the position paper was released only a year after the Tax Amendment Act 2018[272] came into effect, it was released two years after the Draft Tax Bill[273] was released yet it does not address the formal categorisation of cryptocurrency as a financial instrument. It is submitted that, considering the IFWG was formed in order to provide a cohesive standpoint on cryptocurrency and the regulation thereof,[274] the paper it released should at least be reflective of any potential formal regulation of cryptocurrency. In other words, the paper should have mentioned the fact that cryptocurrency will potentially be categorised formally in terms of taxation regulation. It is submitted that even though the Draft Tax Bill applies to taxation regulations specifically, defining cryptocurrency in terms of any area of law will influence how cryptocurrency is regulated and treated generally.

[266] Ibid.
[267] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 14.
[268] Financial Markets Act 19 of 2012: s 1.
[269] Taxation Laws Amendment Act 23 of 2018.
[270] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 7. According to the IFWG position paper, initial coin offerings (hereinafter referred to as 'ICOs') are '… a means of raising capital using distributed ledger technology.' The funds which are accumulated via the ICOs are used to finance certain technological projects such as software program building. The investor receives a token in exchange for financing such projects, which is representative of a right to receive dividends or other types of rights such as (*inter alia*) voting rights or property rights.
[271] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 30.
[272] Taxation Laws Amendment Act 23 of 2018.
[273] Draft Taxation Laws Amendment Bill of 2018.
[274] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020).

Lastly, in order to gauge the parameters of the South African legal position on cryptocurrency, an attempt must be made to review SA's general policy position in regard thereto. SA's current stance in the cryptocurrency debacle is summarised well by the IFWG position paper.[275] The paper crystallises the fact that regulatory authorities in SA do in fact acknowledge crypto assets as a new financial innovation[276] and also mentions that if regulatory safeguards permit, cryptocurrency use is to be welcomed and allowed.[277] The position paper indicates that the regulatory approach in regard to cryptocurrency has been set out and is still to be implemented.[278] It further indicates that other compilations such as the draft Conduct of Financial Institutions Bill[279] as well as the 2020 Financial Markets Review[280] were considered in the position paper and may have an effect on regulatory developments in regard to financial technology.[281] Whilst the IFWG neglected to mention the development of taxation regulation of cryptocurrency, it is submitted that the position paper is the most in-depth and constructive account of future regulatory developments concerning cryptocurrency. The way in which cryptocurrency is categorised by the IFWG is effective in that it covers all areas of concern in regard to how cryptocurrency may be used and the consequences thereof.

After considering the multiple categorisations of cryptocurrency by both authoritative bodies and academics, (in terms of taxation law as well as the financial, legal and digital sectors in general) it can be deduced that there is a lack of cohesion in the understanding of cryptocurrency as well as the formal classification thereof. A consistent categorisation of cryptocurrency by all authoritative bodies which have influence over the regulation thereof needs to be present in order to adequately control the digital system.

2.3.5. Cryptocurrency as virtual property

In analysing the categorisation of cryptocurrency, it is important to obtain a holistic perspective, which is why various opinions must be accounted for. Not only are opinions of authoritative bodies to be considered, but also, those of academics whose fields of study may relate to cryptocurrency, and more specifically, the way in which cryptocurrency is to be categorised. An interesting categorisation (from a South African perspective) of

[275] Ibid at 23.
[276] Ibid at 23.
[277] Ibid at 23.
[278] Ibid at 23.
[279] Draft Conduct of Financial Institutions Bill of 2018.
[280] The Financial Markets Review *Financial Markets Review 2020* (2020).
[281] Ibid.

cryptocurrency is provided by Erlank in his journal article on virtual property.[282] This article was published in 2015, so it will be analysed in retrospect as there have since been further developments in regard to cryptocurrency. Even though the nature of cryptocurrency may not allow for this type of formal categorisation, it must still be considered as this particular viewpoint is valuable in determining various possibilities where cryptocurrency classification is concerned. This viewpoint also serves to illustrate the notion that since there is no formal definition of cryptocurrency in legislation, the regulation of cryptocurrency in various fields of law (to date) is open-ended.

Erlank contends that whilst the term 'virtual property' is subjective, it refers specifically to immaterial property.[283] Virtual property is property which indeed exists, even though one cannot see or touch it.[284] Erlank states that Bitcoin is a form of virtual property.[285] Since Bitcoin is a type of cryptocurrency, it may be inferred that cryptocurrency may be categorised as virtual property. The issue of the taxation of virtual property has been a point of contention, since there has been past academic debate around whether assets amounting to virtual property should be taxed at all.[286] Erlank notes that the movement towards taxing virtual property is gaining traction globally and infers that the need for regulation of virtual property has become imminent. Academics are therefore accepting that there is a need for the regulation of virtual property.[287] If cryptocurrency is to be categorised as virtual property and classified in terms of property law, ownership and transfer thus become points of debate.[288] It is submitted that due to the nature of cryptocurrency and the user anonymity thereof, categorising it as virtual property may have challenging consequences. One such consequence which may be faced if cryptocurrency is to be categorised as virtual property is the issue of ownership rights.[289]

Developers as well as users may both have ownership rights over the cryptocurrency in question if it is categorised as virtual property and functions in terms of property law.[290] The point of contention in this regard is that it is not clear whether the developer of the cryptocurrency in question or the owner of the cryptocurrency will have full ownership rights. It is submitted that this consequence is unfounded, due to the fact that blockchain technology

[282] Wian Erlank 'Introduction to virtual property: lex virtualis ipsa loquitur' (2015) 18 *PELJ* 7.
[283] Ibid at 2525-2526.
[284] Ibid at 2526.
[285] Ibid at 2542.
[286] Ibid at 2542.
[287] Ibid at 2542.
[288] Ibid at 2542.
[289] Wian Erlank 'Introduction to virtual property: lex virtualis ipsa loquitur' (2015) 18 *PELJ* 7.
[290] Ibid at 2543.

ensures that transactions (and the facts thereof) are recorded on a public ledger.[291] Thus, ownership of the cryptocurrency in question is established by virtue of the nature of blockchain technology in that timestamps and computational mathematical verification methods are used to authenticate which user in the chain actually owns the cryptocurrency.[292] In terms of property law however, ownership (in terms of identifying a user and assigning ownership rights thereto) will be an issue due to the fact that users of cryptocurrency systems remain anonymous.[293]

Another issue which may be inferred therefrom is whether the developer of the cryptocurrency in question may have limited rights to the cryptocurrency if it is to be regarded as property. It is submitted however, that due to the nature of cryptocurrency,[294] it would be practical for the user to maintain ownership rights over the cryptocurrency in question. Whilst the mechanics of cryptocurrency have been discussed above,[295] it must be noted further that due to user anonymity in relation to cryptocurrency transactions, ownership rights may be unclear. This is due to the fact that the identity of the owners of cryptocurrency remain anonymous as cryptocurrency transactions require no real-world information from users thereof.[296]

Based on the fact that user anonymity is a facet of cryptocurrency transactions, if cryptocurrency were to be categorised as property and function within the parameters of property law, the liability of a user in terms of the ownership of cryptocurrency may also be uncertain.[297] Since users of cryptocurrency remain anonymous[298] it may be difficult to establish ownership due to the fact that the actual identity of the user cannot be established.[299] This would mean that even though the actual cryptocurrency transaction is recorded by the blockchain system, the person who made the transaction remains unknown.[300] Some cryptocurrency platforms (such as Luno) allow for real world personal information about users

[291] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[292] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[293] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14. The issue of user anonymity was discussed above at 2.2. thoroughly and indicates the fact that even though each transaction is recorded, no personal information from cryptocurrency users is recorded, thus, there are no real world links (in most cases) between the actual user of the cryptocurrency and the transaction in question.
[294] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[295] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[296] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14.
[297] Wian Erlank 'Introduction to virtual property: lex virtualis ipsa loquitur' (2015) 18 *PELJ* 2543.
[298] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14.
[299] Ibid at 14.
[300] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.

to be linked to the system itself, however, user anonymity is still an element of most cryptocurrency[301] which are available on various platforms.[302]

Furthermore, if '… bitcoin addresses are mixed up or scrambled, then transferred to an exchange platform and subsequently cashed out, it becomes impossible to link the cryptocurrency transactions in question to the real-world user of the cryptocurrency.[303] The anonymous nature of cryptocurrency transactions thus makes it difficult to ascertain the identity of the owner of the cryptocurrency in question.[304] It is submitted that this may create an issue in terms of taxation liability (if cryptocurrency is to be considered as property) as there would be uncertainty as to who would be liable to pay tax on the cryptocurrency earnings in question if there is ambiguity in terms of the identity of the owner of the cryptocurrency.[305] Erlank does not expand on this issue in relation to cryptocurrency, however it is submitted that categorising cryptocurrency as virtual property in terms of property law specifically[306] may be the cause of complications arising in respect of ownership and the rights associated therewith, as discussed above. In terms of the taxation of virtual property, the nature of cryptocurrency[307] would make it exceptionally difficult to regulate effectively if it is considered to be virtual property in terms of property law.

[301] For example, Bitcoin, which is based on user anonymity depending on whether the user decides to transact via a platform that can trace their personal information or not.
[302] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14.
[303] Ibid at 15.
[304] Ibid at 14.
[305] Wian Erlank 'Introduction to virtual property: lex virtualis ipsa loquitur' (2015) 18 *PELJ* 2543.
[306] It must be noted that this point is raised on the basis of cryptocurrency being considered as virtual property for the purposes of property law specifically, which would entail the application of ownership regulations associated with property law considerations. This is the foundation upon which (as discussed under this heading) the submission is made that for the purposes of property law, cryptocurrency should not be considered as virtual property as the particulars of the ownership thereof is not easily ascertainable. It is submitted that this does not preclude cryptocurrency from being considered an asset, and more specifically, an asset for the purpose of CGT, provided that the element of user anonymity is taken into account. See 3.3.2. and 3.7. below for a discussion on CGT.
[307] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.

CHAPTER 3

CRYPTO ASSETS AS A CHALLENGE IN THE LEGAL SPHERE WITH SPECIFIC REFERENCE TO TAXATION REGULATIONS

3.1. OVERVIEW

The concept of crypto assets[308] is challenging in that the mechanics are difficult to understand, thus complicating the use of CAs in real-world situations. Financial systems operate in conjunction with economies, society and technology. This suggests that financial technology systems specifically, should be regulated in accordance with economic standards which have been formed in societies which operate on the basis of functional financial systems. In order for users to transact appropriately, regulations need to be in place for all financial systems to operate in accordance with the law. It is submitted that taxation laws serve as the foundation of a country's socio-economic functioning. This is due to the fact that governments are able to use the money they obtain via taxation in order to run their countries for the benefit of their citizens. Thus, a strong link is created between taxation and the operation of a country. Without taxation, countries may not be able to function efficiently. Without taxation regulations, the effective functioning of a country's financial sector would slowly regress. Since CAs are rapidly being integrated into the financial sector, they must be regulated and subjected to taxation regulations in order to prevent tax evasion.[309]

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[308] Crypto assets will hereinafter be referred to as 'CAs.' A preliminary note in respect of chapters 3-5: in chapters 3-5, the digital innovation which has been referred to as 'cryptocurrency' in chapters 1-2 will be referred to as 'crypto assets,' but will be taken to mean the same as the widely used and well-known term 'cryptocurrency.' It must be noted that the reason as to why the digital innovation was stated as 'cryptocurrency' in the initial chapters of this research, is due to the fact that the reference to 'cryptocurrency' (in general) as 'crypto assets' is a new development in SA and has been a point of contention. In order to detail this point of contention in relation to the classification of 'cryptocurrency' (as it is generally termed) and the interplay between the various categorisations thereof as mentioned in chapter 2 of this research, the digital innovation has been referred to as the umbrella term of 'cryptocurrency' thus far in the research. This has enabled the analysis of the very issue of the classification of cryptocurrency through this research. However, from chapters 3-5, the term 'crypto assets' will be used as it is the term referred to in the Tax Amendment Act 2020 and is also the term referred to by the IFWG accordingly. Where necessary however (in order to further illustrate the issue of the classification/formal wording of the term), the term 'cryptocurrency' may be used. For example, if the issue of the classification of 'cryptocurrency' as 'crypto assets' is specifically discussed (in chapters 3-5), the term 'cryptocurrency' will then be used as the context requires. Furthermore, where the source being referred to makes reference only to 'cryptocurrency,' (for example, in SARS' statement on cryptocurrency) the term 'cryptocurrency' will be used accordingly. For the purpose of the headings and sub-headings in chapters 3-5, where the source/ authoritative body in question which is being analysed has referred to 'cryptocurrency,' the heading will reflect same in order to accurately account for the source being used in relation to the respective heading.

[309] A complete analysis of tax evasion as well as tax avoidance relating to CAs will be made in Chapter 4 of this research at point 4.2 and 4.3. below.

However, due to the nature of CAs,[310] they have proven to be difficult to regulate – especially in accordance with existing taxation regulations. In SA specifically, there has not been much development in regard to the taxation regulation of CAs until recent years. This chapter therefore serves as an analysis of the challenges faced insofar as CA taxation regulation is concerned. Furthermore, this chapter will provide an in-depth discussion on the current taxation regulations of CAs as well as the stance of the taxation authority[311] in SA.

3.2. THE CHALLENGE OF TAXING CRYPTO ASSETS

The importance of taxation is not only to ensure the effective functioning of a country through the *fiscus*,[312] but to simultaneously (and inadvertently) prevent tax evasion through anti-avoidance provisions.[313] Taxes are imposed through legislation, which allows for the effective collection of taxes by SARS through the administration of the Income Tax Act.[314] The obligation to pay normal tax (which South African taxpayers are liable for in relation to their gross income) is imposed on persons who have taxable income.[315]

Since there were no formal taxation regulations pertaining to CAs[316] in SA until 2018,[317] income derived therefrom was not (formally) subject to normal tax.[318] It can be argued that a person can only be taxed in conjunction with promulgated legislation,[319] as opposed to informal guidelines provided by SARS. Practically, this would mean that individuals who were investing or earning in CAs may have found ambiguities in CA regulation which facilitated the non-inclusion of their CA income in their gross income for the purpose of determining their normal tax liability.

If taxpayers were not bound by legislation, (as CAs remained unregulated before 2018) tax avoidance would be prevalent where CA transactions are concerned. Even though SARS had

[310] See Chapter 2 for a discussion on the nature and mechanics of cryptocurrency.
[311] SARS.
[312] Phillip Haupt *Notes on South African Income Tax* (2020) 2.
[313] Ibid at 639.
[314] Income Tax Act 58 of 1962. Phillip Haupt *Notes on South African Income Tax* (2020) 2.
[315] Phillip Haupt *Notes on South African Income Tax* (2020) 5.
[316] Which would have been referred to as 'cryptocurrency' at the time.
[317] By virtue of the Taxation Laws Amendment Act 23 of 2018.
[318] It is submitted that even though there have since been legislative developments regarding the regulation of CAs, the lack of understanding of CAs as well as effective regulation thereof is still very much apparent in SA. This is a point which has been strongly advanced from the beginning of this research and is maintained in the context of this chapter as a general consideration.
[319] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1116.

aimed to tax CAs in accordance with existing taxation principles,[320] there was no indication by SARS regarding the taxation treatment of CAs before 2018,[321] thus, it is submitted that the taxation implications of the failure to pay tax on one's CA earnings were unclear. To date, the issue of unclear legal and regulatory framework[322] relating to CAs is a challenge where the taxation of CAs is concerned.

Since the absence of taxation regulation relating to CAs has been addressed by the inclusion of provisions in the Tax Amendment Act 2018[323] and the Tax Amendment Act 2020,[324] taxpayers will be bound thereto and thus have to declare their CA earnings.[325] However, the fact that there are legislative provisions in existence relating to the taxation of CAs, does not mean that these regulations are effective in accomplishing their intended purpose. A major challenge associated with the taxation of CAs is the fact that users thereof remain anonymous in terms of their transactions.[326] It is submitted that this issue will be an obstacle for taxation authority in the process of tax collection.

According to the IFWG, a major risk relating to CAs includes user anonymity, which may result in illegitimate purchases on behalf of users of CAs.[327] If the identity of a person transacting via CAs remains anonymous and their personal details are not linked to their usage of CAs, in order for them to be liable for normal tax on their gross income, (relating to their CA earnings) it will be at their own discretion and integrity to declare their CA earnings. Thus, the IFWG correctly classifies illegitimate purchases (as facilitated by user anonymity) as an integrity risk[328] of the CA system.[329] The element of user anonymity may thus create issues with the administration of tax as well as the enforcement thereof on taxpayers who do not

[320] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.

[321] No media release, interpretation note or practice note relating to the taxation treatment of CAs (or 'cryptocurrency,' as the context requires) by SARS can be found pre-2018

[322] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 16.

[323] Taxation Laws Amendment Act 23 of 2018. An exposition of this Act in relation to CAs will be outlined below at 3.4.

[324] See 3.7. below for a discussion on the Taxation Laws Amendment Act 23 of 2020.

[325] See 3.4. below for a discussion on the provisions relating to CAs in the Taxation Laws Amendment Act 23 of 2018.

[326] The anonymous nature of CAs (when same was generally referred to as 'cryptocurrency') was discussed above at Chapter 2.

[327] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 16.

[328] Even though the notion of an integrity risk regarding user anonymity relates to illegitimate purchases using CAs, tax evasion is also categorised within the ambit of integrity risks, which provides a concrete link between the IFWG's analysis of integrity risks and the integrity risk user anonymity poses regarding the viability of CAs from a taxation perspective.

[329] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 16.

declare their CA earnings. It is submitted that the fact that legislation is in place in terms of the taxation of CAs will be of less administrative consequence if there is no ascertainable link between the person transacting and their transaction.

It is submitted further that those who generate income via CA platforms which require personal details of the user (Luno being the primary example)[330] will be liable for normal tax or capital gains tax[331] on the amounts in question (provided that the amounts are declared in the taxpayer's return or if SARS obtains the information via an audit or investigation), whilst those who generate income via CA platforms which do not require personal details of the user[332] may be able to avoid paying tax altogether, since they themselves cannot be linked to their CA transactions. The issue thus arises as to whether this constitutes tax evasion or tax avoidance,[333] considering the fact that the existing CA taxation regulations do not account for the fact that most CA users will remain anonymous when transacting. Not only is the anonymous nature of CA transactions a point of contention when determining the challenges regarding the regulation thereof, but the fact that CAs are a part of a complicated financial technology system is unfavourable in terms of the understanding and regulation thereof.

By analysing taxation regulation of CAs in SA,[334] it is evident that the nature, function and processes of CA transactions were not accounted for holistically in the formulation of the legislative provisions relating to CAs. This will present a further challenge in terms of CA regulation in future, due to the fact that it may be easier for taxpayers to evade tax (and perhaps attribute this to tax avoidance instead) by virtue of the lack of effective legislative provisions regarding CAs.

It is submitted that there seems to be another challenge regarding the regulation of CAs. This challenge may be illustrated through the fact that legislative authority seems to be applying existing regulations of traditional financial systems to CA systems. This is being achieved by virtue of taxation legislation, wherein regulations which apply to traditional methods of transacting (financial instruments for example)[335] will inadvertently apply to CAs, even though

[330] Eveshnie Reddy and Vivienne Lawack 'An overview of the regulatory developments in South Africa regarding the use of cryptocurrencies' (2019) 31 *Merc LJ* 1 at 14.
[331] Capital gains tax will hereinafter be referred to as 'CGT.'
[332] In other words, user data or 'know your customer' (KYC) data. Thales 'Know Your Customer in banking' available at *https://www.thalesgroup.com/en/markets/digital-identity-and-security/banking-payment/issuance/id-verification/know-your-customer*, accessed on 24 June 2021.
[333] A complete analysis of tax evasion as well as tax avoidance relating to CAs will be made in Chapter 4 of this research.
[334] See 3.4. below for an analysis of the Tax Amendment Act 2018.
[335] See 3.4.1. below for a discussion on cryptocurrency as a financial instrument for the purposes of taxation regulations.

it is an entirely unique system. By restricting the regulation of CAs to legislative approaches that are in existence by virtue of traditional financial systems, the effectiveness of CA regulation in mitigating specific challenges associated therewith (such as tax evasion) will be reduced. The IFWG however, offers a more holistic perspective on the taxation regulation of CAs, (as it has accounted for the nature of CAs) which should be considered when developing legislative provisions regarding the taxation of CAs.[336]

The current taxation position on CAs and the historical development thereof must be set out in order to ascertain a concise reflection of the legislative intentions of authoritative bodies. Currently, the parameters of the taxation regulation of CAs are unclear.[337] It must be determined whether these regulations are effective in providing a framework through which CAs may be taxed. The following discussion will set out an exposition of the historical development of the taxation of CAs through the examination of SARS' initial stance regarding CAs, the IFWG's stance in that respect and the evolvement of the legislature's stance regarding the taxation of CAs. This exposition will be conducted chronologically so as to illustrate the development of the South African position on CA taxation.

3.3. THE SOUTH AFRICAN REVENUE SERVICE'S STATEMENT ON CRYPTOCURRENCY

By considering the taxation of CAs specifically and how it will be taxed based on its classification, SARS holds authority thereon to a large extent as it is an organ of state which is tasked with taxation administration.[338] SARS, however, must act in accordance with legislation and any statements made independently are not binding on taxpayers, but rather, aim to assist taxpayers in understanding how SARS will interpret legislation. Thus, the statement SARS released on the taxation treatment of cryptocurrency[339] (before the Tax Amendment Act 2018[340] came into effect) must be considered in order to ascertain how SARS attempted to tax cryptocurrency earnings (before the consideration of 'crypto assets' arose).[341] This analysis

[336] See 3.5. below for an analysis of the IFWG's stance on cryptocurrency taxation.
[337] See 3.3.1. below for a discussion on the normal tax versus capital gains tax considerations in terms of CAs.
[338] Phillip Haupt *Notes on South African Income Tax* (2020) 2.
[339] See footnote 308. In this subheading, the term 'cryptocurrency' will be used predominantly since the source which is being examined and discussed refers to 'cryptocurrency.' Where the context permits otherwise, the term 'crypto assets' will be used interchangeably in the context of commentary on the source.
[340] Taxation Laws Amendment Act 23 of 2018.
[341] It is important to note that since SARS' statement which was released in 2018, it has released a one page 'FAQ' on its updated website, which contains one line relating to cryptocurrency. In this regard, the FAQ page states that 'SARS will apply general tax principles and tax income or capital gains that are received or accrued to the

will be made in retrospect due to the fact that since the release of the statement, there have been legislative developments regarding the taxation of CAs.[342] Taxation developments regarding CA regulation must be discussed chronologically, which is why SARS' stance will be analysed first. The contents of the statement made by SARS is important in that it provides an illustrative indication of how CAs are viewed by SARS (save for the fact that at the time, CAs were referred to as 'cryptocurrency') as well as methods by which it may be regulated.

Furthermore, most of the content in the statement made by SARS is still relevant, even though the Tax Amendment Act 2018[343] and the Taxation Laws Amendment Act 23 of 2020[344] has been effected and addresses the taxation of CAs. It is submitted that a point of contention (from the outset) regarding the statement made by SARS is the fact that it was released approximately 9 months before the Tax Amendment Act 2018[345] came into effect, yet it does not address or make reference to the Tax Amendment Act 2018[346] or the contents thereof in relation to CAs. There was no mention made in the statement of the fact that 'cryptocurrency' was to be considered as a financial instrument,[347] which would have inadvertently affected the contents of the statement.

In the statement which was released on its website (in terms of the taxation treatment of cryptocurrency earnings), SARS indicates that cryptocurrency is to be considered as '… assets of an intangible nature…'[348] and not to be categorised as a currency.[349] In terms of current taxation legislation, this particular broad categorisation would be retrospectively subject to speculation to a small extent (regarding the type of asset cryptocurrency may be held as) because of the categorisation of cryptocurrency as a financial instrument.[350] In this regard, Haupt contends that the fact that cryptocurrency has since been formally defined as a financial instrument means that '…it cannot be a personal use asset for an individual.'[351] A personal use asset qualifies as such by virtue of the fact that it is held by a natural person and is an asset

taxpayer.' – South African Revenue Service 'FAQ: How will SARS treat cryptocurrencies?' available at *https://www.sars.gov.za/faq/faq-how-will-sars-treat-cryptocurrencies/*, accessed on 18 May 2021.

[342] See 3.4. below for a discussion on the Tax Amendment Act 2018 and 3.7. below for a discussion on the Taxation Laws Amendment Act 23 of 2020.

[343] Taxation Amendment Act 23 of 2018.

[344] Hereinafter referred to as the 'Tax Amendment Act 2020.'

[345] Taxation Amendment Act 23 of 2018.

[346] Ibid.

[347] By virtue of the Taxation Laws Amendment Act 23 of 2018.

[348] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.

[349] Ibid.

[350] Taxation Laws Amendment Act 23 of 2018.

[351] Phillip Haupt *Notes on South African Income Tax* (2020) 669.

which is used for purposes other than to carry on a trade.[352] Furthermore, such personal use assets are not subject to CGT.[353]

By virtue of the fact that personal use assets are not subject to capital gains or losses in respect of the disposal of such assets, financial instruments are specifically excluded as being personal use assets.[354] Haupt indicates however, that CAs may be considered as trading assets if it is acquired for the purpose of being sold for a profit.[355] Reflecting on the uncertainty of the categorisation of CAs, it is submitted that it is apparent that CAs can be both a financial instrument and an asset, even though financial instruments function within the parameters of a specific set of regulations, which may not apply to certain types of assets.[356]

In its statement, SARS maintained that it will '…apply normal income tax rules to cryptocurrencies and will expect affected taxpayers to declare cryptocurrency gains or losses as part of their taxable income.'[357] The question thus arises as to how SARS plans to enforce this regulation. In this regard, the statement released by SARS goes on further to state that taxpayers have the responsibility of declaring their cryptocurrency earnings or losses.[358] If taxpayers do not adhere to this, they risk having to pay interest and penalties.[359] SARS indicates further that cryptocurrency earnings may be considered to be revenue in nature.[360]

However, SARS also states (further on in its statement) that cryptocurrency earnings may be regarded as capital in nature.[361] Even though there is no clarification in the statement regarding this notion, it may be inferred that SARS intended that cryptocurrency earnings accumulated from buying cryptocurrency would constitute a revenue nature, whilst cryptocurrency earnings accumulated from selling cryptocurrency would constitute a capital nature.[362] Even though the Tax Amendment Act 2018[363] came into effect after SARS released its statement, the stance

[352] Ibid at 674.
[353] Ibid at 674.
[354] Eighth Schedule to the Income Tax Act 58 of 1962, para 53.
[355] Ibid at 669.
[356] See 3.4.1. below for a discussion on cryptocurrency as a financial instrument.
[357] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.
[358] Ibid.
[359] Ibid.
[360] Ibid.
[361] Ibid.
[362] See 3.3.1. below for a discussion on receipts and accruals of a revenue or capital nature in relation to cryptocurrency.
[363] Taxation Laws Amendment Act 23 of 2018.

SARS takes in relation to CAs as revenue or capital in nature is important to analyse as it relates to how CAs will be taxed in terms of a taxpayer's gross income.[364]

It is submitted that a statement alone will not suffice in terms of addressing the taxation treatment of CAs. A formal legislative exposition of the taxation treatment of CAs must be available in order for taxpayers to gain clarity on the taxation treatment of their CA earnings as well as to analyse how this will affect CA transactions. In the statement, SARS indicates that an interpretation note addressing the taxation of cryptocurrency is unnecessary as the existing tax framework will serve to guide SARS and taxpayers in terms of cryptocurrency issues.[365] It is submitted that this contention by SARS is unfounded as the nature of CAs is unlike any other financial system or means of payment, exchange and investment, which is why it cannot merely be dealt with in the same way as traditional payment methods. It is submitted further that an interpretation note addressing the taxation of CAs would be of immense value.[366]

3.3.1. Receipts and accruals of a revenue or capital nature

As mentioned above,[367] SARS recognises 'cryptocurrency' as being an intangible asset.[368] This would mean that CGT may apply to CAs.[369] However, on the other hand, SARS also states that CA earnings are to be treated as revenue in nature and taxed as such under gross income.[370] SARS does not clarify the inference that CA earnings may be treated as revenue in nature if the taxpayer concerned is buying CAs and accumulating income therefrom, but may be treated as capital in nature and subject to CGT if the taxpayer is selling CAs and accumulating value therefrom. Therefore, the issue of discerning between receipts and accruals of a revenue or capital nature as well as a discussion on CGT in terms of CA earnings is crucial in determining how CAs may be taxed.

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[364] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019. See 3.4. and 3.7. below for a discussion on the taxation consequences regarding the new legislative provisions in terms of the taxation of cryptocurrency

[365] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.

[366] The potential of an interpretation note relating to the taxation of cryptocurrency will be discussed in Chapter 5 of this research at 5.2.3.

[367] At 3.3.

[368] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.

[369] Ibid.

[370] Ibid.

In terms of the gross income definition, receipts and accruals which are revenue in nature are included in a taxpayer's gross income in order to determine their normal tax liability.[371] However, receipts and accruals which are capital in nature are excluded in the gross income definition in terms of determining a taxpayer's gross income.[372] Receipts and accruals of a capital nature are excluded in the determination of a taxpayer's gross income, but are included when determining a taxpayer's liability for normal tax. These excluded receipts and accruals may thus fall within the ambit of CGT[373] (regulated by the Eighth Schedule[374]) if they meet the necessary requirements,[375] which will serve to include such amounts in the determination of a taxpayer's taxable income.

A determining factor relating to whether a capital amount[376] will be subject to CGT is that CGT applies only where the disposal of assets is concerned.[377] In other words, if there is a capital amount, it will not be included in gross income and will only be subject to CGT if an asset is present, as opposed to a revenue amount,[378] which will be included in gross income. It is submitted therefore, that in relation to CAs, CGT would only apply if CAs are to be considered as assets specifically. Furthermore, even if 'cryptocurrency' is considered an asset, only the disposal (sale) thereof will arguably trigger a CGT obligation on the taxpayer in question.[379] Therefore, distinguishing between revenue and capital amounts is imperative in order to establish whether certain amounts must be included in the determination of a taxpayer's gross income or not.[380] Case law may be used to adequately distinguish between revenue amounts and capital amounts, which is what SARS points out in its statement.[381] The stance that SARS takes on the jurisprudence relating to CGT in the statement however, is subject to criticism.

SARS states that there is no shortage of existing jurisprudence in regard to the 'determination of whether an accrual or receipt is revenue or capital in nature…'[382] Whilst it is true that there are a multitude of cases which exist in terms of determining whether an accrual or receipt is of

[371] Income Tax Act 58 of 1962: s 1.
[372] Ibid.
[373] See 3.3.2. below for an analysis of capital gains tax in relation to cryptocurrency.
[374] Eighth Schedule to the Income Tax Act 58 of 1962.
[375] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 582.
[376] In other words, an amount of a capital nature.
[377] Ibid at 577.
[378] In other words, an amount of a revenue nature.
[379] See 3.3.2. below for a discussion on capital gains tax in relation to cryptocurrency.
[380] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 42-43.
[381] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.
[382]Ibid.

a revenue or capital nature, it is submitted that this abundance of case law is not as significant as SARS implies it to be in relation to CAs. This is due to the fact that the case law which exists in terms of distinguishing revenue and capital does not deal with any CA matters.

Leading cases[383] concerning the distinction between receipts and accruals of a revenue and capital nature deal with transactions relating to traditional payment systems and not virtual currency. Even though the SARS statement is slightly misleading in this regard, it must be noted that through a thorough analysis of taxation principles and case law, SARS' intention in terms of how CAs are to be taxed will be more evident.

A useful tool to distinguish revenue from capital (in terms of the sale of assets) is to determine the purpose of the receipt or accrual.[384] If a taxpayer has an asset which is used to produce income, the asset will be considered to be capital in nature and therefore excluded from their gross income in the determination of their taxable income.[385] On the other hand, the revenue is considered to be what the capital asset produces.[386] The 'fruit and tree principle'[387] has been used in order to illustrate the distinction between receipts and accruals which are revenue or capital in nature.[388]

In this regard, the tree would represent the asset which is used in the production of income/revenue and the fruit which is produced by the tree represents the revenue itself.[389] However, if assets (such as cars, for example) are being sold by a taxpayer in terms of a business (such as a car dealership, for example) which generates income primarily by selling such assets, the profits accumulated from the sale thereof will be considered to be revenue in nature.[390] By applying these principles to CA earnings, it can be established that if a taxpayer buys CAs and generates profits therefrom, this will be considered as revenue in nature and the earnings will be subject to normal tax in terms of the gross income definition. However, in a second scenario, if the taxpayer sells CAs,[391] this disposal of the CAs triggers the operation of the Eighth Schedule[392] and subjects the disposal to CGT considerations. In this regard, if this

[383] An example of a leading case in terms of the distinction between receipts and accruals of a revenue or capital nature is *Commissioner for Inland Revenue v Visser* 1937 TPD 77.
[384] *Commissioner for Inland Revenue v Visser* 1937 TPD 77.
[385] Supra.
[386] Supra.
[387] Supra.
[388] Supra.
[389] Supra.
[390] Supra.
[391] In other words, disposes of the cryptocurrency.
[392] Eighth Schedule to the Income Tax Act 58 of 1962.

disposal results in a taxable capital gain, the earnings from the sale of the CAs will be subject to normal tax, even though these capital amounts are not included in a taxpayer's gross income.

Bearing this in mind, it must be noted that distinguishing revenue assets from capital assets in this practical manner is simple, but only effective insofar as the determination of the purpose of the actual asset itself is concerned.[393] The problem arises where a determination of the various purposes for which different people may hold assets is to be made.[394] Since '…different people hold assets for different purposes,'[395] the intention of the owner of the asset regarding the sale thereof is of the utmost importance.[396] It is submitted in this regard, that determining the intention of the taxpayer (a subjective test) in terms of their use of the CAs in question will be a determining factor (amongst other important considerations) regarding the inclusion of the amount in question in their gross income for the purpose of determining their normal tax liability.[397]

A third scenario exists however, which involves possible CGT in relation to CAs. CGT is regulated in terms of the Eighth Schedule to the Income Tax Act.[398] A taxpayer who buys CAs (with the intention of using it to accumulate earnings) and generates profits from it over time, but then sells it in order to accumulate earnings therefrom, may be liable in terms of CGT on the sale[399] of the CAs in question.[400] This however, would only be applicable if the cryptocurrency is considered to be an asset, as an asset (in terms of the formal definition thereof) has to be present before CGT can apply[401] and a subsequent disposal or deemed disposal event must occur. Whilst CGT considerations are taken into account in the determination of normal tax in any event, it is still important to ascertain the circumstances in which CGT may apply as the calculation of the capital gain (or loss) in question will affect the determination of a taxpayer's normal tax liability.

[393] Phillip Haupt *Notes on South African Income Tax* (2020) 43.
[394] Ibid at 43.
[395] Ibid at 43.
[396] Ibid at 43.
[397] The issues regarding the subjective versus the objective approach in relation to the determination of revenue and capital will not be discussed as it is not within the scope of this research and will detract from the main focus thereof.
[398] Eighth Schedule to the Income Tax Act 58 of 1962.
[399] In other words, the disposal of cryptocurrency.
[400] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.
[401] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 546.

3.3.2. Capital gains tax

In terms of the Eighth Schedule,[402] an asset is considered to be '… property of any nature, whether movable or immovable, corporeal or incorporeal. This excludes any currency but includes any coin made mainly from gold or platinum.'[403] An asset is also considered to be '… a right or an interest of any nature…' and includes non-capital as well as capital assets.[404] Due to the volatile nature of CAs (and more specifically, the erratic changes in value thereof) as well as its unique nature within the financial sector,[405] it is submitted that the imposition of CGT be taken into account cautiously.

Relating to the price volatility of CAs, it must be noted that in the past few months alone, the price of Bitcoin specifically has generally increased tremendously, but has also decreased drastically at certain points during each month.[406] According to the well-known CA application Luno, the price of Bitcoin has increased by approximately 366% over the past year.[407] However, there have been major fluctuations in the price of Bitcoin historically. The price volatility of CAs may be illustrated clearly through an example of a drastic decrease in the value of Bitcoin when it 'crashed' in March 2020 overnight by an astounding 55%.[408]

It is therefore submitted that by virtue of the price volatility of CAs, it may be unreasonable and unwise to subject CAs to CGT. It is unclear whether (and in which particular situations) CGT will apply to CAs,[409] however, this type of tax must be discussed fully in order to obtain the possible consequences for a taxpayer who is disposing of CAs.[410]

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[402] Eighth Schedule to the Income Tax Act 58 of 1962.
[403] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 547.
[404] Ibid at 547.
[405] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[406] The information relating to the price volatility of Bitcoin has been obtained via the speculation of the Luno application homepage, which offers users an overview of the price fluctuation of various cryptocurrencies.
[407] Ibid.
[408] Clem Chambers (Forbes) 'Bitcoin Crash 2020' available at *https://www.forbes.com/sites/investor/2020/03/13/bitcoin-crash-2020/?sh=4e75872961c8*, accessed on 14 February 2021.
[409] Considering the research conducted thus far, it must be noted that the point made regarding the submission that it is unclear whether cryptocurrency 'gains' would be subject to CGT is based on the fact that, in accordance with the Tax Amendment Act 2020, cryptocurrency has merely been referred to as 'crypto assets,' but no further legislative clarity has been offered in that regard. There are no legislative provisions which explicitly include cryptocurrency within the ambit of the application of CGT. This point is discussed further at 3.7. above in respect of the analysis of the Tax Amendment Act 2020.
[410] Capital gains tax as it relates to cryptocurrency is also important to consider at this point in the research due to the fact that the Tax Amendment Act 2020 refers to cryptocurrency as 'crypto assets.' See 3.7. below for a discussion on the Tax Amendment Act 2020.

In terms of CGT in general, disposing of an asset will either result in a taxable capital gain or an assessed capital loss.[411] This would depend on whether the taxpayer has made a profit or a loss from the disposal of the asset in question.[412] If a taxpayer makes a capital gain which is taxable (in other words, not excluded from being subject to CGT), it will be subject to normal tax.[413] This affirms the fact that CGT is a tax on income and not a separate type of tax.[414] It is merely used in order to deal with the disposal of assets.[415] If it is determined that a taxpayer has made a capital gain, the inclusion thereof in their taxable income is regulated in terms of Section 26A[416] of the Income Tax Act.[417] On the other hand, if a taxpayer makes an assessed capital loss in terms of the disposal of an asset, the loss cannot be set off against taxable income and must be carried forward to the next year of assessment.[418]

According to Haupt, a Bitcoin is considered as a typical asset as it is a right a person can hold for primary use as a currency which has value.[419] Haupt contends further that the term 'currency' is not defined in the Income Tax Act[420] but since cryptocurrency '…exists as a medium of exchange of value,'[421] it is not excluded from being considered as currency.[422] It must be borne in mind however, that SARS specifically indicated that cryptocurrencies are not currency for normal tax considerations.[423] Haupt acknowledges SARS' statement in this regard, but still contends that 'cryptocurrency' should not be excluded from being considered as a currency.[424] It is submitted that it seems logical for cryptocurrency to be considered a 'currency,' but this may not be entirely accurate in reflecting the uses of CAs. Furthermore,

[411] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 537.
[412] Ibid at 537.
[413] Ibid at 537.
[414] Ibid at 537.
[415] Ibid at 537.
[416] Income Tax Act 58 of 1962: s 26A.
[417] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 545.
[418] Ibid at 537.
[419] Phillip Haupt *Notes on South African Income Tax* (2020) 668.
[420] Income Tax Act 58 of 1962.
[421] Phillip Haupt *Notes on South African Income Tax* (2020) 669. In light of Haupt's contention, it is submitted that CAs do not merely exist as a '…medium of exchange of value…', but also facilitate the storage of value and have other uses, as outlined by the IFWG in its position paper.
[422] Ibid at 669.
[423] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019. The IFWG, in its position paper, also adopts this stance. This is an important consideration since the IFWG represents the various authoritative bodies in its submissions made.
[424] Phillip Haupt *Notes on South African Income Tax* (2020) 668-669.

since SARS' stance evidently refutes that notion,[425] further confusion is created as to the actual categorisation of cryptocurrency for taxation purposes.[426]

If cryptocurrency is to be considered as currency (which is the approach Haupt supports), it will not be deemed to be an asset,[427] (for the purpose of CGT) thus the accumulated amounts relating to the sale of cryptocurrency will not be subject to CGT. Haupt takes cognisance of the fact that 'cryptocurrency' is an asset in the normal sense,[428] but firmly contends that there was an opportunity for the National Treasury (through the Tax Amendment Act 2018[429]) to formally categorise cryptocurrency as an asset which will specifically be subject to CGT, but it neglected to do so.[430]

By reflecting on this, it is evident that Haupt is inferring the notion that the failure to categorise cryptocurrency as an asset specifically subject to CGT would inadvertently mean that cryptocurrency will not be subject to CGT. By taking into consideration the IFWG[431] position paper, it is submitted that even though the National Treasury did not take the opportunity to formally categorise cryptocurrency as an asset in the Tax Amendment Act 2018[432] specifically, it is affirmed through the paper that cryptocurrency may be held as an asset (and thus considered as a 'crypto asset').[433]

Even though Haupt indicates that a Bitcoin is in fact an asset,[434] he also indicates that the National Treasury could have formally defined cryptocurrency as such but did not do so.[435] Haupt's ambiguity in this regard creates further misunderstanding in terms of whether

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[425] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.

[426] This consideration is in addition to the fact that cryptocurrency has been referred to as 'crypto assets' in the Tax Amendment Act 2020, as it is submitted that merely referring to cryptocurrency as 'crypto assets' does not automatically subject same to CGT.

[427] Phillip Haupt *Notes on South African Income Tax* (2020) 669.

[428] Ibid at 668.

[429] Taxation Laws Amendment Act 23 of 2018.

[430] Phillip Haupt *Notes on South African Income Tax* (2020) 669. The reference to cryptocurrency as 'crypto assets' in the Tax Amendment Act 2020 will be considered below at 3.7. in this regard. Whilst Haupt's contention in respect of the Tax Amendment Act 2018 seems to be irrelevant in light of the Tax Amendment Act 2020, it is submitted that his view is still founded upon strong considerations. This argument will be substantiated below at 3.7. through the discussion of the Tax Amendment Act 2020.

[431] It must be noted that the National Treasury is party to the IFWG.

[432] Taxation Laws Amendment Act 23 of 2018.

[433] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020).

[434] Phillip Haupt *Notes on South African Income Tax* (2020) 668.

[435] Ibid at 669. It must be noted however, that the legislature did in fact refer to 'cryptocurrency' as 'crypto assets' in the Tax Amendment Act 2020, even though it did not define cryptocurrency formally as 'crypto assets.' This must be borne in mind when considering Haupt's contentions in general.

cryptocurrency is to be considered an asset or not.[436] This may infer that the intention of the taxpayer in relation to the purpose of the CA transaction in question may be a determining factor in terms of establishing the taxation treatment of the amount which the CA yields.[437] However, even in consideration of the taxpayer's intention, it is submitted that it would arguably make no difference to the taxation treatment of CAs as the nature of CAs is entirely unique. The intention of the taxpayer will either be to accumulate gains from CA trading or transact[438] using CAs. From a taxation perspective (and accounting for the differentiation between income and capital), the use of CAs and subsequent accumulation of value thereof blurs the line between the accumulation of capital gains from CA trading versus that of income from CA trading.

It is submitted that due to the lack of clarity in terms of 'cryptocurrency' in relation to CGT as well as the fact that the definition of an asset in terms of taxation is extremely wide,[439] cryptocurrency/CAs may (or may not) be subject to CGT for the purposes of taxation.[440] An analysis therefore needs to be made regarding how CGT will function in relation to a CA transaction. In applying the principles set out above, it is submitted that if a taxpayer sells CAs (which have been stored and used over time to generate earnings) and in turn profits from the disposal thereof, CGT may be applied. Even though this seems straightforward and effective, it is submitted that due to the volatile nature of CA transactions,[441] determining when to impose CGT might be difficult.[442] What complicates matters further is that there is no precedent or authority regarding how such scenarios may be dealt with. This further affirms the notion that CAs should be classified as a separate entity to traditional financial instruments as the nature of CAs makes the regulation thereof (under existing taxation constraints) complex.

[436] A discussion on cryptocurrency as an asset in terms of current taxation legislation will be discussed below at 3.6.
[437] Phillip Haupt *Notes on South African Income Tax* (2020) 669.
[438] An example of a practical cryptocurrency transaction would be the purchasing of products online using cryptocurrency or the transference of funds to other users or the user's personal bank account.
[439] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) at 547.
[440] It is maintained that the fact that the Tax Amendment Act 2020 refers to 'cryptocurrency' as 'crypto assets' does not explicitly mean that CAs will be subject to CGT accordingly. See 3.7. below for a discussion on the Tax Amendment Act 2020 in conjunction with this new categorisation of cryptocurrency.
[441] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[442] Cryptocurrency being regarded as an asset for the purpose of capital gains tax will be discussed further at 3.7. below in the context of current taxation legislation.

3.3.3. Deductions on cryptocurrency expenditure

The statement made by SARS indicates that taxpayers may claim cryptocurrency expenditure which is incurred in the production of income.[443] Even though this is the way in which SARS worded this particular part of the statement, it is submitted that instead of stating that taxpayers are permitted to claim 'expenses',[444] SARS should have stated that taxpayers may be entitled to claim a 'general deduction'[445] associated with their cryptocurrency receipts and accruals. This would offer more clarity to taxpayers. Even though this is a technicality, it is crucial that SARS (being an authoritative body) explores the correct terminology and exercises preciseness when addressing the public on cryptocurrency protocol. The importance of specificity lies in the fact that there is already confusion about the taxation treatment of cryptocurrency, therefore the way in which the statement by SARS is worded may cause further misunderstanding, which does not bid well for the future regulation of CAs.

Bearing SARS' stance in mind (in terms of a taxpayer possibly being able to claim a deduction on their CA expenditure), taxation legislation must be considered in order to determine if and when a general deduction will be allowed. Since 'cryptocurrency' has been formally categorised in legislation,[446] it is submitted that normal taxation consequences will apply thereto. Deductions form part of normal taxation consequences[447] and even though the Tax Amendment Act 2018[448] and the Tax Amendment Act 2020[449] do not clarify how CAs will be dealt with in this regard, it is inferred that due to the normal taxation consequences of financial instruments generally, CAs may be subject to such consequences. Deductions in terms of taxation law regulate the expenses which may be removed from the calculation of a taxpayer's gross income.[450] General deductions are determined using the general deduction formula, which states that:

> *'For the purpose of determining the taxable income derived by any person from carrying on a trade, there shall be allowed as deductions from the income of such person so derived –*

[443] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx*, accessed on 14 March 2019.
[444] Ibid.
[445] Income Tax Act 58 of 1962: s 11 (*a*).
[446] Taxation Laws Amendment Act 23 of 2018: s 1 (*f*) and the Taxation Laws Amendment Act 23 of 2020.
[447] Income Tax Act 58 of 1962: s 11 (*a*).
[448] Taxation Laws Amendment Act 23 of 2018.
[449] Taxation Laws Amendment Act 23 of 2020. This legislation will be discussed below at 3.7.
[450] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 114.

(a) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature; …'[451]

Section 11 (a) as stated above indicates what is deductible from a taxpayer's gross income but has to be read in conjunction with section 23 (g),[452] which indicates what is not deductible from a taxpayer's gross income. In terms of this section:

'No deductions shall in any case be made in respect of the following matters, namely […]

(g) any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purposes of trade; …'[453]

In relation to the sections set out above, the taxation consequences of CAs must be analysed. It is submitted that the one element which would pose difficulty for a taxpayer in terms of claiming a general deduction in respect of CA expenditure is that of 'carrying on a trade.' Taxation legislation[454] requires that in order to claim a general deduction, a person has to be carrying on a trade.[455] Since this is an essential requirement in claiming a deduction, there would be debate surrounding the issue of whether a person is in fact carrying on a trade in respect of their CA transactions.

Since CAs have been formally categorised as financial instruments[456] in terms of taxation, but there is no precedent in terms of how these earnings must be dealt with, it may seem as if considering the taxation consequences of existing financial instruments in general (such as shares, for example) is the best way to determine what the outcome of a situation involving CAs may be.

In this regard, it must be noted that despite the exceptionally wide and inclusive meaning of a trade, certain income (such as interest, dividends and annuities) is not deductible due to the nature thereof.[457] A case which illustrates this point is Income Tax Case No 1275,[458] in which it was maintained that a person who invests their savings in interest bearing securities or shares which are held essentially as assets of a capital nature do not earn that income due to carrying on a trade.[459] Therefore, no deduction will be allowed.[460] It is submitted that in a scenario

[451] Income Tax Act 58 of 1962: s 11 (*a*).
[452] Ibid at s 23 (*g*).
[453] Ibid at s 23 (*g*).
[454] As stated directly above by virtue of s 11(*a*) and s 23(*g*) of the Income Tax Act 58 of 1962.
[455] Income Tax Act 58 of 1962: s 11 (*a*).
[456] Taxation Laws Amendment Act 23 of 2018: s 1 (*f*).
[457] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 115.
[458] *Income Tax Case No 1275* (1978) 40 SATC 197 (C).
[459] Supra.
[460] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 115.

involving CA transactions, it may be difficult to determine whether the taxpayer concerned is in fact carrying on a trade, and it is probable that this could be a point of contention as both arguments (that taxpayers engaging in CA transactions are carrying on a trade or that they are not) may be viable. CAs (as financial instruments) may be subject to the same principles as traditional financial instruments, but this notion cannot be affirmed due to the lack of precedence relating to the taxation treatment of CAs.

Upon further investigation into existing case law dealing with general deductions in respect of financial instruments, it is submitted that they are not wholly effective in addressing the taxation treatment of CA transactions. This is due to the unique nature and functioning of CAs.[461] There are cases as well as legislation which apply to financial instruments due to the distinct nature thereof, which is why it is important to categorise CAs separately. It is submitted therefore, that CAs should not be subject to the exact same taxation consequences as other financial instruments but regulated specifically.[462]

3.4. AN ANALYSIS OF THE TAXATION LAWS AMENDMENT ACT 23 OF 2018 WITH SPECIFIC REFERENCE TO THE CRYPTOCURRENCY PROVISIONS

The Tax Amendment Act 2018[463] addresses the changes that have been made to taxation regulations regarding the tax treatment of certain amounts. The amendments which the Tax Amendment Act 2018[464] proposes in terms of cryptocurrency[465] are in relation to the Income Tax Act[466] as well as the Value-Added Tax Act.[467] These amendments are necessary due to the fact that the financial sector is constantly evolving in order to allow for the economic growth of the country. The updating and amending of legislation are methods which may be used by lawmakers to address any inconsistencies or gaps which exist in the law. Similarly, the amending of legislation indicates clearly that there is a need for change.

However, it is submitted that in order to create progressive change in any sector, effective legislation must be promulgated. If legislation addressing cryptocurrency is present but ineffective or incoherent, the aim of regulating cryptocurrency constructively will be

[461] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[462] Recommendations will be made in Chapter 6 of this research regarding the taxation treatment of CAs.
[463] Taxation Laws Amendment Act 23 of 2018.
[464] Ibid.
[465] Note that the term 'cryptocurrency' will primarily be used in the context of this subheading as the Tax Amendment Act 2018 refers to 'cryptocurrency' and not 'crypto assets.'
[466] Income Tax Act 58 of 1962.
[467] Value-Added Tax Act 89 of 1991.

weakened. Addressing the taxation regulation of cryptocurrency through the Tax Amendment Act 2018[468] however, is an indication that lawmakers are ready and willing to accept the fact that cryptocurrency is becoming a large part of the financial sector.

Even though the Tax Amendment Act 2018[469] has been amended further by the Tax Amendment Act 2020,[470] the Tax Amendment Act 2018[471] is still relevant and application in terms of the CA provisions discussed in this research. The only change which has been effected through the Tax Amendment Act 2020,[472] is the inclusion of a different term (i.e., 'crypto assets') which cryptocurrency is to be referred as for the purpose of taxation.[473] The following considerations in terms of the Tax Amendment Act 2018[474] however, remain relevant to CA taxation regulation in SA and must be analysed and applied.

3.4.1. Cryptocurrency as a financial instrument

The Tax Amendment Act 2018[475] illustrates that section 1 of the Income Tax Act[476] (the definition section of the Act) is to be amended to include 'cryptocurrency' in the definition of a 'financial instrument.'[477] This means that cryptocurrency transactions are subject to the same regulations which apply to financial instruments in general. According to the law firm Cliffe Dekker Hofmeyr, (in its interpretation of the proposed 2018 Draft Tax Bill[478]) it is implied that there are concerning consequences for including cryptocurrency in the definition of a financial instrument.[479]

One of these consequences is that cryptocurrency will be subject to section 22 of the Income Tax Act.[480] Section 22[481] outlines how trading stock amounts are to be dealt with in terms of calculating a taxpayer's taxable income.[482] In terms of section 22(1),[483] which deals with

[468] Taxation Laws Amendment Act 23 of 2018.
[469] Ibid.
[470] Taxation Laws Amendment Act 23 of 2020.
[471] Ibid.
[472] Ibid.
[473] See 3.7. below for an exposition of the amendment of the Tax Amendment Act 2018 via the Tax Amendment Act 2020 in relation to cryptocurrency.
[474] Taxation Laws Amendment Act 23 of 2018.
[475] Ibid.
[476] Income Tax Act 58 of 1962: s 1.
[477] Taxation Laws Amendment Act 23 of 2018: s 1 (1) (*f*).
[478] Draft Taxation Laws Amendment Bill of 2018.
[479] Cliffe Dekker Hofmeyr 'Treasury includes cryptocurrency in draft taxation legislation' available at *https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-27-july-treasury-includes-cryptocurrency-in-draft-tax-legislation.html*, accessed on 11 March 2020.
[480] Income Tax Act 58 of 1962: s 22.
[481] Ibid at s 22.
[482] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 433-453.
[483] Income Tax Act 58 of 1962 s 22 (1).

closing stock,[484] any proceeds from trading stock which a taxpayer acquires or manufactures and sells in the same year will be included when calculating taxable income, but the cost of the trading stock will be deducted in that same calculation.[485] However, if such trading stock is not sold in the year it was acquired by the taxpayer, they will '… only deduct the cost [of the trading stock] for tax purposes without including any amount in gross income.'[486] This leads to discrepancies between income and expenses when calculating taxable income.[487] Therefore, to make sure such a discrepancy does not occur, the taxpayer who is '…carrying on a trade must take the value of trading stock held and not disposed of […] at the end of the year of assessment (closing stock) and add it back to taxable income.'[488]

According to section 22(1)(*a*),[489] the value of the closing stock which is to be added to the taxpayer's taxable income is the '… cost price to the taxpayer less any amount by which the value of trading stock has reduced due to [certain external factors].'[490] The relevance of this section to financial instruments lies in the fact that legislation indicates that these instruments must be valued at cost price for the purposes of calculating a taxpayer's taxable income, therefore the calculation rule stated above will not apply to financial instruments.[491] Thus, if CAs are considered to be financial instruments, they will be valued at cost price for taxation purposes and any decrease in market value will not be considered. It is submitted that this would be an unrealistic requirement in terms of the calculation of taxable CA earnings due to the volatile nature of CA prices.[492]

Another consequence of CAs being defined as financial instruments in terms of the definition thereof is that CGT may apply to CA earnings.[493] This possibility was affirmed by the statement which SARS released regarding the taxation treatment of cryptocurrency.[494] However, the fact

[484] Ibid at s 22 (1).
[485] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 435.
[486] Ibid at 435.
[487] Ibid at 435.
[488] Ibid at 435.
[489] Income Tax Act 58 of 1962 s 22 (1) (*a*).
[490] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 435. These factors include damage, deterioration, change in fashion or decrease in market value.
[491] Ibid at 435-436.
[492] The market fluctuation and volitivity of cryptocurrency was discussed above at 3.3.2. as these concepts attribute to the nature of cryptocurrency and serve as an explanatory tool in addressing the question of why cryptocurrency is difficult to regulate.
[493] Cliffe Dekker Hofmeyr 'Treasury includes cryptocurrency in draft taxation legislation' available at *https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-27-july-treasury-includes-cryptocurrency-in-draft-tax-legislation.html,* accessed on 11 March 2020.
[494] South African Revenue Service 'SARS'S stance on the tax treatment of cryptocurrencies' available at *https://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx,* accessed on 14 March 2019.

that cryptocurrency has been defined as a financial instrument means that it cannot be considered as a personal use asset.[495] However, the effect of imposing CGT on cryptocurrency (if it is considered to be a financial instrument) must be analysed further.

If a taxpayer makes '…a capital loss on the disposal of a financial instrument…'[496] and acquires or enters into a contract to acquire the same type of financial instrument within 45 days before such a disposal or 45 days after the date of disposal, the loss suffered cannot be accounted for at the time of the disposal.[497] However, such loss will be '… carried forward and added to the base cost of the replacement asset.'[498] Bearing this in mind, it is submitted that due to the fact that frequent and short-term disposals are indicative of the nature of CA dealings,[499] imposing such a stringent taxation regulation thereon is impractical and ineffective. Furthermore, there is no indication in the Tax Amendment Act 2018[500] that the National Treasury intends to subject cryptocurrency to CGT,[501] however, since the Tax Amendment Act 2020 refers to cryptocurrency as 'crypto assets,' it may be the intention of the legislature to subject cryptocurrency to CGT.[502]

3.4.2. Ring-fencing in relation to cryptocurrency

In addition to the amendment of the definition of a financial instrument (to include cryptocurrency) in terms of section 1,[503] the Tax Amendment Act 2018[504] also indicates an amendment to be made to section 20A[505] in terms of ring-fencing provisions.[506] Ring-fencing is an anti-avoidance measure which specifies that expenditure incurred by a taxpayer in the

[495] Phillip Haupt *Notes on South African Income Tax* (2020) 669. The lack of clarity regarding capital gains tax as it relates to cryptocurrency (in other words, if cryptocurrency is considered to be an asset) was discussed above at 3.3.2. The fact that cryptocurrency cannot be a personal use asset however, does not preclude it from being considered as an asset in the general sense.
[496] Madeleine Stilingh et al *SILKE: South African Income Tax* (2018) 635.
[497] Eighth Schedule to the Income Tax Act 58 of 1962, para 42.
[498] Ibid at para 42.
[499] Cliffe Dekker Hofmeyr 'Treasury includes cryptocurrency in draft taxation legislation' available at *https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-27-july-treasury-includes-cryptocurrency-in-draft-tax-legislation.html,* accessed on 11 March 2020.
[500] Taxation Laws Amendment Act 23 of 2018.
[501] Phillip Haupt *Notes on South African Income Tax* (2020) 669. Even though the Tax Amendment Act 2020 refers to cryptocurrency as 'crypto assets,' the contention that the National Treasury's intention to subject cryptocurrency to capital gains tax is not present is still valid as the Tax Amendment Act 2020 does not serve to solidify whether cryptocurrency will be subject to capital gains tax in any event. This issue will be explored further at 3.7. below through a discussion on the Tax Amendment Act 2020.
[502] See 3.7. below for a discussion on the Tax Amendment Act 2020 and the lack of clarification regarding the application of CGT to cryptocurrency proceeds/gains.
[503] Income Tax Act 58 of 1962 s 1. It must be noted that this is still relevant in terms of the Tax Amendment Act 2020.
[504] Taxation Laws Amendment Act 23 of 2018.
[505] Income Tax Act 58 of 1962 s 20A.
[506] Taxation Laws Amendment Act 23 of 2018.

course of them conducting a trade is limited to the income of only that specific trade.[507] Furthermore, in conjunction with the meaning of ring-fencing, it must be noted that any excess assessed loss will be '…carried forward and is only set off against any income derived from that trade in a subsequent year of assessment.'[508]

There are currently eight specific activities to which ring-fencing applies as an anti-avoidance measure in terms of taxable income.[509] The Tax Amendment Act 2018[510] indicates that this list of activities should include 'the acquisition or disposal of any cryptocurrency'[511] as the ninth activity to which ring-fencing will apply.[512] This provision will be included as 's20A(2)(*b*)(*ix*).'[513] The consequence of this provision applying to CA earnings is that taxpayers may face restrictions in terms of their assessed losses incurred in the process of CA trading.[514] If a taxpayer does not treat cryptocurrency as a capital asset, they will be limited in terms of this provision.[515]

3.5. THE INTERGOVERNMENTAL FINTECH WORKING GROUP'S STANCE ON THE TAXATION OF CRYPTO ASSETS IN SOUTH AFRICA

When considering the IFWG's stance on the taxation of cryptocurrency, it must be noted preliminarily that it classifies cryptocurrency as 'crypto assets.'[516] By virtue of the fact that the disposal of assets (specifically) gives rise to CGT, it may be inferred that the IFWG is in favour of cryptocurrency being subject to CGT exclusively even though the paper does not mention its position on CGT specifically. The fact that the IFWG refers to cryptocurrency as 'crypto assets' provides further affirmation that the IFWG is a proponent for the application of CGT to the disposal of cryptocurrency.

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[507] South African Revenue Service 'Guide on the ring-fencing of assessed losses arising from certain trades conducted by individuals' available at *https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G04%20-%20Guide%20on%20the%20Ring%20Fencing%20of%20Assessed%20Losses%20Arising%20from%20Certain%20Trades%20Conducted%20by%20Individuals.pdf*, accessed on 7 June 2020.
[508] Ibid.
[509] Income Tax Act 58 of 1962 s 20A (2) (*b*).
[510] Taxation Laws Amendment Act 23 of 2018.
[511] Ibid. This consideration still applies in terms of the Tax Amendment Act 2020.
[512] Ibid.
[513] Ibid.
[514] Cliffe Dekker Hofmeyr 'Treasury includes cryptocurrency in draft taxation legislation' available at *https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-27-july-treasury-includes-cryptocurrency-in-draft-tax-legislation.html*, accessed on 11 March 2020.
[515] Ibid.
[516] See 2.3.4. above for a discussion on the IFWG's categorisation of cryptocurrency.

Even though there is no mention of cryptocurrency being considered as an asset specifically in the Tax Amendment Act 2018,[517] the IFWG indicates its support for the new taxation regulations relating to cryptocurrency as contained in the Tax Amendment Act 2018.[518] The Tax Amendment Act 2020 does, however, refer to 'cryptocurrency' as 'crypto assets,' but neglects to formally define 'crypto assets' or provide further clarity regarding whether such CAs will be considered as assets for the purposes of CGT. The IFWG recommends that the National Treasury along with SARS, should consider constructing a cohesive definition of 'crypto assets' specifically so as to apply effective regulations to cryptocurrency in conjunction with its nature as a type of 'asset' for the purposes of exchange and taxation regulation.[519]

In this regard, it is submitted that a definition be provided for 'crypto assets' and if the National Treasury indeed intends to categorise cryptocurrency as crypto assets, it must define this term clearly and formally in legislation or at the very least, formally set out its intention to treat cryptocurrency as crypto assets specifically. This would eliminate any ambiguity relating to the categorisation of CAs and thus, clarify the taxation treatment thereof.

This clarification would provide taxpayers and legal practitioners with further insight into the taxation treatment of CAs and how they are to function practically. In light of what seems to be a mere issue of semantics, (but is in fact, an issue of incohesive regulation) it is submitted that the categorisation and taxation treatment of CAs (in terms of such categorisation) remains somewhat ambiguous.[520]

3.6. INTERNATIONAL TAXATION REGULATIONS OF CRYPTO ASSETS AS SET OUT BY THE INTERGOVERNMENTAL FINTECH WORKING GROUP

In order to create substantial and effective development in the field of CA taxation in SA, regulations regarding the taxation of CAs internationally must be considered. Not only will this comparative analysis provide a brief insight into the progress of SA's CA taxation regulation in relation to other countries, but it will also provide a means by which innovative solutions formed by other countries may be examined in order to ascertain whether these ways of regulating CAs may be viable in SA. It is submitted that, in consideration of the price volatility of CAs (as well as other associated risks relating thereto), some governments (such as the South

[517] Taxation Laws Amendment Act 23 of 2018.
[518] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 27. These new regulations were discussed at 3.4. above.
[519] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 27.
[520] This ambiguity may be illustrated further through this research, by the constant necessity (in the body of this research) to refer to 'cryptocurrency' and/or 'crypto assets' where the context requires same, or interchangeably.

African government for example) are weary of adopting an entirely friendly stance towards the digital financial system.

Since the IFWG provides the most recent position on issues relating to CAs, it is submitted that its position paper is valuable in setting out a brief analysis of international CA taxation regulations. This portion of the research will include a concise analysis of the position on CA taxation in the following countries: the United Kingdom,[521] Australia and Germany. The UK and Australia are considered in this research due to the fact that they both provide a contemporary stance on financial technology developments and the UK law in particular is closely linked to South African law.

The CA taxation regulations in Germany will be dealt with briefly. This is due to the fact that this country has adopted a progressive and positive stance towards CAs. Although there is no direct relation between Germany and SA in terms of the economic position thereof, it is submitted that only once there is a holistic examination of regulations in countries which are open to CAs and technologically progressive, may SA begin to develop new and simple solutions. Germany's position on CAs should thus be considered for guidance in a South African context.

3.6.1. United Kingdom

In the UK, CAs are subject to CGT (as is the case with other countries that recognise and welcome cryptocurrency as part of their financial systems) even though the term is not yet formally classified.[522] Taxation authority in the UK has provided clarity on the taxation treatment of CAs,[523] which attests to the country's welcoming attitude towards CAs. This is an important consideration from a South African perspective, since SA aims to be welcoming of the developments in financial technology (and CAs specifically) but has neglected to provide extensive clarity on the taxation treatments of CAs. This supports the contention that SA may learn from the UK in terms of the clarity provided by the UK government on CA regulation.

[521] Hereinafter referred to as the 'UK.'
[522] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 51.
[523] Ibid at 51.

Even though the legislature in SA has not formally defined cryptocurrency as CAs for the purpose of CGT,[524] since the Tax Amendment Act 2020[525] refers to cryptocurrency as CAs,[526] the UK position (which subjects cryptocurrency to CGT) must be analysed thoroughly. This is due to the fact that the UK position may create somewhat of a 'blueprint' in terms of the future regulation of CAs in SA as well as which considerations must be taken into account to ensure regulatory clarity and effective regulation of CAs.

In a position paper released by the UK taxation authority,[527] the government provided clarity on which taxes apply to individuals who use/trade CAs. The UK has identified that individuals usually hold CAs as personal investments or in order to effect purchases.[528] On this basis, CGT will only be imposed on individuals when they dispose of their CAs. In terms of income tax[529] and national insurance contributions, the individual's liability will arise when they receive CAs from their employer in lieu of a salary or remuneration or when they receive CAs as a result of '…mining, transaction confirmation or airdrops.'[530] The position paper goes on further (in considering more specific scenarios which individuals may be subject to) to state that if an individual runs a business which trades in CAs (and accumulates trading profits therefrom accordingly) the income tax regulations would apply instead of the CGT regulations.[531]

It is submitted in this regard that this clarification which is provided to taxpayers in the UK regarding the taxation treatment of their CA proceeds is necessary in terms of ensuring the effective regulation of CAs. If SA were to follow suit and provide regulatory clarity to taxpayers, it would lessen the burden on taxpayers, SARS and the *fiscus* as the parameters of the administration of tax collection would be clear and thus simpler to effect. If taxpayers are cognisant of the taxation treatment of their CA proceeds and the process in respect of SARS' collection of the tax therefrom, there is a higher chance of tax compliance.

Regarding the substance of the position paper (in respect of taxes for individuals), it is submitted that the stance the UK government takes in applying either income tax or CGT to specific situations is the correct stance and it takes the commercial realities which may be at

[524] This is in consideration of the fact that the Tax Amendment Act 2020 merely refers to 'crypto assets,' but nowhere in any legislative provisions is the term defined accordingly.
[525] Taxation Laws Amendment Act 23 of 2020.
[526] See 3.7. below for a discussion on cryptocurrency being referred to as crypto assets in the Tax Amendment Act 2020.
[527] The UK Taxation authority is known as HM Revenue and Customs.
[528] HM Revenue and Customs position paper *Cryptoassets: tax for individuals* (2019).
[529] Also referred to as 'normal tax' in SA but is referred to synonymously as 'income tax' in SA in addition thereto.
[530] Ibid. An airdrop refers to a situation in which an individual receives tokens or crypto assets as a result of a marketing campaign through which such individual would be selected to receive crypto assets or tokens.
[531] Ibid.

play into consideration. This simple approach to what can be a very complex issue seems to be a practical solution to the taxation regulation of CAs.

It is submitted that the fact that the UK has published a position paper on the taxation treatment of CAs indicates not only the need for cryptocurrency regulation but also the possibility thereof. In terms of considerations from a South African perspective (in conjunction with the UK position on tax regulation of CAs), it is submitted that it is indeed possible for SARS and the legislature to vigorously pursue the development of effective cryptocurrency regulation, or at the very least, provide formal guidance to users as to the system of CA taxation in SA.

Based on the premise that the UK taxation authority is the equivalent to SARS in SA, SA should look towards the UK regarding the development of taxation regulations through formal position papers or guides relating to the taxation of cryptocurrency. It is submitted further that not only should SA consider implementing a position paper on the taxation of CAs, but the legislature and SARS should consider the substance of the UK position paper in terms of the actual legislative provisions or content of a potential position paper to be formulated and effected in regulating CAs in SA effectively in order to mitigate possible tax evasion.

3.6.2. Australia

In Australia, a similar position to that of the UK is adopted by taxation authority in that CAs are considered to be assets for CGT purposes.[532] Taxation authority in Australia have specifically excluded CAs from being classified as money or currency,[533] thus mirroring the position in SA. This therefore provides a basis for the consideration of the Australian position on CAs in this research. The fact that Australia does not consider CAs to be currency supports the inference made by the reference to 'cryptocurrency' as 'crypto assets' in the Tax Amendment Act 2020.[534]

Australian taxation authority has indicated that (in addition to CAs being categorised as assets for the purpose of CGT) CAs are to be considered as property for taxation purposes.[535] In this regard, a parallel may be drawn between Australia's categorisation of CAs as property[536] and Erlank's position (from a South African perspective) on CAs.[537] Even though it was

[532] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 41.
[533] Ibid at 41.
[534] Taxation Laws Amendment Act 23 of 2020.
[535] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 41.
[536] Ibid at 41.
[537] See 2.3.5. above for a discussion on cryptocurrency as virtual property and Erlank's position on the matter.

contended[538] that CAs should not be formally considered as property exclusively in a South African context, Australia's position on CAs in relation to CAs being subject to CGT remains relevant to this brief international comparison.

According to Australian taxation authority,[539] the disposal of CAs creates a CGT event, thereby triggering an individual's CGT liability.[540] This liability is created when an individual sells or gifts CAs, trades or exchanges CAs, converts CAs to fiat currency or uses CAs to obtain goods or services.[541] In this regard, if any capital gain is made on the disposal of CAs in these various manners, a portion of the gain or all of the gain may be subject to CGT.[542]

It is submitted that this level of clarity provided by the Australian taxation authority is necessary by taxation authorities in countries which permit the use of CAs. It is submitted further that the comprehensive guide (setting out a precise exposition of the taxation treatment of CAs) provided to Australian users of CAs is effective in mitigating any lack of regulatory clarity that may exist amongst such users of CAs.

Furthermore, it is contended that this extent of regulatory clarity (as is also the case in terms of the UK position paper) will serve as a mitigating factor in respect of tax evasion in Australia by virtue of the fact that the Australian taxation authority is enforcing formal and specific regulations upon users of CAs. Thus, the possibility of evading tax by failing to declare CA earnings will decrease as opposed to the situation in SA, where the lack of regulatorily clarity pertaining to CAs allows for the inadvertent abuse of the taxation system.

3.6.3. Germany

Germany has adopted a friendly stance on CAs, which is important to note for the future and potential growth of CAs in SA.[543] Germany's taxation position in relation to CAs is worth taking cognisance of due to the fact that the finance ministry in Germany considers Bitcoin (in particular) to be a financial instrument.[544]

[538] See 2.3.5. above for a discussion on why it may not be favourable to categorise cryptocurrency exclusively as property according to the definition thereof.
[539] The Australian Taxation Office.
[540] The Australian Taxation Office *Tax treatment of cryptocurrencies in Australia – specifically Bitcoin* (2020).
[541] Ibid.
[542] Ibid.
[543] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 45and 51.
[544] Ibid at 45.

This categorisation is important in a South African context as SA has also categorised CAs as financial instruments for taxation purposes, and formally done so through legislation.[545] Where the German taxation position differs from the South African position however, lies in the fact that Germany treats CAs as legal tender.[546] Germany has further affirmed the fact that it officially recognises CAs as 'private money.'[547] This is in direct conflict with the position of Australian taxation authority, since CAs are not to be considered as money in Australia.[548]

Germany has implemented CA regulation so efficiently that it has even defined 'crypto assets' in its Banking Act[549] and included CAs specifically in the definition of financial instruments.[550] In this regard, CAs are defined by the KWG (according to the English interpretation)[551] as:

> *Digital representations of value [that are] not issued or guaranteed by a central bank or a public authority, do not possess the legal status of currency or money, [but] based on agreement or actual practice, are accepted as means of exchange or payment or serve investment purposes [and] can be transferred, stored and traded electronically.*

It is submitted that SA ought to adopt a formal definition of CAs through legislation, as Germany has done. This will have the effect of strengthening the development of CA regulation in SA and, from a taxation perspective, provide clarity as to the exact tax treatment of CAs without the regulatory uncertainty faced by users of CAs in SA currently.

It is submitted that (reflecting on the various categorisations and stances relating to CAs and the taxation thereof) even though the international regulations of CAs range from virtually non-existent to highly precise and integral to the financial systems of the countries in question, there has been no formal attempt to separate CAs from the limits of traditional categorisations within the existing financial regulatory framework. CAs have been defined, classified and categorised in relation to existing financial constructs as opposed to being regulated separately and in accordance with its own set of rules and principles.

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[545] See 3.4.1. above for a discussion on cryptocurrency as a financial instrument, as formally categorised by the Taxation Laws Amendment Act 23 of 2018.
[546] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 45.
[547] Ibid at 45.
[548] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 41.
[549] Germany's Banking Act is known as the Kreditwesengesetz or KWG. Kreditwesengesetz will hereinafter be referred to as 'KWG.'
[550] Norton Rose Fulbright 'New regulatory regime for crypto assets in Germany' available at *https://www.nortonrosefulbright.com/en/knowledge/publications/5ee1e37e/new-regulatory-regime-for-crypto-assets-in-germany*, accessed on 27 February 2021.
[551] Ibid.

It is accepted that CAs are based on a complex digital system and regulating them within an existing financial framework is rational and reasonable. However, it is submitted that due to the unique nature of CAs, its price volatility as well as its potential for the future, (and the potential of blockchain technology specifically) it should be regulated separately and according to its own limitations, nature and mechanics. It is submitted that the formation of separate regulations for CAs is reasonable and possible insofar as preliminary regulatory steps are concerned.[552]

3.7. AN ANALYSIS OF THE TAXATION LAWS AMENDMENT ACT 23 OF 2020 WITH SPECIFIC REFERENCE TO CRYPTO ASSETS

It is worth noting that the Tax Amendment Act 2020[553] illustrates that section 1 of the Income Tax Act[554] (the definition section of the Act) is to be amended further to include 'crypto assets' (as opposed to 'cryptocurrency') in the definition of a 'financial instrument.'[555] As stated above,[556] 'cryptocurrency' (and thus CAs) will still be categorised as financial instruments as per the Tax Amendment Act 2018,[557] however, the Taxation Amendment Act 2020[558] envisages the use of the term 'crypto assets' specifically, instead of 'cryptocurrency.' No further explanation or definition of 'crypto asset' is offered through this legislation, which is cause for concern. Furthermore, the Tax Amendment Act 2020 neglects to explore the consequences of the reference to cryptocurrency as 'crypto assets.'

It is submitted in this regard that merely changing the term 'cryptocurrency' to that of 'crypto assets' will have no clear meaning unless the legislature sets out a proper definition of CAs in taxation legislation. It is submitted further that it is unreasonable to merely change the term which cryptocurrency is to be referred to with no clear indication of the legislature's intention in this regard. If CAs are to be considered as assets for the purposes of the application of CGT thereto, this should be indicated in taxation legislation. Users should not be misguided or misinformed due to ineffective and unclear legislative provisions.

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[552] It is submitted that some preliminary regulatory measures include defining cryptocurrency specifically (as mentioned below at 5.2.1.) and not in relation to existing financial systems as well as possibly developing a taxation system which accounts for the unique nature of cryptocurrency.
[553] Taxation Laws Amendment Act 23 of 2020.
[554] Income Tax Act 58 of 1962: s 1.
[555] Taxation Laws Amendment Act 23 of 2020: s 1 (1) (*f*).
[556] See 3.4.1. above for a discussion on cryptocurrency as a financial instrument.
[557] Taxation Laws Amendment Act 23 of 2018.
[558] Ibid.

Haupt's argument[559] that the National Treasury had the opportunity to define cryptocurrency as assets specifically for the purpose of CGT but did not do so, still applies in respect of the Tax Amendment Act 2020.[560] Even though this Act refers to cryptocurrency as 'crypto assets,' there is still no legislative indication that CGT is to apply to the disposal of CAs and in what instances such CGT is to apply thereto. It is submitted in this regard that formalising a definition of CAs in taxation legislation would serve as a potential solution to this issue.

It is submitted that the legislature had yet another opportunity to define CAs or even clarify the taxation position thereof[561] but failed to do so. It is submitted further that merely referring to 'cryptocurrency' as 'crypto assets' could potentially be subject to interpretation and debate. In this regard, it seems wise to provide guidelines and legislative clarity to users of CAs as to the consequences of cryptocurrency being referred to as 'crypto assets' for the purpose of taxation.

One could hypothesise and interpret the legislation to mean that CAs will be subject to CGT. However, with no legislative clarity in this regard, it is submitted that no real clarity regarding the taxation treatment of CAs can be attained. It is unreasonable for the legislature to expect users of CAs to come to the conclusion that their CA earnings (by virtue of the disposal of their CAs) will be subject to CGT without legislative clarity in this regard.

In any event, since cryptocurrency has been referred to as 'crypto assets' in the Tax Amendment Act 2020,[562] the CGT consequences associated therewith must be considered. It is submitted that if CAs are to be considered as assets for the purpose of CGT, the price volatility of CAs will make the imposition of CGT on the disposal of CAs difficult.[563] CGT is imposed on the disposal of assets and specifically, in relation to the gains or losses emanating therefrom. In order to calculate an amount subject to CGT, the base cost of the asset (CA in this case, if it is considered to be an asset for the purpose of CGT) is deducted from the proceeds of the disposal of such asset.

By virtue of the simple analogy of the 'fruit and tree' principle[564] as a core consideration for the differentiation between receipts or accruals which are income or capital in nature, CA receipts or accruals may function as either income or capital. It would therefore be an oversight

[559] See 3.3.2. above for a discussion on Haupt's stance regarding the categorisation of cryptocurrency as assets and the failure of the legislature to provide clarity on the treatment of cryptocurrency in this regard.
[560] Taxation Laws Amendment Act 23 of 2020.
[561] Through the Tax Amendment Act 2020.
[562] Taxation Laws Amendment Act 23 of 2020.
[563] This is in consideration of the nature of CAs and the fact that the value thereof fluctuates rapidly and constantly.
[564] *Commissioner for Inland Revenue v Visser* 1937 TPD 77. This principle was discussed above at 3.3.1.

to consider CAs exclusively as assets for the purpose of CGT without taking into account the potential for CAs to be considered as income for the purpose of normal tax.

As a practical (and hypothetical) analogy of CAs being formally considered as assets exclusively – if one were to buy R1000.00 worth of Bitcoin and leave that amount in their Bitcoin wallet on their Luno application for one year (allowing exponential growth) and the value increases to an amount of R20 000.00 for example, when they withdraw the funds into their local bank account, CGT will apply to the proceeds. Thus, (in terms of basic CGT considerations) the base cost of the cryptocurrency will be R1000.00 and the amount subject to capital gains will be R19 000.00 (this is not accounting for any exclusions which may be applicable in respect of the calculation of CGT liability).

After analysing the Tax Amendment Act 2020[565] in respect of the reference to 'cryptocurrency' as 'crypto assets,' it is submitted that the legislature should have clearly set out its intention in respect of such reference. Merely referring to 'cryptocurrency' as 'crypto assets' in legislation does not automatically alert users of CAs as to the taxation consequences of CA trading. Since there is no formal and exclusive definition of CAs in the Tax Amendment Act 2020[566] and no indication of how CAs are to be taxed in relation to the new provision, users of CAs may be misguided as to the exact taxation consequences of CA transactions. This will inadvertently lead to *lacuna* in the application of taxation regulations in respect of CAs, which will create potential for tax evasion as a consequence of the misapplication thereof.

[565] Taxation Laws Amendment Act 23 of 2020.
[566] Ibid.

CHAPTER 4

CRYPTO ASSETS AND TAX EVASION IN SOUTH AFRICA

4.1 OVERVIEW

Until this point in the research, the focus was centered around establishing the foundation of CA mechanics and the taxation regulation of CAs in order to determine the effectiveness thereof. These are crucial factors when determining the consequences of ineffective regulation. It is submitted that the success of taxation regulation of CAs is largely dependent upon the existing consequences and implications of the use of CAs even after there have been legislative developments in this regard.

It is submitted that taxation legislation should not serve to offer only superficial remedies to taxpayers and the *fiscus* but should ensure the development of concise and effective provisions. This is especially necessary when considering CAs since this digital innovation is a relatively new and complex composite facet of financial technology. In this regard, it is submitted that effective taxation regulation of CAs will result in fewer adverse consequences for taxpayers and the *fiscus* and a lessened margin for potential tax evasion.

Fraud, money laundering and the all-inclusive issue of tax evasion[567] are examples of criminal activity perpetuated by taxpayers which serve as adverse consequences for the *fiscus* and SARS. In order to mitigate crimes such as tax evasion, taxation authority and the legislature have put rules and regulations[568] in place which guide taxpayers as to which activities and behaviours are permissible and which are not.

In this chapter, the concepts of tax avoidance and tax evasion will be examined and then analysed in relation to CAs. Furthermore, the issue of whether CAs (and the lack of regulation thereof) provides a favourable means for taxpayers to evade tax or impermissibly avoid tax will be discussed on the background of the theoretical aspects of tax evasion and tax avoidance. This chapter will provide an exposition of the crux of the research[569] in an attempt to eventually determine whether the existing taxation regulations are effective in mitigating the facilitation of tax evasion through CA transactions.

[567] Fraud and money laundering will not be discussed specifically, however, the broader issue of tax evasion will be examined as this is inclusive of a variety of issues, which include fraud and money laundering.
[568] These rules and regulations will be discussed below at 4.3.
[569] The crux of the research being the issue of tax evasion as facilitated by cryptocurrency transactions.

It must be noted from the outset that the scenarios and eventualities discussed within the ambit of this chapter are examined to the extent that a taxpayer has not opted to declare their CA earnings as part of their gross income for the determination of their normal tax liability or in their tax returns in general.

4.2. TAX AVOIDANCE

In SA, the liability for normal tax[570] incurred on a taxpayer's gross income only exists insofar as their earnings meet the requirements of the charging provisions of the Income Tax Act.[571] Thus, it is possible for taxpayers to reduce their normal tax liability or avoid it altogether.[572] If there is no legal provision in legislation barring a taxpayer from transacting in a way which reduces their normal tax liability,[573] they are entitled to legitimately organise their financial affairs in a manner which has the effect of decreasing their normal tax liability.[574] This lessening of one's taxable income in order to lawfully reduce their tax liability is referred to as tax avoidance, and is permitted within the ambit of taxation law.[575]

Tax avoidance serves the interests of the taxpayer in question but has proven to have a somewhat negative effect on the *fiscus* regarding tax revenue gains accumulated by it.[576] The loss of tax revenue by the *fiscus* resulting from individual taxpayers avoiding tax is not as much of a threat to the *fiscus* than that of large businesses and enterprises engaging in tax avoidance practices.[577] Tax avoidance on a large scale, even though legal and legitimate, can have the effect of short and long-term consequences for the *fiscus*.[578] Revenue loss is indicative of a short-term negative consequence, whilst '… damage to the tax system and economy…'[579] is indicative of a long-term negative consequence of tax avoidance.[580]

It is submitted that tax avoidance and tax evasion represent varying degrees of similar activities or behaviours displayed by taxpayers in an effort to reduce or escape their tax liability in respect

[570] See 3.2. where the parameters of normal tax are briefly discussed. Normal tax is synonymous with the term 'income tax' and is used to refer to a taxpayer's tax liability in relation to their income.
[571] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1115.
[572] Ibid at 1115.
[573] Ibid at 1115.
[574] *Duke of Westminister v IRC* 1953 51 TLR 467, 19 TC 490 at para 520.
[575] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1115.
[576] Ibid at 1115.
[577] Ibid at 1115. In relation to cryptocurrency however, (and in consideration of the price volatility of the value thereof) the fact that the individual taxpayer's accumulation of income may exponentially increase rapidly indicates that the threat to the *fiscus* becomes greater.
[578] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1115 – 1116.
[579] Ibid at 1116.
[580] Ibid at 1116.

to their intention. In this regard, (and upon analysing the principles of tax avoidance and tax evasion) it seems as if tax avoidance consists of permissible commercial activities for the purpose of reducing tax liability, impermissible tax avoidance consists of activities conducted by taxpayers to the extent that their efforts to reduce their tax liability constitute a larger degree of tax avoidance and tax evasion is merely the absolute extent of impermissible behaviour in relation to the conduct of taxpayers in terms of their efforts to escape their tax liability, as opposed to reducing or legally avoiding it.

However, since taxpayers can only be taxed in accordance with promulgated legislation,[581] any ambiguities in tax law can be legitimately used to the advantage of the taxpayer, irrespective of whether avoiding tax has negative consequences for the *fiscus*. In order to mitigate these negative consequences however, the legislature has aggressively addressed tax avoidance schemes by including specific anti-avoidance provisions in the Income Tax Act.[582]

4.2.1. Anti-avoidance provisions

Even though tax avoidance is generally permitted, due to the negative consequences faced by the *fiscus* and SARS which are associated therewith as well as the ambiguities in legislation which taxpayers use to their advantage (to avoid tax), it became increasingly important for SARS to distinguish permissible tax avoidance from impermissible tax avoidance.[583] The Income Tax Act[584] contains specific anti-avoidance provisions[585] throughout the Act which deal with particular avoidance schemes (as opposed to general anti-avoidance schemes) and aim to counter such schemes in order to mitigate impermissible tax avoidance relating to these specific schemes.[586]

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[581] Ibid at 1116.
[582] Income Tax Act 58 of 1962.
[583] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) at 1117. It must be noted that generally, impermissible tax avoidance can be understood as tax avoidance to the extent where the activities of the taxpayer (in an effort to reduce or avoid their tax liability) cause undue prejudice to the *fiscus* and SARS even though such activities are not illegal.
[584] Income Tac Act 58 of 1962.
[585] Hereinafter referred to as the 'specific provisions.'
[586] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) at 1116-1117. A few examples (unrelated to cryptocurrency) of specific schemes which are addressed via specific anti-avoidance sections in the Income Tax Act are set out as follows: section 23B prohibits accounting for an amount as a deduction or allowance more than once when determining a taxpayer's taxable income, section 23F prevents the permittance of deductions for unsold trading stock which is not so reflected as closing stock at year-end and section 24J is a deeming provision which deems interest to have been incurred on a yield-to-maturity basis in order to prevent tax avoidance schemes. (Note that these examples are merely included in this research for illustrative purposes in order to establish that there are in fact many specific anti-avoidance provisions which relate to specific scenarios as envisaged by the Income Tax Act)

In addition to the specific provisions, there was a need to address general anti-avoidance schemes which may not have been subject to the specific anti-avoidance provisions by virtue of the fact that the specific anti-avoidance provisions only apply to the particular scenarios as envisaged therein. In this regard, the general anti-avoidance rule[587] was established. Section 103(1) of the Income Tax Act[588] set out this general rule in order to address general impermissible tax avoidance, which cannot be attributed to one particular scenario, but can be applied to impermissible tax avoidance in general. This general rule, however, was deemed ineffective by SARS as it contained inherent weaknesses in SARS' view.[589] The general rule thus did not serve the purpose of curbing impermissible tax avoidance.

In order to address any weaknesses in the ineffective general rule, (which was in place for a considerable amount of time before the various anti-avoidance provisions came into effect) it was entirely replaced by the general anti-avoidance provision,[590] which consists of provisions 80A to 80L.[591] These general provisions address an array of scenarios which the specific provisions do not account for.[592] Since no specific provisions which address tax avoidance in relation to CAs are in existence, the general provisions must be considered.

In order to be liable under the general provisions, the tax avoidance activities conducted by the taxpayer must meet the requirements of the general provisions. For the purpose of this research, the requirements for an impermissible tax avoidance arrangement[593] (including the consequences thereof) will be discussed briefly as well as reportable tax avoidance arrangements, due to the fact that contentions will be made[594] regarding the applicability of this type of arrangement to CA transactions.

For an impermissible tax avoidance arrangement to exist, there are requirements which must be met.[595] By setting out the parameters of impermissible tax avoidance, it becomes simpler for SARS to distinguish between permissible tax avoidance and impermissible tax avoidance which is aimed at abusing *lacuna* which exist by virtue of certain loopholes in taxation legislation.[596] For a tax avoidance arrangement to be impermissible, three preliminary

[587] Hereinafter referred to as the 'general rule.'
[588] Income Tax Act 58 of 1962, s103(1).
[589] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) at 1117.
[590] Hereinafter referred to as the 'general provision.'
[591] Phillip Haupt *Notes on South African Income Tax* (2020) 640.
[592] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) at 1117.
[593] Impermissible tax avoidance arrangements are dealt with by section 80A of the general provisions in the Income Tax Act.
[594] See 4.2.2. below for a discussion on tax avoidance in relation to CAs.
[595] Section 80A of the Income Tax Act sets out these requirements.
[596] Phillip Haupt *Notes on South African Income Tax* (2020) 641.

requirements have to be met. Firstly, there must be an arrangement.[597] Secondly, the sole or main purpose[598] of such arrangement must be to obtain a tax benefit.[599] Thirdly, the tax avoidance arrangement must be abnormal,[600] lack commercial substance[601] or create a non-arm's length[602] right or obligation in the furtherance of abusing[603] the provisions in the Income Tax Act.[604]

If the requirements of the impermissible tax avoidance arrangement are met in respect of any transaction, operation, scheme, agreement or understanding, the Commissioner may take action and make use of certain remedies to counter the effects of the impermissible tax avoidance arrangement in question.[605] The power the Commissioner in respect of the remedies they may employ is so wide that they can disregard the impermissible tax avoidance arrangement completely or disregard any part of it so as to impose tax consequences on the parties of the arrangement as if such arrangement had not been entered into in any event.[606] This may result in the party/parties to the impermissible tax avoidance arrangement being

[597] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) at 1119. The word 'arrangement' includes transactions, operations, schemes, agreements, understandings as well as the alienation of property relating to these various arrangements. A wide interpretation is used when determining which arrangements fall within a transaction or scheme and any agreements or understandings do not have to be enforceable in order to be considered an arrangement in terms of s80A.

[598] Ibid. The purpose of an arrangement must be determined in order to establish whether the true and main objective is to gain a tax benefit. In this regard, an objective test must be used. However, according to section 80G of the Income Tax Act 58 of 1962, it is indicated that the purpose of the impermissible tax avoidance arrangement must be determined in consideration of the facts and circumstances in each case. This implies the application of a subjective test. Thus, the determination of the purpose of a tax avoidance arrangement is twofold, with objective as well as subjective factors having to be considered. According to section 80G of the Income Tax Act 58 of 1962, a tax avoidance arrangement is presumed to having been entered into with the sole purpose of obtaining a tax benefit unless the taxpayer who is obtaining the tax benefit proves (objectively) that the main purpose of the arrangement in question was not to obtain a tax benefit. The subjective factors must not conflict with the objective purpose and both of these elements must be investigated to the extent required in terms of determining whether they align.

[599] Phillip Haupt *Notes on South African Income Tax* (2020) 641 and 643. According to Section 1 of the Income Tax Act, a tax benefit includes any avoidance, postponement or reduction of any tax liability.

[600] Ibid. Haupt contends that establishing the normality of a tax arrangement (in determining whether it is impermissible) must be done in context of the circumstances at hand. In this regard, Haupt indicates further that the reason as to why transactions were entered into must be considered when determining the normality of a tax avoidance arrangement. If the transactions in question were entered into abnormally in light of the circumstances and in order to avoid tax, this requirement will most likely be met.

[601] Section 80C of the general provisions in the Income Tax Act deals with the requirement of the 'lack of commercial substance' in relation to impermissible tax avoidance arrangements. This section envisages that a tax avoidance arrangement lacks commercial substance '…if it results in a significant tax benefit for a party but does not have a significant effect on the business risks or net cash flows of that party.'

[602] Ibid at 643. Arm's length is not a term which is defined in the Income Tax Act, but according to *Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A), is indicative of a scenario whereby each party would seek to strike a bargain independently, which would result in each party gaining the maximum advantage from the transaction in question.

[603] This abuse of the provisions of the Income Tax Act may take place either directly or indirectly.

[604]Phillip Haupt *Notes on South African Income Tax* (2020) 643.

[605] Income Tax Act 58 of 1962, section 80B.

[606] Phillip Haupt *Notes on South African Income Tax* (2020) 641.

wholly or partially liable for tax they were aiming to avoid having to be liable for and will consequently combat the arrangement which was conducted in order to reduce or avoid their liability.

Another instance (in addition to impermissible tax avoidance arrangements) where tax avoidance is dealt with is when reportable arrangements are in existence. This type of arrangement is one through which the line between permissible tax avoidance and impermissible tax avoidance may be crossed by virtue of the fact that permissible tax avoidance has the potential to be (or is in the process of becoming) an impermissible tax avoidance arrangement.[607]

Reportable arrangements serve the purpose of warning SARS as to the existence or development of any transactions '…that may be perceived as constituting unacceptable tax avoidance, or that might otherwise go undetected and remain untaxed.'[608] The purpose of the provisions relating to reportable arrangements is to mitigate the development and prevalence of impermissible tax avoidance arrangements and alert the Commissioner to such developments before they advance in the realm of impermissible tax avoidance arrangements.[609] The failure to report arrangements which may lead to impermissible tax avoidance may result in administrative penalties for the taxpayer.[610]

4.2.2. Tax avoidance and crypto assets

To determine whether tax avoidance in relation to CAs is permitted, the tax avoidance provisions must be considered[611] even though CAs present with their own array of taxation regulation issues by virtue of their nature.[612] Submissions will be made in this regard in order to establish the events through which impermissible tax avoidance may be facilitated by CA transactions. Since tax avoidance relating to CAs is not covered by the specific anti-avoidance provisions, the general anti-avoidance provisions[613] must be considered in order to determine

[607] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1124. See 4.2.1. above for a discussion on reportable arrangements in relation to cryptocurrency.
[608] Ibid at 1124.
[609] Ibid at 1124.
[610] Ibid. The failure to disclose a reportable arrangement will result in the person who directly or indirectly derived a tax benefit from such reportable arrangement being liable for an administrative non-compliance penalty for each month that they continue to fail to report the arrangement.
[611] On the background of the foundational aspects of cryptocurrency taxation regulation as explored throughout the former chapters of this research.
[612] See Chapter 2 at 2.2. for a discussion on the nature of cryptocurrency.
[613] See 4.2.1. above for a discussion on the general anti-avoidance provisions.

whether (and in which particular instances) CA transactions facilitate impermissible tax avoidance.

Since CAs are based on a unique digital system, applying the traditional tax avoidance principles to CA transactions may be difficult where the consequences of the existence of an impermissible tax avoidance arrangement are concerned. Whilst tax avoidance is characterised as such irrespective of the fact that CAs form the subject of contention, it is submitted that fulfilling every requirement of the general provisions with the result that a CA transaction would be considered as an impermissible tax avoidance arrangement may be challenging.

This is due to the fact that when establishing whether the requirements of an impermissible tax avoidance arrangement have been met regarding the non-disclosure of the taxpayer's CA earnings (for the purpose of determining their tax liability), the surrounding circumstances as well as the nature of CAs must be considered. In consideration of such circumstances and the nature of CAs, it is submitted that the existence of an impermissible tax avoidance arrangement as facilitated by CA transactions will be difficult to establish with certainty.

In this regard, it is submitted that the likelihood of a CA transaction satisfying every element of the impermissible tax avoidance 'test' will be low due to the fact that the regulations[614] in place which address CAs are very menial in any event and will not provide extensive rules which cover a range of eventualities of CA transactions. It is submitted in this regard, that there is a higher possibility of CA transactions (which may facilitate tax avoidance) being considered as reportable arrangements (as opposed to impermissible tax avoidance arrangements) insofar as tax avoidance is concerned.

A CA transaction will be a reportable arrangement if the taxpayer in question is a participant in the transaction, the transaction is indicative of certain characteristics,[615] it has been formally listed as an arrangement and is not specifically excluded[616] in operating as an arrangement.[617] In relation to CAs, the relevant characteristic of a reportable arrangement is that of the transaction being indicative of a tax avoidance arrangement.[618] In terms of reportable arrangements in relation to CAs, it is submitted that it would be wise of a taxpayer to make use of this provision in order to ensure their compliance with taxation legislation. A taxpayer

[614] By virtue of the Tax Amendment Act 2018 and the Tax Amendment Act 2020.
[615] Tax Administration Act 28 of 2011, s 35. This section contains a list of characteristics which indicate a reportable arrangement.
[616] In terms of the Tax Administration Act 28 of 2011, s 36.
[617] Tax Administration Act 28 of 2011, s 35.
[618] Ibid at s35(1)(*b*).

should rather disclose a reportable arrangement in respect of their tax avoidance relating to CAs than allow such tax avoidance to continue to the point where they would be liable for greater penalties by virtue of the fact that their arrangement would be indicative of impermissible tax avoidance.

4.3. TAX EVASION

Tax evasion is a broad term which can generally be attributed to the conducting of illegal activities by a taxpayer in order to '… free [themselves] from a tax burden.'[619] Tax evasion is largely characterised by (within the ambit of income tax) the non-disclosure and non-payment of normal tax that the taxpayer would ordinarily be liable to pay had they made an honest and thorough disclosure of their income.[620] Tax evasion also includes unlawful activities such as '…fraud and deceit, […] the conclusion of sham transactions, the deliberate non-disclosure of income or the deliberate over-statement of deductible expenditure.'[621] Fraud and deceit in this context are inclusive of the falsification of a taxpayer's returns, books and accounts specifically.[622] Tax evasion is considered to be a criminal offence[623] and non-compliance with the requirements of the Tax Acts[624] which aim to regulate taxation liability result in severe consequences[625] for the taxpayer concerned.[626]

One of the main issues which may result in higher instances of tax evasion (if CAs remain unregulated to the extent that they currently remain unregulated) is the nature of CAs and user anonymity associated therewith, which will thus place CA earnings out of SARS' reach.[627]

It is submitted that the behaviours which will be considered as tax evasion must be severe for a taxpayer to be convicted. In order to address tax evasion, there are legislative provisions in place which set out consequences for non-compliance and offences relating to taxation laws.[628]

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[619] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1116.
[620] Ibid at 1116.
[621] Ibid at 1116.
[622] Ibid at 1116.
[623] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1116.
[624] Examples of Tax Acts include the Income Tax Act, the Value-Added Tax Act, the Estate Duty Act as well as the Transfer Duty Act, among others. Include full citation of Acts – i.e.: Value-Added Tax Act 89 of 1991.
[625] See 4.3.1. and 4.3.2. below for a discussion of the consequences of tax evasion.
[626] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1143.
[627] Omri Marian "Are Cryptocurrencies 'Super Tax Havens?'" (2013) 112 Mich. L. Rev. First Impressions 38 at 43-44.
[628] As discussed at 4.3.1. below.

4.3.1. Tax evasion provisions

Tax evasion may result in serious penalties as it is considered to be a criminal offence if specific requirements are satisfied.[629] In the ambit of certain transgressions, non-compliance with tax Acts as well as the evasion of tax must be considered as they are offences which bear the consequences of serious penalties and in certain circumstances, imprisonment.[630] Certain serious offences relating to the non-compliance with tax Acts may indicate that a person has committed a criminal offence and their non-compliance will result in a fine or imprisonment.[631]

In terms of tax evasion specifically, a person is guilty of an offence if they intend to evade tax or assist another in evading tax by making false entries or statements in their returns, (or any other document) giving a false answer when information is requested from them in terms of the Tax Administration Act,[632] maintaining, authorising or preparing false records or books of account, making use of fraud or contrivance or making false statements in order to obtain a refund or tax exemption.[633] A taxpayer who commits any of these offences may be liable to a fine or imprisonment not exceeding five years.[634]

Furthermore, in terms of the understatement[635] penalty specifically,[636] (relating to tax evasion) the consequences of a taxpayer's failure to submit their returns, construction of incorrect statements in their returns, omission from their returns as well as their failure to pay the correct tax amount will result in penalties incurred by the taxpayer.[637]

4.3.2. Tax evasion and crypto assets

Upon analysing the main provisions relating to tax evasion,[638] it is evident that a CA transaction would have to fall within the ambit of very specific events in order for any transgression relating thereto to be considered as an offence. Regarding the general provision in the Tax

[629] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1116.
[630] Ibid at 1144.
[631] Ibid. If the criminal offence relating to non-compliance with tax Acts is committed within the ambit of section 234 of the Tax Administration Act 28 of 2011, the consequential imprisonment period cannot exceed 2 years.
[632] Tax Administration Act 28 of 2011.
[633] Ibid at s 235 (1) (*a*)-(*e*).
[634] Ibid at s 235 (1) (*a*)-(*e*).
[635] Ibid at s 221. 'Understatement' is specifically defined by section 221 of the Tax Administration Act 28 of 2011 as the failure of a taxpayer to submit their returns, any omission from their returns, the construction of an incorrect statement in their returns, their failure to pay the correct amount of tax if no returns are required as well as any prejudice imposed on SARS or the *fiscus* by the taxpayer as a result of an impermissible tax avoidance arrangement.
[636] Ibid at s 221.
[637] See 4.3.2. below for a discussion on the understatement penalty in relation to tax evasion.
[638] See 4.3.1. above for a discussion on the tax evasion provision in terms of s235 of the Tax Administration Act 28 of 2011.

Administration Act[639] which relates to tax evasion, the taxpayer must have the intention to evade tax when conducting a particular action which is considered to be an offence.[640] It is submitted that (coupled with the intention to evade tax) when applying section 235[641] to a situation involving a CA transaction, if a taxpayer makes false statements regarding their returns, prepares false books or records or makes use of fraud, they will be subject to the penalties set out in this section.[642]

After the consideration of the general tax evasion provision, it is necessary to determine whether certain regulatory measures are in place to address the manner of tax evasion which may be facilitated through CA transactions. Even though there are no specific tax evasion provisions relating to CA offences, it is submitted that the understatement penalty provision will suffice in addressing the consequences of a taxpayer's failure to declare their CA earnings insofar as possible tax evasion is concerned.

An important element of the understatement penalty is the fact that it operates through varying degrees of non-compliance.[643] In this regard, the penalties imposed on the taxpayer concerned vary according to the degree of their behavior in connection with any action which constitutes an understatement. Thus, if a taxpayer's actions (for example) are indicative of a substantial understatement,[644] the penalty they will incur in a standard case is 10%,[645] whereas, if they commit an impermissible tax avoidance arrangement[646] or intentional tax evasion, the penalties they will incur in a standard case will be 75% and 150% respectively.[647] This penalty also

[639] Tax Administration Act 28 of 2011.
[640] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1116.
[641] Tax Administration Act 28 of 2011, s235.
[642] See 4.3.1. above for a discussion on the consequences of tax evasion.
[643] Phillip Haupt *Notes on South African Income Tax* (2020) 1002-1003.
[644] Tax Administration Act 28 of 2011, s221. 'Substantial understatement' is specifically defined by section 221 of the Tax Administration Act 28 of 2011 as an instance where prejudice to the *fiscus* (on account of the taxpayer's actions relating to the understatement of their returns) '…exceeds the greater of 5% of the amount of tax properly chargeable or refundable under a tax Act for the relevant period or R1 000 000.
[645] Tax Administration Act 28 of 2011, s223. This understatement penalty represents the percentage applied (according to the table as set out in section 223 of the Tax Administration Act 28 of 2011) to the shortfall (degree of understatement) of the tax, which the taxpayer will be liable for if they commit any actions within the ambit of sections 221 to 223 of the Tax Administration Act 28 of 2011. This penalty applies to all types of tax. This penalty will thus be applied on the degree to which the taxpayer did not incur the tax they would have if they did not understate their returns.
[646] See 4.2.1. above for a discussion on impermissible tax avoidance arrangements.
[647] Tax Administration Act 28 of 2011, s223.

applies to repeat cases[648] (of the understatement of a taxpayer's returns) and any actions of avoidance which are covered by any general anti-avoidance[649] provisions.[650]

In terms of CAs, (in consideration of the understatement penalty table)[651] it is submitted that if a taxpayer makes a substantial understatement, does not take reasonable care in completing their return or if there are no reasonable grounds in existence through which they could have taken the tax position which they adopted, they will be liable for the understatement penalty in accordance with section 223,[652] depending on the degree of their transgression.[653] In this regard, if the understatement is a repeat case, the penalty percentage will be higher, but if the taxpayer voluntarily disclosed the understatement made, the penalty percentage they will be liable for will be lower, or even zero, depending on when they voluntarily disclosed their transgression.[654]

If there was an impermissible tax avoidance arrangement in existence, there was gross negligence present or the taxpayer committed intentional tax evasion, they will also be liable for the understatement penalty in accordance with section 223,[655] depending on the degree of their transgression.[656] In this regard, if the understatement is a repeat case, the penalty percentage will be higher, but if the taxpayer voluntarily discloses the understatement of their returns, the penalty percentage will be lower or zero, depending on when they voluntarily disclosed their wrongful actions.[657]

However, in the cases of gross negligence and intentional tax avoidance, the penalty percentage cannot be zero, even if the taxpayer voluntarily discloses their transgression before any investigation has commenced.[658] Thus, in terms of any taxation transgressions committed by the taxpayer regarding their CA returns, it is submitted that it is wise to err on the side of

[648] Tax Administration Act 28 of 2011, s221. 'Repeat case' is specifically defined by section 221 of the Tax Administration Act 28 of 2011 as an understatement case which takes place within five years of a previous case of the understatement of a taxpayer's returns.
[649] See 4.2.1. above for a discussion on impermissible tax avoidance arrangements.
[650] Tax Administration Act 28 of 2011, s221.
[651] Ibid at s223(1). This section provides a penalty table through which the penalty percentages to be applied in specific scenarios are displayed.
[652] Tax Administration Act 28 of 2011, s223(1).
[653] Phillip Haupt *Notes on South African Income Tax* (2020) 1003.
[654] Tax Administration Act 28 of 2011, s223(1). The exact percentages are displayed in the understatement penalty percentage table in section 223(1) of the Tax Administration Act 28 of 2011.
[655] Tax Administration Act 28 of 2011, s223(1).
[656] Phillip Haupt *Notes on South African Income Tax* (2020) 1003.
[657] Tax Administration Act 28 of 2011, s223(1). The exact percentages are displayed in the understatement penalty percentage table in section 223(1) of the Tax Administration Act 28 of 2011.
[658] Tax Administration Act 28 of 2011, s223(1).

caution and voluntarily disclose any actions which may be seen to be an understatement of their returns, so that they may lessen the penalties incurred as a result of such transgression.

The issue of user anonymity will again arise in the ambit of whether tax evasion consequences can apply to taxpayers who cannot be readily traced by SARS. If a transaction cannot be linked to the taxpayer in question, the facilitation of tax evasion through CAs becomes easier and the consequences of tax evasion may not apply due to this user anonymity. Furthermore, it is submitted that if there are no legislative provisions to address this issue, tax evasion remaining undetected (in relation to CA users who cannot be traced) will be a serious issue for the *fiscus*.

4.4. CONCLUSION

Since the formal taxation regulation of CAs is not currently extensive, (and thus will not address the plethora of issues which may arise by virtue of the complex nature of CAs) it is submitted that in any case where there is a possibility of a taxpayer committing any offence, they should adopt a conservative approach insofar as it is necessary, until there are more effective regulations in place to address the taxation of CAs. Since the practical approach SARS (as the administrative facilitator of tax collections in SA) will take in terms of ensuring CA earnings/proceeds are taxed according to the legislative provisions in place[659] is to a large extent, unknown, it is submitted that taxpayers should be cautious not to conduct behaviour that is indicative of the actions which the legislature seeks to mitigate.[660] It is submitted further that the effective regulation of CAs is in the interest of the *fiscus*, in order to prevent further major tax evasion[661] through the CA system. The facilitation of tax evasion through CAs will remain an issue for the *fiscus* if legislative provisions are not effective enough to address weaknesses in the regulations which arise by virtue of the unique nature of CAs.

[659] Tax Amendment Act 2020.
[660] The legislature seeks to mitigate the behaviour categories associated with and set out by section 223 of the Tax Administration Act 28 of 2011.
[661] In addition to tax evasion facilitated through traditional financial systems.

CHAPTER 5

RECOMMENDATIONS AND CONCLUSION

5.1. OVERVIEW

Considering the amendments in terms of the Tax Amendment Act 2018,[662] it is submitted that the inclusion of CAs into existing legislation[663] is evidence of the need for the regulation thereof. However, it is submitted that the amendments are insufficient to a large extent. This is due to the fact that many shortfalls and *lacuna* exist in terms of the application of these provisions to real-world scenarios.[664] The existence of these *lacuna* in taxation legislation in relation to CAs may have the effect of increasing the tax evasion or impermissible tax avoidance potential associated with CA use in general. It is submitted that if lawmakers use existing financial terms and systems to regulate CAs (which are based on the unique system of blockchain technology)[665] any provisions relating thereto may not serve their intended purpose of effectively regulating this digital financial innovation completely.

This chapter will set out an exposition of the findings made in the research and explore possible solutions to the issue of the lack of effective CA taxation regulation in an effort to determine whether more stringent measures may be taken in future to mitigate potential tax evasion. The future of CAs and the taxation thereof will be examined, and recommendations will be made regarding how CA regulations ought to be developed in accordance with the nature of CAs. Furthermore, a conclusion will be reached (by considering the research questions posed) in terms of whether the current CA taxation regulations are effective enough to mitigate potential tax evasion in SA or whether such regulations need to be developed and improved in order for efficacy in the legislative progress regarding financial technology reform.

[662] Taxation Laws Amendment Act 23 of 2018.
[663] Income Tax Act 58 of 1962 and Value-Added Tax Act 89 of 1991.
[664] See 3.4. for a discussion on the Tax Amendment Act 2018, in which such shortfalls and gaps in the provisions therein are examined.
[665] See 1.2.2. for a discussion on blockchain technology.

5.2. SUMMARY OF THE ISSUES AND FINDINGS

5.2.1. South Africa's legal position and stance on cryptocurrency and crypto assets as a challenge for law enforcement

It was discovered, through the examination and analysis of current CA regulations in SA (as well as the historic lack of regulations pertaining to CAs), that this technological advancement has been challenging to regulate. The innovation of cryptocurrency (represented by Bitcoin and facilitated through what would later be referred to as 'blockchain technology'[666]) emerged over ten years ago.[667] Bearing this in mind, it was necessary to determine (through this research) why there has been confusion surrounding the concept of 'cryptocurrency' in general and why it has been a challenge to regulate.[668]

It was found that the mechanics of CAs are based on computational mathematics and cryptography, which are contributing factors to the complex nature of CAs.[669] Another factor which was discovered to have made CAs difficult to regulate was the initial scepticism of the government and regulatory authority to accept the integration of CAs[670] into the economy. This scepticism resulted in a lack of regulatory clarity and guidance even from authoritative bodies such as SARS.[671]

This cautious stance on CAs has changed to a large extent in recent years, as there has been an attempt (through taxation legislation)[672] to address CAs. Even though this attempt does not fully address the extensive parameters of CAs transaction eventualities,[673] it is submitted that including CAs in legislation is a progressive step towards the future in which more extensive CA regulations are envisioned.

The importance of having a solidified definition of CAs lies in the fact that creating concrete parameters within which this digital innovation functions will result in it being easily understood. The lack of understanding of CAs has largely been the downfall of its regulatory

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[666] See 1.2.2. above for the definition of 'Blockchain.'
[667] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[668] See 3.2. above for an in-depth discussion in the challenge of regulating CAs.
[669] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.
[670] CAs were initially referred to as 'cryptocurrency,' which has been noted throughout this research and these terms have been used in context of the content of each chapter and consideration therein accordingly.
[671] This lack of regulatory clarity and guidance from SARS is illustrated through the fact that SARS was responsible for merely one media release on the taxation treatment of cryptocurrency.
[672] Taxation Laws Amendment Act 23 of 2018.
[673] See 3.4. above for an analysis of the Tax Amendment Act 2018.

potential to the extent that it has always been seen as an extremely complex system. Whilst CAs are based on a complicated system, a legislative attempt to define CAs will lessen the gaps which exist in relation to the understanding of CAs as well as the regulation thereof. Once CAs have been formally defined in legislation, they may also be categorised accordingly. Defining a concept is an important step in the legislative process, especially if the concept is new or has not yet been defined in any other legislative provisions. Regulatory clarity is of the utmost importance in ensuring the fair operation of the CA system in SA and amongst South African users. Thus, defining CAs through legislation is imperative.

Though the new Taxation Amendment Bill[674] has amended the Taxation Amendment Act[675] to refer to 'cryptocurrency' as 'crypto assets,' there is no formal definition of such 'crypto assets' in the Taxation Amendment Bill.[676] Since taxation authoritative bodies form part of the IFWG, it is submitted that the definition of CAs as posed by the IFWG be incorporated into legislation. It is clear that taxation legislative authority approves the categorisation of cryptocurrency as CAs, thus it would be wise to define crypto assets in taxation legislation. In this regard, it is submitted that the Taxation Amendment Act be amended to reflect a concrete definition of crypto assets. It is submitted further that the definition modelled by the IFWG in its position paper be added to and set out in an amendment to the Taxation Amendment Act for regulatory clarity. This definition is set out as follows:[677]

> *A crypto asset is 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.*

It is submitted that this definition is effective insofar as the current widespread usage of CAs is concerned. Due to the fact that blockchain technology may be used for various purposes,[678] it should be noted that the definition of crypto assets posed by the IFWG is not exhaustive but is sufficient for legislative purposes considering the context in which CAs are being integrated into the South African financial system. In this regard, it is submitted that the definition of

[674] Taxation Laws Amendment Bill B27 of 2020.
[675] Taxation Laws Amendment Act 23 of 2018.
[676] Taxation Laws Amendment Bill B27 of 2020.
[677] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 9.
[678] See 2.2.1. above for a discussion on blockchain technology.

'crypto assets' as envisaged above should be included in the definition section of the Income Tax Act[679] by virtue of the next Tax Amendment Act to be promulgated.

Through this research, it was found that the current legislative provisions[680] in the Tax Amendment Act 2018[681] and the Tax Amendment Act 2020[682] do not regulate CAs to the extent that is necessary in order for such regulations to be effective. This is largely due to the fact that CAs have a distinctive nature and thus cannot be taxed in conjunction with existing financial systems. The current regulation of CAs by virtue of the application of the Tax Amendment Act 2018[683] thereto[684] is limited to the application of the regulations which apply to financial instruments.[685] This illustrates the inadequacy of existing CA taxation regulations as CAs ought to be taxed in accordance with its unique nature in a separate legislative provision (within the Tax Amendment Act 2018[686]) which is entirely dedicated to addressing CA taxation.

Certain CAs such as Bitcoin is founded on user anonymity, which means that it is extremely difficult to track users of this type of CA. It is submitted therefore that taxation legislation ought to account for this factor when integrating CAs into the Tax Amendment Act 2018.[687] Not only was it found through this research that the existing taxation legislation is ineffective in accounting for the nature of CAs, but it can also be concluded that the inclusion of CAs in the Tax Amendment Act 2018[688] and the Tax Amendment Act 2020[689] is sparce and requires development.[690] In this regard, it is recommended that, in addition to implementing a formal legislative definition of 'cryptocurrency' (as a CA) as set out above, the IFWG (specifically) should work closely with the authoritative bodies which it represents in order to resolve the

[679] Income Tax Act 58 of 1962.
[680] Which are applicable to CAs accordingly insofar as the specific provisions in the Tax Amendment Act 2018 which referred to 'cryptocurrency' remained in the Tax Amendment Act 2020 and apply to CAs as mentioned in the Tax Amendment Act 2020.
[681] Taxation Laws Amendment Act 23 of 2018.
[682] Taxation Laws Amendment Act 23 of 2020.
[683] Taxation Laws Amendment Act 23 of 2018.
[684] Insofar as the Tax Amendment Act 2018 is relevant to CAs in that the same provisions apply in terms of the Tax Amendment Act 2020.
[685] See 3.4.1. above for a discussion on cryptocurrency as a financial instrument.
[686] Taxation Laws Amendment Act 23 of 2018.
[687] Ibid.
[688] Ibid.
[689] Taxation Laws Amendment Act 23 of 2020.
[690] See 3.4. above for a discussion on the Tax Amendment Act 2018 and comments on the sparseness of the cryptocurrency provisions contained therein.

confusion relating to the categorisation of cryptocurrency as illustrated by the various bodies.[691]

Another issue which was discovered through this research is that of CGT in relation to CAs.[692] The application of CGT and the parameters thereof in relation to CA transactions were not addressed by legislation but will still be applicable due to the fact that the Tax Amendment Act 2020[693] envisages that cryptocurrency will be referred to as 'crypto assets.'[694] In this regard, it is submitted that legislative clarity is required in order to alert taxpayers as well as tax practitioners and users of CAs as to the consequences associated with gains and losses resulting from CA transactions. It is submitted that in this regard, Haupt's statement[695] regarding the absence of formal clarity on CGT is relevant to the findings. It is submitted further that if the current taxation legislation aims to regulate CAs in a certain manner or even in accordance with existing taxation systems such as CGT, taxpayers must at least be informed on the way in which they are to be taxed.[696]

5.2.2. The effectiveness of South Africa's taxation regulation of crypto assets in mitigating tax evasion

Since SARS, SARB and the legislature has clearly established a need for legislative developments regarding CAs, it is submitted that the acceptance of CAs in SA has been solidified to a certain extent. This is evident in the fact that the Tax Amendment Act 2018[697] and the Tax Amendment Act 2020[698] have addressed cryptocurrency in general. Even though the current legislation is not as effective as it ought to be, the mere existence of such legislation is an indication of the readiness for legislative reform regarding CAs. This may not seem to be a substantial advancement (especially considering the fact that the inception of blockchain

[691] In other words, the IFWG should address the discrepancies which exist in terms of the classification of cryptocurrency according to different authoritative bodies, which classification should, in essence, adopt the same stance (or rather, a more unified stance) by all South African legal and financial authorities.
[692] See 3.3.2. above for a discussion on capital gains tax in relation to cryptocurrency.
[693] Taxation Laws Amendment Act 23 of 2020.
[694] Ibid.
[695] This statement was discussed above at 3.3.2. In this regard, Haupt indicates briefly that there was a chance for the National Treasury to formally subject cryptocurrency to capital gains tax through the Tax Amendment Act 2018 but that the opportunity was not fulfilled. Even though the new Taxation Laws Amendment Bill B27 of 2020 refers to cryptocurrency as 'crypto assets,' there is no further clarification on the taxation treatment of such crypto assets in consideration of this new development.
[696] Especially in consideration of the various eventualities resulting from cryptocurrency transactions as well as the distinctive nature of cryptocurrency and novelty of this digital innovation.
[697] Taxation Laws Amendment Act 23 of 2018.
[698] Ibid.

technology occurred more than ten years ago)[699] but it has provided a platform through which further legislative developments may be facilitated.

The importance of the taxation regulation of CA transactions is extensive due to the fact that South African governmental systems (aimed at developing the country) are funded by taxes. Even though the aim of blockchain technology and Bitcoin (specifically) was to create a system devoid of third-party influence,[700] it is submitted that the integration of CAs into the economic sphere is so widespread and rapid that if left unregulated, CAs may pose a threat to the entire taxation system and in turn, the effective functioning of the country.

In this regard, it is submitted that the taxation regulation of CAs must be effective enough to combat illegal activity which may arise as a result of the misuse of the digital innovation. Currently, the extent to which CAs are accounted for in taxation legislation is extremely minimal. It is submitted that it is insufficient to merely mention 'cryptocurrency' or 'crypto assets' and categorise the digital innovation in conjunction with existing financial instruments. CAs should be regulated in the form of a *sui generis* provision within taxation legislation. In this regard, an exclusive definition of cryptocurrency (as 'crypto assets') should be included in taxation legislation in order to formally categorise this digital innovation.[701] In addition to the formal legislative definition, it is recommended that a provision be inserted in the Income Tax Act[702] by virtue of a Tax Amendment Bill (and then ultimately, a Tax Amendment Act) which deals directly with the taxation of CAs and details the way in which they are to be taxed for the purposes of South African tax.[703]

Furthermore, it is submitted that the functional parameters of CAs be addressed through taxation legislation insofar as it affects the taxation potential of CAs. On the premise that the legislature intended to subject cryptocurrency to CGT,[704] this should be clarified in legislation

[699] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[700] Ibid.
[701] See 5.2.1. above for a discussion on a possible definition of crypto assets.
[702] Income Tax Act 58 of 1962.
[703] In this regard, it is submitted that the legislature's intention regarding the taxation treatment of cryptocurrency must be clearly stated and not merely inferred, as it is in the Tax Amendment Act 2020. If cryptocurrency is to be treated as an asset for the purpose of CGT, this insertion in the Income Tax Act 58 of 1962 should address that. To this end, it is submitted that a provision be inserted in the Eighth Schedule to the Income Tax Act 58 of 1962 (which deals with the regulation of CGT specifically) in order to address the taxation of cryptocurrency as an asset, if that is indeed the intention of the legislature (in consideration of the nature of cryptocurrency).
[704] This is on the basis of the fact that the Tax Amendment Act 2020 refers to cryptocurrency as 'crypto assets' which infers that cryptocurrency may be subject to capital gains tax. Even though there was no legislative clarity provided in this regard, it is submitted that it is more likely than not that the legislature referring to cryptocurrency as crypto assets is indicative of its intention to subject cryptocurrency earnings to capital gains tax.

as opposed to a mere reference to the term 'crypto assets.' It is submitted that if CGT is to be imposed on CAs, the next Tax Amendment Act should state this specifically instead of merely relying on the fact that taxpayers will interpret the legislative inferences according to the intention of the legislature.

It must be noted that the IFWG recommended (in respect of CA taxation legislation) that cryptocurrency be defined in taxation legislation and be categorised as CAs for the purpose of taxation.[705] Whilst cryptocurrency has since been referred to as CAs in the Tax Amendment Act 2020,[706] it has not been formally defined in line with the IFWG definition thereof in taxation legislation. It is submitted in this regard that taxpayers should not be expected to rely on the IFWG position paper as taxation legislation should provide the necessary clarity to taxpayers regarding the taxation treatment of CA trading, transactions and earnings therefrom.

Even though legislation is of the utmost importance when ensuring tax compliance, it is widely accepted that SARS provides the authority on tax administration and the practical application of legislation to individual scenarios. Due to the fact that SARS is the authoritative body through which taxes are processed and taxation matters are dealt with, it is vital to account for its role in the regulation of CAs and the implementation of such regulations.

Generally, SARS provides interpretation notes, practice notes as well as guides to taxpayers and tax practitioners in order to provide clarity on taxation concepts, processes and methods through which taxes are to be treated and guidance on how value and transactions are to be accounted for. This is an effective means by which taxpayers and tax practitioners may gain clarity and ensure tax compliance. It is submitted that this method of providing guidance will be suitable in affording clarity to taxpayers and tax practitioners on the taxation treatment of CAs. It is therefore proposed that SARS draft and implement an interpretation note on the taxation treatment of CAs in SA.

Even though the legislative regulations of CAs are sparce, SARS (being an authoritative body which regulates the administration of tax) is able to provide guidance to taxpayers and tax practitioners outlining the filing of their tax returns where CA transactions are concerned. This will aid taxpayers in ensuring tax compliance as well as create a somewhat formal record of how SARS aims to tax CAs in a practical sense. Providing an interpretation note will further

[705] Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 27.
[706] Taxation Laws Amendment Act 23 of 2020.

guide taxpayers and tax practitioners in terms of the different scenarios in which tax events may arise by virtue of various CA transactions.

The construct of tax evasion was discussed in this research along with that of tax avoidance as it was contended that each concept is a varying degree of the other.[707] Whilst tax evasion is an illegal activity,[708] tax avoidance is permissible.[709] There are however, a range of behaviours which can result in the existence of impermissible tax avoidance arrangements[710] or reportable arrangements.[711] It is submitted that having this degree of variance where tax evasion is concerned is a realistic legislative reflection of practical scenarios or circumstances which may arise by virtue of taxation in SA in relation to issues of evasion or impermissible avoidance.

Notwithstanding the extensive regulations in respect of tax evasion, it is submitted that where CAs are concerned, even the scope for the provision of various circumstances in legislation (in relation to tax evasion and impermissible tax avoidance) may not address CA taxation events accordingly. It is submitted further that this is largely due to the nature of CAs. In this regard, if CAs remain ineffectively regulated, SARS, the *fiscus* and the taxpayer in question may be prejudiced in relation to issues regarding tax evasion or impermissible tax avoidance.

It is submitted that legislative clarity will serve to mitigate instances of tax evasion not only by virtue of the fact that specific CA regulations will provide a guideline of how legislation relating to tax evasion will apply thereto, but also due to the fact that certain activities or behaviour relating to CAs may not fall within the ambit of tax evasion, but rather, tax avoidance. Furthermore, due to the nature of CAs[712] it was deduced via this research that the use of CAs may be perceived by SARS as being indicative of impermissible tax avoidance arrangements or even activities which are indicative of tax evasion (in specific circumstances), but the likelihood is that if the nature of CAs was to be considered (in addition to the promulgation of separate, specific and effective legislation relating to the taxation of CAs), CA dealings which may facilitate tax avoidance would be considered as reportable arrangements. This would mitigate potential serious criminal sanctions for the taxpayer concerned who is a user of CAs.

[707] See 4.2. and 4.3. above for a discussion on tax evasion and tax avoidance.
[708] Madeleine Stilingh et al *SILKE: South African Income Tax* (2020) 1116.
[709] See 4.2. and 4.3. above for a discussion on tax evasion and tax avoidance.
[710] See 4.2.1. above for a discussion on impermissible tax avoidance arrangements.
[711] See 4.2.1. above for a discussion on reportable arrangements.
[712] See 2.2. above for a discussion on the nature and mechanics of cryptocurrency.

It is submitted that through an interpretation note or guide on CAs, SARS should outline the taxation consequences of investing in CAs, purchasing CAs, selling CAs, mining CAs as well as CA transactions which may trigger CGT.[713] By providing a comprehensive interpretation note, SARS will not only be guiding taxpayers and providing clarity to tax practitioners, but also contributing to the mitigation of instances of tax evasion and impermissible tax avoidance schemes. Furthermore, SARS will be lessening the burden placed on it to ensure tax compliance or to use extra resources and funds to scope out taxpayers who have not declared their CA earnings (due to a lack of knowledge and regulatory clarity) by providing formal clarity on the taxation of CAs. It is submitted that it is to the benefit of SARS and the *fiscus* for SARS to provide taxpayers and tax practitioners with an interpretation note or guide on CA taxation.

5.2.3. International taxation regulation of crypto assets

Whilst this research is not a comparative study in its entirety, the importance of a brief international comparison between CA taxation regulations in other countries and that of SA is reflected through the need for CA regulation in light of the fact that it is a new digital innovation. Obtaining an exposition of CA taxation regulation on an international platform is useful in examining the effectiveness of South African CA taxation regulation comparatively and subsequently speculating whether other countries may be more successful in their attempts to regulate CAs in this regard.

Through this research, the relative sparseness of specific CA taxation regulations[714] internationally was illustrated. It is submitted that this sparseness is largely due to the lack of specific taxation regulations in relation to CAs. It is submitted further that this is also the case in SA. It was deduced from the research that whilst other countries have formalised CA taxation regulation to a large degree, the regulations implemented in this regard are synonymous with regulations pertaining to traditional financial systems. This further illustrates the need for effective and coherent regulation of CAs.

It is submitted that the extremely different approaches and attitudes towards CAs in general (internationally) reflect the need for global consensus on the categorisation of CAs in order to ascertain the correct taxation treatment thereof. In this regard, whilst it is accepted that different

[713] VAT consequences of cryptocurrency transactions need not be mentioned as cryptocurrency is currently not subject to VAT.
[714] In other words, taxation regulations which are specifically tailored to the nature of cryptocurrency so as to ensure the effectiveness of the regulations.

countries will have different attitudes towards CAs, there should at least be a certain level of coherence in regard to the categorisation of CAs by virtue of the nature thereof. This will in turn mitigate the lack of understanding of CAs in a global sense in order to ensure the effective regulation thereof.

On the other hand, however, analysing taxation regulations in relation to CAs as they apply to other countries has proved to be useful in this research in terms of obtaining a holistic sense of possible solutions or reform in respect of ineffective CA taxation regulation in SA. In this regard, the countries which have an overtly friendly attitude towards CAs and have made substantial efforts to formalise CA regulation should be looked to for guidance from a SA legal perspective. It is submitted that in order to develop the SA taxation system in relation to CA taxation regulations, SA should adopt a level of solidity where taxation legislation (as it relates to CAs) is concerned.

One important observation from the brief international comparison conducted through this research was made when Germany's CA regulations were examined.[715] In this regard, Germany has adopted a friendly stance towards CAs and as such, has formalised a legislative definition thereof by virtue of the KWG.[716] It is submitted that SA should incorporate a formal definition of CAs as Germany has done, in order to further the development of CA taxation regulation in SA. This will provide a basis for the categorisation of CAs for the purpose of taxation and may serve as a foundation for gaining clarity regarding how CAs should be taxed accordingly.

Another important observation to note pertaining to the international taxation regulation of CAs relates to the UK's stance on CAs and its position paper on the taxation of CAs.[717] This position paper is simple, but effective and should be looked towards in terms of the future of taxation regulation of CAs in SA. In this regard, the UK taxation authority illustrates that it is possible to set out (clearly and concisely) how proceeds from CAs will be taxed. Not only is the structure of the UK position paper to be referred to by SARS or the legislature in terms of setting out CA taxation regulations, but the substance of the position paper should be considered when regulating CAs in SA.

The recommendation in respect of the UK position on CA taxation regulation is twofold: firstly, it is recommended that SARS publish a position paper or interpretation note on CAs as

[715] See 3.6.3. above for a discussion on Germany's CA regulations.
[716] Ibid.
[717] See 3.6.1. above for a discussion on the UK's CA taxation position paper.

the UK taxation authority has done and secondly, that SARS refer to the UK position paper in terms of the substance thereof in formulating the South African position paper/interpretation note on CAs. In respect of the second recommendation, it is subsequently submitted that the UK adopts the correct approach regarding the taxation of CAs in the sense that individuals should be liable for CGT when disposing of their CAs, liable to pay income tax when they receive CAs in connection with their employment, mining of CAs or in conjunction with their business activity if the CAs are indicative of trading profits accordingly.

If SARS were to publish a position paper or interpretation note on CAs, the taxation treatment thereof would be clarified (to a large extent) for users thereof and serve as an indication of the taxation consequences relating to CA earnings. It is submitted further that this would address many of the existing *lacunae* in SA CA taxation regulation by virtue of formal clarity from SARS on current South African CA legislative developments.[718] It is recommended in this regard that the legislature also take cognizance of the UK position when formulating and implementing provisions in tax legislation relating to CAs.

Even though (from a South African perspective) there are uncertainties relating to the consequences of the implementation of CA provisions in legislation in the sense that the practical outcome of the tax administration and regulation of CAs is unknown,[719] it is submitted that implementing formal legislative provisions specifically aimed at outlining the tax treatment of CAs depending on the use thereof is wise and will lead to less administrative complications for SARS and the *fiscus* and less potential prejudice caused to taxpayers.

5.3. THE FUTURE OF CRYPTO ASSET TAXATION

Much like the concept of printing which was considered a magnificent system at the time of its inception but is now a basic method of spreading, storing and documenting various data, it is submitted that CA transactions will become as frequent and widely used as traditional methods of transacting in future. Focusing specifically on the concept of printing and the printing press as a technological advancement, (to illustrate the rapid growth of cryptocurrency, and in turn, CAs) it is submitted that parallels can be drawn between such invention and blockchain

[718] The current legislative developments refer to the Tax Amendment Act 2018 and the Tax Amendment Act 2020.
[719] Due to the price volatility of CAs as well as the nature thereof.

technology due to the growth of CAs. It is submitted that there is a high likelihood of CAs becoming increasingly common as a method of transacting, storing value and trading.[720]

Whilst the general rate of the development of technological advancements is much higher now than it was when the concept of printing arose, the progression of the concept of printing to the invention of the printing press may be likened to that of blockchain technology in the economic sphere. There have been many technological advancements throughout the history of the development of societies and economies and through the rapid onset of globalisation. This suggests the continuance of the advancement of technological innovations over time.

A more recent technological advancement is the emergence of the internet, which paved the way for what may be referred to as an information technology revolution.[721] This advancement also integrated quickly into the very operation of society, resulting in individuals relying on the internet to perform daily tasks. It is submitted that blockchain technology (and by implication, CAs) is one such innovation which will be at the epicentre of the global economy in future. Like many different technological innovations (such as the printing press or the internet) which emerged before CAs, CAs have the potential for wide, frequent and global usage in the future.

In terms of the taxation of CAs in the future, innovative and new solutions must be pursued in order to account for numerous eventualities resulting in the frequent use of CAs and thus, the potential for this digital system to be misused. An alternate perspective on the taxation of cryptocurrency[722] is suggested by Harari[723] and worth examining in order to prepare for a future where blockchain technology is more widely used than traditional financial systems.

Harari suggests that due to the constant evolution of technology as well as the '…rise of AI[724] and the blockchain revolution,'[725] there may come a point in the future when natural persons can no longer make sense of finance.[726] In this hypothetical future, governments may even have to rely on algorithms to promulgate tax reform.[727] Considering the current pace of the

[720] The uses/purpose of cryptocurrency and reasons for the use of cryptocurrency include: investing, the use of cryptocurrency as a medium of exchange in order to transact so as to acquire goods and services, access to specific goods and services as well as utilities which are catered for via cryptocurrency transactions and for the purpose of trading. Intergovernmental Fintech Working Group position paper *Crypto Assets* (2020) 9-10.
[721] Yuval Noah Harari *21 Lessons for the 21st Century* (2018) 25.
[722] Since Harari refers to 'cryptocurrency,' the digital innovation will be stated to as such when referring to this source.
[723] Yuval Noah Harari is a Professor, an Historian and author.
[724] Artificial Intelligence.
[725] Yuval Noah Harari *21 Lessons for the 21st Century* (2018) 26.
[726] Ibid at 26.
[727] Ibid at 26.

integration of blockchain technology into the financial sphere, blockchain networks and cryptocurrency (specifically) have the potential to change the traditional monetary system and centralised financial systems entirely.[728] This change will subsequently affect the taxation system and create the need for '… radical tax reforms.'[729]

In this regard, it is submitted that due to the fact that the main objectives of Bitcoin (specifically) were initially to create a decentralised financial system where individuals would not have to be 'slaves' to centralised banks and where the basis of the validity of transactions was determined using irrefutable mathematic calculations,[730] (rather than third party regulation) taxation reform becomes inevitable. It is submitted further that the current taxation regulations which are being applied to the regulation of CAs are not all-encompassing and do not account for the nature of CAs, but rather, have been developed through considering regulations of existing and traditional financial systems. Due to the unique nature of blockchain technology and CAs, separate regulatory measures should be implemented in order to adequately regulate CA transactions.

Harari indicates that since it may become entirely irrelevant to tax traditional currencies in future as '… most transactions will not involve a clear-cut exchange of national currency, or any currency at all.'[731] Thus, entirely new taxes and methods of taxation ought to be developed[732] in order for governments to account for new financial technology advancements such as blockchain technology and CAs.[733] In this regard, Harari suggests a 'tax on information' for a future where information will be the most valued asset in the economy and subsequently, become a means of exchange to effect transactions.[734] Any radical tax reform in this regard would inevitably change societies and economies and allow for the emergence of an entirely new era for laws and the operation of the legal fraternity. Change is inevitable in any system upon which the functioning of the economy, society and more specifically, financial system are based. It is submitted that the global readiness for this foreseeable change lies largely in legal reform and adequate regulations which serve to effectively standardise technological advancements.

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[728] Ibid at 26.
[729] Ibid at 26.
[730] Satoshi Nakamoto 'Bitcoin: a peer-to-peer electronic cash system' available at *https://bitcoin.org/bitcoin.pdf*, accessed on 31 July 2020.
[731] Yuval Noah Harari *21 Lessons for the 21st Century* (2018) 26.
[732] Ibid at 26.
[733] This affirms the contention made at 5.2.2. above regarding the integration of cryptocurrency in taxation regulations as a *sui generis* legislative provision.
[734] Yuval Noah Harari *21 Lessons for the 21st Century* (2018) 26.

5.4. CONCLUSION

The emergence of cryptocurrency[735] in recent years has proven to be an indication of the rapid integration of technology into various spheres of society. The financial and legal sectors have been constantly evolving inadvertently through this development of digital technology. To deny this development or continue to leave CAs unregulated is dangerous and unwise. This is due to the fact that these technological advancements are becoming part of the functioning of everyday life. This affirms the importance of the regulation of digital innovations such as blockchain technology and (by extension) CAs. The taxation of CAs is important when one considers the growth of the financial technological system and its integration into the South African financial space. Furthermore, effective taxation regulations will ensure an efficient transition into a new financial era.

Even though the new Tax Amendment Act 2020[736] indicates the use of the term 'crypto assets' instead of 'cryptocurrency,' (in conjunction with the classification of cryptocurrency as crypto assets by the IFWG)[737] it does not make provision for a completely separate legislative definition of CAs. It is submitted in this regard that legislative clarity is necessary in order to properly regulate CAs holistically. To this extent, it is recommended that a legislative definition of CAs be inserted into the Income Tax Act[738] by virtue of the next Tax Amendment Act. Apart from there being no concrete definition of CAs, the legislative provisions which do exist are ineffective to the extent that they do not account for the unique nature of CAs and various uses thereof, but rather, aim to regulate CAs in conjunction with existing financial systems and concepts.

By virtue of the fact that CAs are developed on the basis of blockchain technology, (which is a relatively new innovation that is unaccounted for in any regulations) regulating and defining it according to existing legislative standards which apply to tradition financial systems is unwise. A balance ought to be struck between regulating CAs in accordance with concepts that are understood by taxpayers and ensuring that CAs are regulated in their own right in order for the effective regulation thereof.

In terms of taxation specifically, CA regulations need to be developed further in order to mitigate tax evasion and provide clarity on impermissible tax avoidance arrangements. In this

[735] And by extension, CAs.
[736] Taxation Laws Amendment Act 23 of 2020.
[737] See 2.3.4. for a discussion on the IFWG's categorisation of cryptocurrency.
[738] Income Tax Act 58 of 1962.

regard, it is submitted that SARS release a position paper on the tax treatment of CAs and that the UK position thereon be referred to by SARS as well as the legislature when regulating CAs and providing clarity on the taxation thereof, It can be concluded through this research that the current taxation regulation of CAs is only effective to a small extent in mitigating tax evasion in SA. Not only are the parameters of tax evasion and impermissible tax avoidance unclear (in taxation legislation) due to the nature of CAs, but the existing legislation is ineffective in fully addressing certain issues which are associated with CA transactions.[739]

It is submitted that the steps to be taken in order to ensure effective legislative development in future are within the means of legislative bodies. It is recommended that cohesion in terms of the approach of different authoritative bodies[740] to CAs[741] is necessary as a preliminary step in ensuring the effective regulation of CAs. Furthermore, a separate provision in taxation legislation dealing with CA regulation is crucial and indeed possible. Considering the growth of CAs and integration thereof into the South African economy, it is vital to ensure a strong legislative foundation. In terms of taxation legislation specifically, the importance of legislative provisions addressing CAs is reflected in the need to fairly regulate CAs so as to create a balance between mitigating possible prejudice to taxpayers and the *fiscus* simultaneously and importantly, preventing tax evasion.

[739] These issues include (but are not limited to) user anonymity, price volatility as well as the possible application of capital gains tax.
[740] For example, SARS, SARB and the legislature.
[741] This consideration is in addition to the consideration of the need for the cohesive categorisation of CAs by the various authoritative bodies.

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