

Bitcoin investors should be taxed like any other investor

Written by Jason Potts, Professor of Economics, RMIT University

Despite its name, cryptocurrency isn't just money. It could also be debt or equity and so it should be regulated and taxed in the same way as other finance.

The tokens investors get when they buy a cryptocurrency, like Bitcoin, can be used to buy into [blockchain](#) startups (businesses that use the same online ledger as cryptocurrencies). When blockchain startups issue shares in their businesses using cryptocurrency, it's called an initial coin offering. For investors, this is like any other equity investment.

Cryptocurrency can also be used to finance specific assets, like debt. So what we have is a single financial instrument that has the advantages of both debt *and* equity.

So startups issuing their own tokens for investment purposes should have to comply with the same rules and regulations that startups issuing more traditional instruments must comply with. Cryptocurrency investors should be taxed on the same basis as traditional investors.

Why cryptocurrency is a mix of money, debt and equity

Money is very often defined by its functions: a medium of exchange, a unit of account (used to represent the real value or cost of any economic item), and a store of value (that can be saved, retrieved and exchanged at a later time). [The early consensus](#) about Bitcoin among economists is that it's not money.

At best cryptocurrencies are a medium of exchange. But many [economists](#) doubted that Bitcoin, given its volatility, could ever serve as a unit of account, let alone as a store of value.

So if cryptocurrency isn't money, it has to be something else. It could be an asset of some sort.

Usually if investors acquire or sell an asset, it would be liable to tax, [such as the GST](#). This means people using Bitcoin would be taxed twice when using it.

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It would be taxed when the person buys the Bitcoin and taxed again when they used it to buy something. Luckily the [federal government realised this was a bad idea](#) and moved to repeal the double taxation of Bitcoin.

Clearly the federal government's view is that cryptocurrency is not legal tender – so don't try pay your income tax in Bitcoin anytime soon. And there are important differences between money, specifically legal tender, and cryptocurrency.

Cryptocurrencies tend to strictly rules bound. How they're created, when they can be earned, how they're distributed and how many there ever can be, is all determined by rules. In fact, [use rs like strict rules](#)

By contrast government controlled money is not rules bound. Government employs substantial discretion in exercising control over money. So while the US dollar has the words "In God we trust" printed on it, this system actually requires substantial trust in government.

This trust has been repaid by [a substantial reduction of value over the past century](#) . It seems that government-backed money may also be a poor unit of account and store of value.

Debt and equity are financial instruments used to raise money to finance economic activity. It is something of a puzzle to financial economists why firms use debt in some instances to raise finance while using equity in other situations.

[An important 1988 paper](#) by the [2009 economics Laureate Oliver Williamson](#) provides a possible answer to that question. Williamson argues that debt, being a strict rules bound financial instrument, is best used to finance general assets, while equity is best used for so-called specific assets. Specific assets are those assets that cannot be cheaply or easily redeployed from their current use to alternate uses without a substantial loss of value.

As it turns out Williamson had speculated about the existence of such an instrument (that he labelled "dequity") and then rejected that instrument as being unworkable. The reason dequity

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was unworkable was due to [opportunism](#) – investors simply could not trust equity issuers.

The ledger that cryptocurrencies use - the blockchain - is a actually “trustless” technology because it’s decentralised. It allow users to see each other’s ledgers and transactions, negating the need for a trusted third party to manage risk. Instead it relies on cryptographic verification.

With the absence of the ability for investors to game the system, cryptocurrencies are the equity Williamson first imagined and it could become an efficient financing mechanism.

How equity should be regulated

The idea of regulating or taxing cryptocurrency finance may not be to the liking of many crypto-enthusiasts who are likely to argue that traditional rules and regulations are very onerous. They are correct, of course. Yet the solution to over-regulation is not a carve-out for special interests but rather regulatory reform that reduces the burden for all business.

The good news for crypto-enthusiasts is that some governments appear willing to engage in genuine regulatory reform and tax competition to attract investment in this space. For example, the [Singaporean government](#) is relaxing existing regulation to accommodate cryptocurrency. Its proposed framework would require applicable companies to obtain a license from the Monetary Authority of Singapore, and divides payment activities into several categories.

But regulators should really regulate cryptocurrencies in much the same way as they do existing financial instruments. It shouldn’t be given special treatment.

Despite all the complexity of cryptocurrency it really is simple: it’s a financial instrument that combines all the advantages of money with debt and equity. It’s none of those well known concepts in isolation, but a viable and workable hybrid of all three.

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