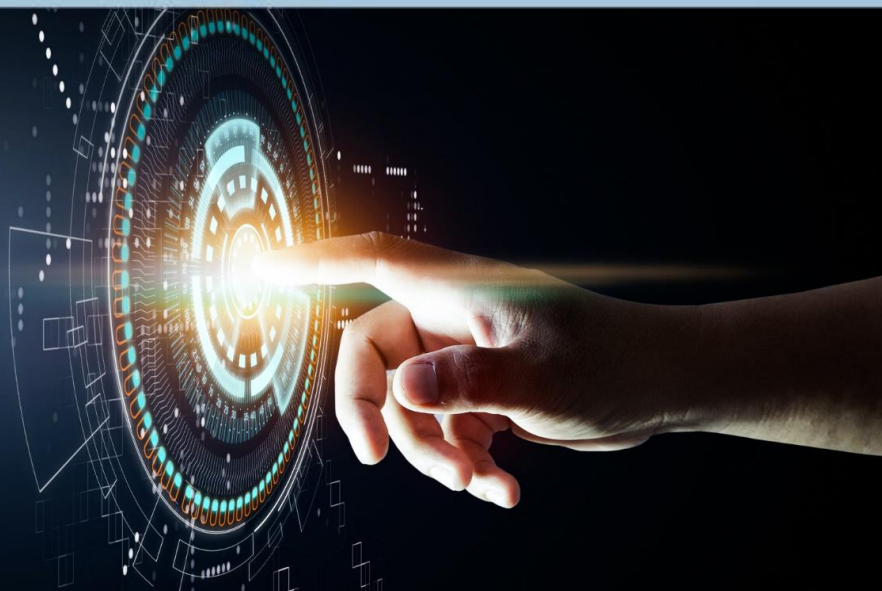


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Tax Treatment of Digital Currency Transactions: Updated Guidelines by the Inland Revenue Board (IRB) dated 26 August 2022

Executive Summary

The rise of digital currencies has generated widespread public attention and interest as to their proper tax treatment. Recently, the IRB has published its updated Guidelines on 26.8.2022,¹ which:

- (a) Supplements the earlier Guidelines of 13.5.2019;²
- (b) Provide further guidance on the taxability for transactions involving digital assets: digital currencies or digital tokens, such as Bitcoin and Ethereum; and
- (c) Applies to any person or company that buys/sells or is in the business of trading of digital assets.

In short, gains from investments would be treated as capital gains, whilst gains from trading transactions would be

¹ Guidelines on Tax Treatment of Digital Currency Transactions, which can be accessed here:

https://phl.hasil.gov.my/pdf/pdfam/GUIDELINES_ON_TAX_TREATMENT_OF_DIGITAL_CURRENCY_TRANSACTIONS.pdf?fbclid=IwAR0QLEMO2m96pYKvOr0302Xul2riMqbRdJFUBqFEkOmCzRvqhI9LUPgkF14

² Guidelines on Taxation of E-commerce Transactions (e-CT)

taxable. The same test for determining the taxability of gains from real property apply: **the badges of trade**.³

Further details of the Guidelines will be explained below.

What are digital currencies and digital tokens?

Digital currencies / digital tokens refer to digital financial assets that are based on distributed ledger technology (**DLT**) and cryptographically secured digital representations of value or contractual rights that can be electronically transferred, stored or traded. Specifically, digital currencies function as a medium of exchange and are interchangeable with any money, including the crediting or debiting of an account.

Examples of digital currencies / digital tokens include Bitcoin and Ethereum (Ether).

Application of the Guidelines

The Guidelines apply to any person (including a company) that: -

- (a) Acquires or disposes of digital currencies; or
- (b) Is involved in the business of digital currencies (e.g., trading, mining and exchange of digital currencies).

General Tax Treatment of Acquisitions and Disposals of Digital Currencies

Many countries such as the United Kingdom, Australia, and Canada subject gains from such transactions to capital gains. Malaysia however does not have a capital gains regime, except for disposals of real properties and shares in real property companies (**RPCs**).

Generally speaking, income tax:

³ Page 3 & 4 of this Alert.

- a) Would only be chargeable on revenue gains i.e., where the transactions are conducted in the nature of trade. Similarly, trading / revenue losses would be deductible; and
- b) Would not be chargeable on capital gains i.e., the realisation of investments in digital currencies. Similarly, capital losses would not be deductible.

The Guidelines provide guidance and specific examples to assist taxpayers in determining whether the gain from a particular transaction is chargeable to income tax or not.

The Badges of Trade

In essence, the taxability of gains from digital currency transactions should apply a similar test used for real property transactions and share sale transactions: the badges of trade.

The badges of trade were established predominantly with real property transactions in mind and would naturally require some modification to be applied to shares and digital currency transactions. For instance, digital platforms are readily available and commonly used to buy and sell shares and digital currencies, which may render the method of disposal a little less important. Further, unlike real properties which can be renovated, cleared, subdivided, etc., shares or digital currencies cannot be easily altered or improved.

The badges of trade however remain applicable and have been successfully applied in the context of share transactions, including in ***Director-General of Inland Revenue v Hypergrowth Sdn Bhd***.⁴ Recently, applying the same principles, taxpayers have also succeeded in establishing an absence of trade in the context of real property transactions in ***PFR Sdn Bhd v KPHDN***⁵ (SCIT) and ***Cash Band (M) Bhd v KPHDN***⁶ (High Court) where the successful taxpayers were represented by LHAG's Tax Practice.

⁴ *Director-General of Inland Revenue v Hypergrowth Sdn Bhd* [2008] 4 CLJ 250

⁵ *PFR Sdn Bhd v KPHDN* [2022] MSTC 10-151

⁶ *Cash Band (M) Bhd v KPHDN* PKCP (R) 564 / 2018 and WA-14-12-08/2021

It can be understood from these cases and taking into account the necessary modifications for application on digital assets that the following considerations would be relevant to determine whether income tax would be payable on transactions:

(a) The nature and the intention of holding the digital asset

- It is an investment holding company.
- Its intention was to hold the digital asset as investment.
- It has never been shown to be a company or individual trading in digital currencies and assets, or having the means, knowledge, or expertise in such areas of business.

(b) Period of ownership

- The digital asset has been held for a considerable amount of time prior to its disposal. A longer period is indicative of an intention to hold for investment.
- As stated in the Guidelines, it will more likely be regarded as held for trading if the holding period is short. However, in ***PFR Sdn Bhd v KPHDN***, despite parts of the asset being held for only a year, the SCIT was of the view that this was inconclusive and must be balanced with other factors.

(c) Frequency of transactions

- The taxpayer did not frequently trade in similar assets as part of its business in the past.
- The existence of many similar past transactions may give rise to a presumption of trade.

(d) Supplementary work

- The Guidelines state that supplementary work refers to additional work done on digital currencies to make it more marketable. The types of additional work done on digital currencies alluded to by the IRB remain to be seen, but

experts in digital currency mining could potentially fall under IRB's radar.

- Similarly, this factor must be considered together with the other badges of trade. For example, in the conventional context of property transactions, the Court in **Cash Band** held that rectification and refurbishment work on the property in question (i.e., a golf club) showed the taxpayer's genuine intention to run the golf club and was not an alteration of property to render it more saleable.

(e) Methods employed in disposing of property

- The Guidelines state that extra effort made to find or attract purchasers for digital currencies is indicative of trading. However, as it is broadly known, selling digital assets on digital platforms or cryptocurrency exchanges is generally a more straight-forward process when compared to a conventional sale of land and property. Therefore, the conventional analysis on methods of disposal of land and property cannot be directly applied on digital asset transactions.
- Nevertheless, engaging digital asset experts or agents to carry out or advise on trades could again fall under IRB's radar.

(f) Circumstances responsible for sale

- A forced sale e.g., due to a sudden emergency or unanticipated need for funds or threat of foreclosure by creditors would indicate that the transaction is not in the nature of trade.

Conclusion

Notwithstanding the above, it must be borne in mind that no single badge of trade is decisive on its own. As such, all the facts and circumstances would have to be carefully considered when determining whether the gains / losses from a transaction (whether involving real property, shares or digital currencies) are taxable / deductible under the ITA.

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It is advisable to seek legal advice at the earliest opportunity, perhaps even before engaging in trading, to minimise exposure to taxes and penalties under the ITA.

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