

The Senate

Economics

References Committee

Digital currency—game changer or bit player

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Abbreviations

ABA	Australian Bankers' Association
ACC	Australian Crime Commission
ACCC	Australian Competition and Consumer Commission
ADCCA	Australian Digital Currency Commerce Association
AFP	Australian Federal Police
AFS licence	Australian Financial Services license
AML/CTF	anti-money laundering and counter-terrorism financing
AML/CTF Act	<i>Anti-Money Laundering and Counter-Terrorism Financing Act 2006</i>
APCA	Australian Payments Clearing Association
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
CGT	Capital Gains Tax
DFAT	Department of Foreign Affairs and Trade
DVS	Document Verification Service
EU	European Union
FATF	Financial Action Task Force
FBT	Fringe Benefits Tax
FSI	Financial System Inquiry
GST	Goods and Services Tax
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
Income Tax Act	<i>Income Tax Assessment Act 1997</i>
KYC	Know Your Customer
RBA	Reserve Bank of Australia

VAT Value Added Tax

UK United Kingdom

Chapter 1

Introduction

1.1 On 2 October 2014, the Senate referred the matter of digital currency to the Economics References Committee for inquiry and report by the first sitting day in March 2015.¹ On 2 March 2015, the Senate granted an extension of time to report by 10 August 2015.²

1.2 Under its terms of reference, the committee was to give particular reference to:

- (a) how to develop an effective regulatory system for digital currency that:
 - (i) ascertains the most appropriate definition of digital currencies under Australian tax law,
 - (ii) promotes competition and growth of the digital currency industry,
 - (iii) ensures ongoing stability in the financial services industry,
 - (iv) secures protection of consumers and businesses against illegal activity,
 - (v) incorporates digital currencies into Australia's national security framework, and
 - (vi) ensures the financial stability of the industry;
- (b) the potential impact of digital currency technology on the Australian economy, including the:
 - (i) payments sector,
 - (ii) retail sector, and
 - (iii) banking sector;
- (c) how Australia can take advantage of digital currency technology to establish itself as a market leader in this field; and
- (d) any other related matters.³

Conduct of inquiry

1.3 The inquiry was established to examine how best to define digital currency within the regulatory frameworks in order to support innovation and the needs of the growing Australian digital currency industry. It comes at an important juncture in the

1 *Journals of the Senate*, No. 59, 2 October 2014, pp. 1583–1584.

2 *Journals of the Senate*, No. 79, 2 March 2015, p. 2203.

3 *Journals of the Senate*, No. 59, 2 October 2014, pp. 1583–1584.

emergence of this new technology where there are both opportunities but also risks. A number of overseas countries are also considering the use of digital currency, and this inquiry is both timely and welcomed.

1.4 The committee advertised the inquiry on its website and in the *Australian*. It also wrote to relevant stakeholders and interested parties inviting submissions. The committee received 48 submissions. The submissions and answers to questions on notice are listed at Appendix 1. On 26 November 2014 and 4 March 2015, the committee held public hearings in Canberra and on 7 April 2015 in Sydney. A list of witnesses is at Appendix 2.

1.5 In December 2014, an international delegation made up of members of the committee travelled to Singapore and Canada. They took the opportunity during their visit to discuss matters related to digital currency including approaches to its regulation. For example, digital currency was considered during meetings with representatives of the Bank of Canada, Finance Canada, the Canada Revenue Agency, and the Royal Canadian Mint. In addition, on 16 December 2014, the delegation met with the Chair, Senator the Hon Irving Gerstein, and members of the Canadian Senate's Standing Committee on Banking Trade and Commerce which is also conducting an inquiry into digital currency. It is worth noting that like Australia, Canada also treats digital currencies, such as Bitcoin, as commodities, and transactions using digital currencies as barter transactions. In this context, committee members were able to exchange views on the regulatory risks related to digital currencies particularly given the rapid rate of changing technology.

Structure of the report

1.6 This report comprises six chapters including this introductory chapter:

- chapter 2—provides an overview of digital currencies and recent developments both in Australia and overseas;
- chapter 3—discusses some of the potential risks and benefits of digital currencies;
- chapter 4—examines the tax treatment of digital currencies;
- chapter 5—looks at how digital currencies fit within the financial and payments system regulatory frameworks; and
- chapter 6—considers whether digital currencies should be brought within the anti-money laundering and counter terrorism regime.

Acknowledgements

1.7 The committee thanks all those who assisted with the inquiry, especially those who made written submissions.

Chapter 2

Overview and recent developments

What is digital currency?

2.1 In its 2014 report on virtual currencies, the Financial Action Task Force (FATF), an inter-governmental body established in 1989 by a Group of Seven (G-7) Summit in Paris, defined digital currency as:

[A] digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. 'real currency', 'real money', or 'national currency'), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency—i.e., it electronically transfers value that has legal tender status.¹

2.2 The term 'digital currency' can sometimes have a broader meaning, which also includes e-money.² For the purposes of this report the terms 'digital currency' and 'virtual currency' can be used interchangeably.³

Types of digital currency

2.3 Digital currency can be divided into two basic types: convertible and non-convertible digital currency. Convertible digital currency has an equivalent value in real (fiat) currency and can be exchanged back-and-forth for real currency (Bitcoin is an example of convertible currency). Non-convertible digital currency, on the other hand, cannot be exchanged for fiat currency and is intended to be specific to a

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- 1 FATF, *Virtual Currencies—Key Definitions and Potential AML/CFT Risks*, 2014, p. 4. <http://www.fatfgafi.org/topics/methodsandtrends/documents/virtual-currency-definitions-aml-cft-risk.html>; see also Attorney General's Department, *Submission 42*, p. 5. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.
 - 2 FATF, *Virtual Currencies—Key Definitions and Potential AML/CFT Risks*, 2014, p. 4. <http://www.fatfgafi.org/topics/methodsandtrends/documents/virtual-currency-definitions-aml-cft-risk.html>; see also Attorney-General's Department, *Submission 42*, p. 6.
 - 3 FATF, *Virtual Currencies—Key Definitions and Potential AML/CFT Risks*, 2014, p. 4. <http://www.fatfgafi.org/topics/methodsandtrends/documents/virtual-currency-definitions-aml-cft-risk.html>; see also Attorney-General's Department, *Submission 42*, p. 6.

particular virtual domain or world, such as a massively multiplayer online role-playing game, for example World of Warcraft Gold is a non-convertible digital currency.⁴

2.4 Digital currency can be further categorised into two subtypes: centralised and non-centralised. All non-convertible digital currencies are centralised, as they are issued by a single administrating authority. Convertible digital currencies can be either centralised or decentralised. Decentralised digital currencies, also known as cryptocurrencies, are distributed, open-source, math-based, peer-to-peer currencies that have no central administrating authority and no central monitoring or oversight. Examples of cryptocurrencies include: Bitcoin, Litecoin and Ripple.⁵

What is Bitcoin?

2.5 Launched in 2009, Bitcoin was the first decentralised convertible digital currency and the first cryptocurrency. Bitcoin was created as an electronic payment system that would allow two parties to transact directly with each other over the internet without needing a trusted third party intermediary.⁶ The 'distributed ledger' (also known as the 'block chain') is used to record and verify transactions, allowing digital currency to be used as a decentralised payment system.⁷ A simplified explanation of the process is as follows:

A user, wishing to make a payment, issues payment instructions that are disseminated across the network of other users. Standard cryptographic techniques make it possible for users to verify that the transaction is valid—that the would-be payer owns the currency in question. Special users in the network, known as 'miners', gather together blocks of transactions and compete to verify them. In return for this service, miners that successfully verify a block of transactions receive both an allocation of newly created currency and any transaction fees offered by parties to the transactions under question.⁸

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- 4 FATF, *Virtual Currencies—Key Definitions and Potential AML/CFT Risks*, 2014, p. 4. <http://www.fatfgafi.org/topics/methodsandtrends/documents/virtual-currency-definitions-aml-cft-risk.html>, see also Attorney-General's Department, *Submission 42*, p. 6.
 - 5 FATF, *Virtual Currencies—Key Definitions and Potential AML/CFT Risks*, 2014, p. 5. <http://www.fatfgafi.org/topics/methodsandtrends/documents/virtual-currency-definitions-aml-cft-risk.html>; see also Attorney-General's Department, *Submission 42*, p. 6.
 - 6 Satoshi Nakamoto, 'Bitcoin: A peer-to peer electronic cash system', <https://bitcoin.org/bitcoin.pdf> (accessed 30 April 2015).
 - 7 Robleh Ali, John Barrdear, Roger Clews and James Southgate, 'The economics of digital currencies', *Quarterly Bulletin*, Q3 2014, Bank of England, vol.54, no.3, p. 277. <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q302.pdf> (accessed 30 April 2015).
 - 8 Robleh Ali, John Barrdear, Roger Clews and James Southgate, 'Innovations in payment technologies and the emergence of digital currencies', *Quarterly Bulletin*, Q3 2014, Bank of England, vol.54, no.3, p. 266. <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q301.pdf> (accessed 30 April 2015).

2.6 While Bitcoin is the most prominent digital currency, there are currently more than five hundred different digital currencies, including Litecoin, Ripple, Peercoin, Nxt, Dogecoin, Darkcoin, Namecoin, Mastercoin and BitcoinDark.⁹ Most of these alternative digital currencies were inspired by, or explicitly modelled on, Bitcoin.¹⁰

Digital currency intermediaries

2.7 Digital currency users may use intermediaries to manage their holdings and facilitate transactions. For Bitcoin users, there is a range of intermediaries which provide services to users.¹¹

Intermediary Service	Description
Bitcoin wallets	Store users' bitcoin address(es) to which their bitcoins are tied and generate messages to transfer bitcoins from one address to another. A user may also choose to store their private keys needed to access their bitcoin addresses in a wallet.
Exchanges and trading platforms	Provide a market for the exchange of bitcoins for national currencies (or other digital currencies); these intermediaries are the main entry and exit points for the Bitcoin system. Exchanges operate order books, matching buyers and sellers of bitcoins and the price (in national currencies or other digital currencies) at which they are willing to trade.
Payments processing for merchants	Provide guaranteed-rate-conversion facilities. Some also offer point-of-sale infrastructure and applications that allow merchants to accept payments in bitcoin.
Intermediation for consumers	Act as an intermediary between users and Bitcoin exchanges or trading platforms, buying and/or selling bitcoins on behalf of the user. Some also provide an interface to facilitate retail payments and/or retain users' private keys.
Bitcoin ATMs	Operate ATMs that allow users to buy bitcoins using cash or sell their bitcoins for cash.

Current regulatory framework

Taxation

2.8 On 20 August 2014, the Australian Taxation Office (ATO) released a suite of draft public rulings on the tax treatment of digital currencies. The ATO's rulings, which were finalised on 17 December 2014, determined that:

Transacting with bitcoins is akin to a barter arrangement, with similar tax consequences.

The ATO's view is that Bitcoin is neither money nor a foreign currency, and the supply of bitcoin is not a financial supply for goods and services tax

9 'Crypto-Currency Market Capitalizations', <http://coinmarketcap.com/>, (accessed 30 April 2015).

10 Robleh Ali, John Barrdear, Roger Clews and James Southgate, 'Innovations in payment technologies and the emergence of digital currencies', *Quarterly Bulletin*, Q3 2014, Bank of England, vol.54, no.3, p. 266. <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q301.pdf> (accessed 30 April 2015).

11 Reserve Bank of Australia, *Submission 19*, p. 3.

(GST) purposes. Bitcoin is, however, an asset for capital gains tax (CGT) purposes.¹²

2.9 The ATO's finalised public rulings are as follows:

- GSTR 2014/3—Goods and services tax: the GST implications of transactions involving Bitcoin
- TD 2014/25—Income tax: is Bitcoin a 'foreign currency' for the purposes of Division 775 of the *Income Tax Assessment Act 1997*?
- TD 2014/26—Income tax: is Bitcoin a CGT asset for the purposes of subsection 108-5(1) of the *Income Tax Assessment Act 1997*?
- TD 2014/27—Income tax: is Bitcoin trading stock for the purposes of subsection 70-10(1) of the *Income Tax Assessment Act 1997*?
- TD 2014/28—Fringe benefits tax: is the provision of Bitcoin by an employer to an employee in respect of their employment a fringe benefit for the purposes of subsection 136(1) of the *Fringe Benefits Tax Assessment Act 1986*?¹³

2.10 A summary of the taxation implication of the ATO's rulings on digital currencies is as follows:

- Capital gains tax (CGT)—Those using digital currency for investment or business purposes may be subject to CGT when they dispose of digital currency, in the same way they would be for the disposal of shares or similar CGT assets; individuals who make personal use of digital currency (for example using digital currency to purchase items to buy a coffee) and where the cost of the Bitcoin was less than AUD\$10,000, will have no CGT obligations.
- Goods and Services Tax (GST)—Individuals will be charged GST when they buy digital currency, as with any other property. Businesses will charge GST when they supply digital currency and be charged GST when they buy digital currency.
- Income Tax—Businesses providing an exchange service, buying and selling digital currency, or mining Bitcoin, will pay income tax on the profits. Businesses paid in Bitcoin will include the amount, valued in Australian currency, in assessable business income. Those trading digital currencies for profit, will also be required to include the profits as part of their assessable income.

12 Australian Taxation Office, 'Tax treatment of crypto-currencies in Australia—specifically bitcoin', <https://www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-bitcoin/> (accessed 30 April 2015).

13 Australian Taxation Office, 'Tax treatment of crypto-currencies in Australia—specifically bitcoin', https://www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/?page=1#Bitcoin_exchange_transactions (accessed 30 April 2015).

- Fringe Benefits Tax (FBT)—remuneration paid in digital currency will be subject to FBT where the employee has a valid salary sacrifice arrangement, otherwise the usual salary and wage PAYG rules will apply.¹⁴

Taxation white paper process

2.11 On 30 March 2015, the Hon Joe Hockey MP, Treasurer, released a tax discussion paper to inform the government's tax options Green Paper, due to be released in the second half of 2015, with the White Paper to be released in 2016 following further consultation.¹⁵

2.12 The tax discussion paper commented on challenges arising from the potential for digital currencies to increase the ability of companies to relocate profits to minimise their tax. The discussion paper noted:

...financial markets are increasingly globally integrated, and the international flow of capital has become less restricted and more mobile. Technology has also allowed new business models to evolve that have substantially changed the way businesses and consumers interact. New ways of transacting, including crypto-currencies such as bitcoin, were not contemplated when the current tax system was designed.¹⁶

International approaches

2.13 The ATO's ruling, that digital currency is a commodity rather than a currency, is similar to the tax guidance provided by relevant authorities in other countries such as Canada and Singapore.¹⁷ Alternatively, other jurisdictions such as the United Kingdom and most recently Spain, have released guidance advising that digital currency is exempt from value added tax (VAT) under Article 135(1)(d) of the European Union (EU) VAT Directive.¹⁸ The EU is waiting on a ruling from the EU

14 Australian Taxation Office, *Submission 8*, pp. 3–4.

15 The Hon Joe Hockey, Treasurer of the Commonwealth of Australia, 'Time to 're:think' our tax system', media release, 30 March 2015, <http://jbh.ministers.treasury.gov.au/media-release/021-2015/> (accessed 30 April 2015).

16 The Australian Government the Treasury, *Re:think: Tax discussion paper: Better tax system, better Australia*, March 2015, p. 9, <http://bettertax.gov.au/publications/discussion-paper/> (accessed 30 April 2015).

17 Inland Revenue Authority of Singapore, 'For GST-registered businesses: e-Commerce', <http://www.iras.gov.sg/irashome/page04.aspx?id=2276> (accessed 18 May 2015); Canada Revenue Agency, 'What should you know about digital currency', 17 March 2015, <http://www.cra-arc.gc.ca/nwsrm/fctshts/2015/m03/fs150317-eng.html> (accessed 30 April 2015).

18 HM Revenue and Customs, 'Policy paper: Revenue and Customs Brief 9 (2014): Bitcoin and other cryptocurrencies', 3 March 2014, <https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies#vat-treatment-of-bitcoin-and-similar-cryptocurrencies> (accessed 30 April 2015); Law and Bitcoin, 'Bitcoin is Exempt from VAT in Spain', 16 April 2015, <http://lawandbitcoin.com/en/bitcoin-is-vat-exempt-in-spain/#vat-and-bitcoin-in-europe> (accessed 30 April 2015).

Court of Justice on the correct interpretation of the relevant EU VAT directive.¹⁹ Sweden's tax authorities have challenged a previous Swedish decision that digital currency should be VAT exempt.²⁰

Financial regulation and consumer protection

Reserve Bank of Australia

2.14 The Reserve Bank of Australia (RBA) is the principal regulator of the payments system, and administers the *Payment Systems (Regulation) Act 1998* (PSRA). The RBA's general regulatory approach under the PSRA relies principally on 'industry- or market-driven solutions', intervening only when necessary on the grounds of its 'responsibility for efficiency and competition in the payments system and controlling systemic risk'. The RBA considers digital currencies are currently in limited use and do not yet raise any significant concerns with respect to competition, efficiency or risk to the financial system; and are not currently regulated by the RBA or subject to regulatory oversight.²¹

2.15 In April 2015, the RBA informed the committee that it would be assessing whether the current regulatory framework could accommodate alternative mediums of exchange such as digital currencies.²²

ASIC and ACCC

2.16 The Australian Securities and Investments Commission's (ASIC) view is that digital currencies themselves do not fall within the legal definition of 'financial product' under the *Corporations Act 2001* (Corporations Act) or the *Australian Securities and Investments Commission Act 2001* (ASIC Act). This means that 'a person is not providing financial services when they operate a digital currency trading platform, provide advice on digital currencies or arrange for others to buy and sell digital currencies'. However, some facilitates associated with digital currencies may fit within the definition as financial products.²³

2.17 ASIC has issued advice to consumers on its MoneySmart webpage outlining some of the of the risks of digital currencies:

Virtual currencies have less safeguards—The exchange platforms on which you buy and sell virtual currencies are generally not regulated, which means that if the platform fails or is hacked, you are not protected and have no statutory recourse. Virtual currency failures in the past have made investors lose significant amounts of real money. Some countries are moving towards

19 Australian Taxation Office, *Submission 8*, p. 5.

20 Australian Securities and Investments Commission, *Submission 44*, p. 31; Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 16.

21 Reserve Bank of Australia, *Submission 19*, p. 9; Dr Anthony Richards, Reserve Bank of Australia, *Committee Hansard*, 7 April 2015, p. 45.

22 Dr Anthony Richards, Reserve Bank of Australia, *Committee Hansard*, 7 April 2015, p. 45.

23 Australian Securities and Investments Commission, *Submission 44*, p. 11.

regulating virtual currencies, however virtual currencies are not recognised as legal tender.

Values fluctuate—The value of a virtual currency can fluctuate wildly. The value is largely based on its popularity at a given time which will be influenced by factors such as the number of people using the currency and the ease with which it can be traded or used.

Your money could be stolen—Just as your real wallet can be stolen by a thief, the contents of your digital wallet can be stolen by a computer hacker. Your digital wallet has a public key and a private key, like a password or a PIN number. However, virtual currency systems allow users to remain anonymous and there is no central data bank. If hackers steal your digital currency you have little hope of getting it back. You also have no protection against unauthorised or incorrect debits from your digital wallet.

Popular with criminals—The anonymous nature of virtual currencies makes them attractive to criminals who use them for money laundering and other illegal activities.²⁴

2.18 In summary, ASIC advised that 'if you decide to trade or use virtual currencies you are taking on a lot of risk with no recourse if things go wrong'.²⁵

2.19 On 26 November 2014, the Parliamentary Joint Committee on Corporations and Financial Services tabled a report on the oversight of ASIC. During the course of the inquiry, ASIC informed the committee of its approach to digital currency:

Virtual currencies such as Bitcoins are a developing area globally. ASIC monitors new developments in the marketplace and, accordingly, ASIC is considering whether and how the legislation it administers, such as the Corporations Act, applies to virtual currencies.

ASIC's view is that Bitcoins themselves (and other virtual currencies) are not financial products and are not regulated under the legislation we administer. Unlike Australian dollars or other traditional currencies, Bitcoins are not issued by a central bank and do not give the Bitcoin holder any right to make payments in this form.

ASIC is consulting with other Australian regulators that are also giving consideration to the regulation of virtual currencies. This includes both financial regulators and law enforcement agencies that are examining the

24 Australian Securities and Investments Commission, 'Virtual currencies: Bitcoin and other virtual currencies', last updated 26 August 2014, <https://www.moneySMART.gov.au/investing/investment-warnings/virtual-currencies> (accessed 30 April 2015).

25 Australian Securities and Investments Commission, 'Virtual currencies: Bitcoin and other virtual currencies', last updated 26 August 2014, <https://www.moneySMART.gov.au/investing/investment-warnings/virtual-currencies> (accessed 30 April 2015).

use of Bitcoin in criminal activities. Additionally, the regulation of Bitcoins is being considered by regulators and policy makers internationally.²⁶

2.20 The Parliamentary Joint Committee on Corporations and Financial Services noted that it will continue to monitor the development of digital currencies.²⁷

2.21 While ASIC does not consider digital currencies to be currency or money for the purposes of the Corporations Act or the ASIC Act, the general consumer protection provisions of the *Competition and Consumer Act 2010* apply to digital currencies, rather than the equivalent provisions in the ASIC Act. The *Competition and Consumer Act 2010* is administered by the Australian Competition and Consumer Commission (ACCC). The ACCC's SCAMwatch and consumer information webpages do not include any specific warnings about digital currencies.²⁸

Financial System Inquiry

2.22 On 20 December 2013, the Hon Joe Hockey MP, Treasurer, announced the final terms of reference for the government's Financial System Inquiry (FSI) and the appointment of four members of the inquiry panel to be chaired by Mr David Murray AO. The purpose of the FSI was to examine how Australia's financial system could be 'positioned to best meet Australia's evolving needs and support Australia's economic growth'.²⁹ On 7 December 2014, the final report of the FSI was released and the Treasury is currently conducting a consultation process on the FSI recommendations.³⁰

2.23 The FSI report noted that national currencies are currently the only instruments widely used to fulfil the economic functions of money—that is, as a store of value, a medium of exchange and a unit of account. The FSI found that:

Digital currencies are not currently widely used as a unit of account in Australia and as such may not be regarded as 'money'. However, their use in payment systems could expand in the future. It will be important that payments system regulation is able to accommodate them, as well as other potential payment instruments that are not yet conceived. Current

26 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation Report No. 1 of the 44th Parliament*, November 2014, p. 25.

27 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation Report No. 1 of the 44th Parliament*, November 2014, p. 26.

28 Australian Competition and Consumer Commission, 'Consumers', <http://www.accc.gov.au/consumers>; SCAMwatch, www.scamwatch.gov.au (accessed 29 May 2015).

29 The Hon Joe Hockey, Treasurer of the Commonwealth of Australia, 'Financial System Inquiry', media release, 20 December 2013. <http://jbh.ministers.treasury.gov.au/media-release/037-2013/> (accessed 30 April 2015).

30 The Treasury, 'Financial System Inquiry Final Report', 7 December 2014, <http://treasury.gov.au/ConsultationsandReviews/Consultations/2014/FSI-Final-Report> (accessed 30 April 2015).

legislation should be reviewed to ensure payment services using alternative mediums of exchange can be regulated—from consumer, stability, competition, efficiency and AML [anti-money laundering] perspectives—if a public interest case arises.³¹

International approaches

2.24 In August 2014, the UK government announced it was considering regulation of digital currencies. In November 2014, it published a call for information and the outcome of this consultation process was released in March 2015. In relation to consumer protection the UK government announced its intention to work with the digital currency industry and the British Standards Institution to develop voluntary standards for consumer protection. In its view, this approach would address potential risks to consumers without imposing a disproportionate regulatory burden on the digital currency industry.³²

2.25 The Canadian Senate's Standing Committee on Banking Trade and Commerce conducted an inquiry into digital currency and tabled its report on 19 June 2015. It investigated how digital currency should be treated, including whether it should be regulated. It recommended that the Canadian government should exercise a regulatory 'light touch' in order to create an environment that fosters innovation and minimises the risks of stifling new technologies.³³

2.26 Both the Singapore and Canadian governments have published advice for consumers, similar to ASIC's MoneySmart webpage, warning consumers of the risks associated with digital currency.³⁴

Law enforcement

2.27 Digital currencies, such as Bitcoin, are not currently covered under section 5 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act). The Act, however, recognises e-currency, which is defined as follows:

e-currency means an internet-based, electronic means of exchange that is:

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- 31 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 166.
- 32 HM Treasury, *Digital currencies: response to the call for information*, March 2015, p. 19, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414040/digital_currencies_response_to_call_for_information_final_changes.pdf (accessed 30 April 2015).
- 33 Canadian Standing Senate Committee on Banking Trade and Commerce, *Digital Currency: You Can't Flip this Coin!*, June 2015, p. 13. <http://www.parl.gc.ca/Content/SEN/Committee/412/banc/rep/rep12jun15-e.pdf> (accessed 23 June 2015).
- 34 Singapore government, 'Virtual Currencies', <http://www.mas.gov.sg/moneysense/understanding-financial-products/investments/consumer-alerts/virtual-currencies.aspx> (accessed 15 May 2015); Financial Consumer Agency of Canada, 'Virtual currencies', <http://www.fcac-acfc.gc.ca/Eng/forConsumers/topics/paymentOptions/Pages/Virtualc-Monnaies.aspx> (accessed 15 May 2015).

- (a) known as any of the following:
 - (i) e-currency;
 - (ii) e-money;
 - (iii) digital currency;
 - (iv) a name specified in the AML/CTF Rules; and
- (b) backed either directly or indirectly by:
 - (i) precious metal; or
 - (ii) bullion; or
 - (iii) a thing of a kind prescribed by the AML/CTF Rules; and
 - (iv) not issued by or under the authority of a government body;
- (c) and includes anything that, under the regulations, is taken to be e-currency for the purposes of this Act.

2.28 The AML/CTF Act currently only covers a very small proportion of the digital currencies. It does not cover digital currencies, such as Bitcoin, that are not backed by precious metal or bullion. While subsection 5(b)(iii) enables the regulation of digital currencies backed either directly or indirectly by 'a thing of a kind prescribed by the AML/CTF Rules', no such rules have been issued to date.³⁵

2.29 Australia's current AML/CTF regime allows for limited regulatory oversight of convertible digital currencies. Because digital currencies such as Bitcoin are not yet widely used and accepted, they are yet to form a 'closed loop' economy, and whenever they are exchanged for fiat currencies, or vice versa ('on ramps' and 'off ramps'), the transactions will generally intersect with banking or remittance services which are regulated under the AML/CTF regime.³⁶ For example, Australian Transaction Reports and Analysis Centre (AUSTRAC), Australia's AML/CTF regulator, is able to monitor and track reportable transactions such as:

- reports of international funds transfer instructions (IFTIs) between Australian accounts and foreign accounts for the purchase/sale of digital currencies;
- threshold transaction reports (TTRs) for cash deposits/withdrawals of AUD10,000 or more involving the bank accounts of digital currency exchange providers; and
- suspicious matter reports (SMRs) submitted where reporting entities consider financial activity involving a digital currency exchange to be suspicious.³⁷

35 Attorney-General's Department, *Submission 42*, p. 10.

36 Attorney-General's Department, *Submission 42*, p. 11.

37 Australian Transaction Reports and Analysis Centre, *AUSTRAC typologies and case studies report 2014*, 2014, p. 13.

Statutory Review of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006

2.30 In December 2013, the Australian government commenced a statutory review of the operation of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act)—the review is required under section 251 of the AML/CTF Act.³⁸ The Attorney-General's Department stated:

The use and ongoing expansion of digital currencies is an area of continuing policy interest to the Attorney-General's Department. A number of options to address the money laundering and terrorism financing issues created by the emergence of digital currency systems are being considered in the context of the statutory review of the AML/CTF Act.³⁹

Parliamentary Joint Committee on Law Enforcement

2.31 The Parliamentary Joint Committee on Law Enforcement is currently conducting an inquiry into financial related crime and received evidence from law enforcement agencies in relation to Bitcoin and financial crime.⁴⁰ The inquiry was referred on 5 March 2014 and is expected to report late in 2015.

International approaches

2.32 In March 2015, the UK government flagged its intention to apply anti-money laundering regulation to digital currency exchanges, and committed to a full consultation on the proposed regulatory approach in the next Parliament in response to the findings of its consultation process.⁴¹

2.33 On 19 June 2014, the Canadian AML/CTF legislation, the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*, was amended to bring money service businesses (MSB) dealing in digital currencies under Canada's AML/CTF regime. Once new regulations are drafted and come into force, they will cover digital currency exchanges, but not individuals or businesses that use digital currencies for buying and selling goods and services.⁴²

38 Attorney-General's Department, 'Statutory Review of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*', <http://www.ag.gov.au/consultations/pages/StatReviewAntiMoneyLaunderingCounterTerrorismFinActCth2006.aspx> (accessed 30 April 2015).

39 Attorney-General's Department, *Submission 42*, p. 17.

40 Parliamentary Joint Committee on Law Enforcement, 'Inquiry into Financial Crime', http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Law_Enforcement/Financial_related_crime; see for example AUSTRAC, *Submission 10*, pp. 20–21.

41 HM Treasury, *Digital currencies: response to the call for information*, March 2015, p. 19, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414040/digital_currencies_response_to_call_for_information_final_changes.pdf (accessed 30 April 2015).

42 Financial Transactions and Reports Analysis Centre of Canada, 'FINTRAC Advisory regarding Money Services Businesses dealing in virtual currency', 30 July 2014, <http://www.fintrac-canafe.gc.ca/new-neuf/avs/2014-07-30-eng.asp> (accessed 15 May 2015).

2.34 In its report on digital currency, the Canadian Senate's Standing Committee on Banking Trade and Commerce recommended that the Canadian government should require digital currency exchanges, excluding businesses that solely provide wallet services, to meet the same requirements as money service businesses under Canada's AML/CTF laws. The report recommended that digital currency exchanges should be defined as 'any business that allows customers to convert state-issued currency to digital currency and digital currencies to state-issued currency or other digital currencies'.⁴³

2.35 On 13 March 2014, the Money Authority of Singapore (MAS) announced that it would regulate digital currency intermediaries that buy, sell or facilitate the exchange of digital currencies for fiat currencies under its AML/CTF regime.⁴⁴

Financial Action Task Force

2.36 The Financial Action Task Force (FATF) is an independent intergovernmental body that develops and promotes policies to protect the global financial system against money laundering and terrorism financing. FATF released a report on digital currencies in June 2014, establishing a common definitional vocabulary and suggesting a conceptual framework for understanding and addressing the AML/CTF risks associated with digital currencies.⁴⁵

2.37 On 1 July 2014, Mr Roger Wilkins AO, former Secretary of the Attorney General's Department, assumed the Presidency of the FATF. Mr Wilkins has indicated that during his term he intends to examine the money laundering and terrorism financing risks associated with digital currencies and, consider whether further policy measures are necessary.⁴⁶

Conclusion

2.38 Countries are considering the regulatory challenges presented by the emergence of new forms of digital currencies. Australia is no exception and in the following chapters the committee will explore some of these challenges and how best to address them.

43 Canadian Standing Senate Committee on Banking Trade and Commerce, *Digital Currency: You Can't Flip this Coin!*, June 2015, p. 13.
<http://www.parl.gc.ca/Content/SEN/Committee/412/banc/rep/rep12jun15-e.pdf> (accessed 23 June 2015).

44 Monetary Authority of Singapore, 'MAS to Regulate Virtual Currency Intermediaries for Money Laundering and Terrorist Financing Risks', media release, 13 March 2014,
<http://www.mas.gov.sg/news-and-publications/media-releases/2014/mas-to-regulate-virtual-currency-intermediaries-for-money-laundering-and-terrorist-financing-risks.aspx> (accessed 15 May 2015).

45 Attorney-General's Department, *Submission 42*, p. 15.

46 Attorney-General's Department, *Submission 42*, p. 15.

Chapter 3

Opportunities and risks

3.1 Advances in technology have produced rapid changes in the way Australians are managing their money. While the advent of digital currency has opened up a range of opportunities, it also presents risks. The Australian Payments Clearing Association (APCA), the self-regulatory body set up by the payments industry to improve the safety, reliability, equity, convenience and efficiency of the Australian payments system, recognised both the possible benefits and drawbacks of emerging digital currencies, observing:

New technologies, particularly network and cloud-based technologies such as the block chain, offer the potential for valuable innovation and competition. However payments system regulation must balance competing policy objectives. It must maintain a balance between stability, efficiency and competition-driven innovation while ensuring confidence and integrity.¹

3.2 In this chapter, the committee explores the potential opportunities and risks of digital currency.

Benefits of digital currencies

3.3 The European Securities and Markets Authority (ESMA) found that the main attraction of digital or virtual currencies (VC) appeared to be the speed and cost. It stated:

The main benefits of VC [virtual currency] based financial assets and asset transfers seem to be speed and cost. From the perspective of the user/investor, the speed of VC based financial asset transactions is higher than traditional financial asset transfers and takes place within a couple of hours at most. The cost of transactions seems to be currently somewhere around a couple of Euro cents. Both speed and cost of transactions vary between different VCs.

The benefit of cost and speed equally holds for issuers in terms of listing an asset on an asset exchange. In the case of the NXT asset exchange, a listing currently costs 1000 NXT (currently around 10 Euro) one-off plus transaction costs when sending rewards to investors. Especially for small and medium sized companies this could become an attractive source of funding.²

3.4 The European Banking Authority similarly referred to the lower transaction costs and the faster speeds associated with virtual currencies. It noted:

1 Australian Payments Clearing Association, *Submission 43*, p. 3.

2 The European Securities and Markets Authority, *Call for evidence, Investment using virtual currency or distributed ledger technology*, 22 April 2015, paragraphs 34 and 35, http://www.esma.europa.eu/system/files/2015-532_call_for_evidence_on_virtual_currency_investment.pdf (accessed 29 May 2015).

Although reliable and independent data on the exact costs of VC transactions is difficult to ascertain, some anecdotal suggestions have been made that average transaction fees on the Bitcoin network tend to be less than 0.0005 BTC, or 1% of the transaction amount.

This compares with 2%–4% for traditional online payment systems or an estimated 8%–9% for remittance without involving bank accounts via money transmitters. Transactions within or between VC schemes are also not subject to the exchange fees applied to conversions for transactions with third countries, therefore providing further potential for cost savings, (although conversion fees would typically apply as and when VC are exchanged against FC [fiat currency] or vice versa). The increase in competition for transaction services may also have a cost-reducing effect on the costs of conventional transactions in FC.³

3.5 In respect to the processing time for transactions, it found:

Transactions using VCs can potentially be settled faster than those of FCs. For Bitcoins, the total process time is said to be between 10 and 60 minutes. It is claimed that, on average, a new block is added every 10 minutes to the blockchain transaction ledger. In this respect, VC payments appear to compare favourably with credit transfers or card payments, particularly for payments between different currency areas. Also, processing VC payments takes place on a 24/7 basis, unlike payments made through traditional payment systems.⁴

3.6 The European Banking Authority lists a number of other advantages attached to virtual currencies including:

- certainty of payments received—allowing merchants to avoid having to refund transactions, particularly those based on an alleged non-fulfilment of a contract;
- contributing to economic growth—spawning new types of businesses; and
- security of personal data.⁵

3.7 While digital currencies offer numerous advantages, their benefits are not as significant in the Australian context. APCA noted that, unlike some other countries, currently Australia 'enjoys a sophisticated, ubiquitous...globally competitive payment

3 European Banking Authority, *EBA Opinion on 'virtual currencies'*, EBA/Op/2014/08, paragraphs 46 and 47, July 2014, <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf> (accessed 29 May 2015).

4 European Banking Authority, *EBA Opinion on 'virtual currencies'*, EBA/Op/2014/08, paragraph 52, 4 July 2014, <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf> (accessed 29 May 2015).

5 European Banking Authority, *EBA Opinion on 'virtual currencies'*, EBA/Op/2014/08, paragraphs 53–59, 4 July 2014, <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf> (accessed 29 May 2015).

system with generally high quality regulatory structures and settings'.⁶ Australia's payment system is already overwhelmingly digital in nature, with only about 18 per cent of Australian currency existing in physical form.⁷

3.8 For example, EFTPOS transactions in Australia cost 16 cents on average, so there is little room for digital currencies to improve on domestic point-of-sale purchases, which account for around 40 percent of all transactions by value.⁸ Australians already have many different payment systems including EFTPOS, interbank transfers, PayPal and international transfer via SWIFT. In this context, digital currencies, such as Bitcoin, do not offer much more additional capability. But in developing countries, digital currencies may provide secure international facilities for the transfer of funds at a much lower transaction cost than available from institutional banking.⁹

Distributed ledger technology

3.9 A distributed public ledger is a major innovation and integral to the appeal Bitcoin. The Chamber of Digital Commerce, a US not-for-profit trade association, explained that the underlying source code or algorithm of the Bitcoin protocol, often referred to as the blockchain, is built for the transfer of information. While the distributed ledger currently stores, transfers and accounts for financial assets, there is potential for the distributed ledger technology to be used to store and transfer other types of digital assets.¹⁰

3.10 In APCA's view, the use of distributed ledger technology in digital currencies is unique and genuinely new, providing the opportunity to conduct both storage and transmission of value without the traditional financial intermediaries. APCA supported the potential for competition and innovation which could help improve Australia's payment system in the future, noting the potential for the distributed ledger technology to be used in the broader sphere—beyond payments and currencies.¹¹ Mr Christopher Hamilton, of the APCA, noted:

As a concept, as a way of recording ownership of assets—it can in principle be any asset including existing currency—it [distributed ledger technology]

6 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 1.

7 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 1.

8 Mr Robert Vong, *Submission 4*, p. 1.

9 Mr Mark Pesce, 'Where the bank keeps your money safe', *The Drum* (Australian Broadcasting Corporation), 15 July 2014, <http://www.abc.net.au/news/2014-07-15/pesce-where-the-bank-keeps-your-money/5595664> (accessed 29 May 2015).

10 Chamber of Digital Commerce, *Submission 37*, p. 2.

11 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 1.

is genuinely a new way of doing it. For that reason, it is worth exploring and understanding the implications of it.¹²

International remittance and financial inclusion

3.11 As Australia already has a well-established and efficient payments system, Mr Andreas Antonopoulos, an author and computer security expert, suggested that Bitcoin may represent a unique opportunity in two areas:

Firstly, bitcoin can introduce much needed competition in the retail payments industry, undercutting the expensive systems offered by credit and debit cards, while significantly improving security and privacy for consumers. Secondly, the bitcoin industry can establish Australia at the forefront of the next wave of innovation in financial services, a wave that can extend financial services to more than two billion people throughout Southeast Asia who are currently underbanked.¹³

International remittance

3.12 Mr Jonathon Miller, co-founder of Bit Trade Australia, advised the committee that he considered the overseas remittance market would be a growth area in Australia for digital currency such as Bitcoin.¹⁴ He also noted benefits for Australians using digital currency to purchase goods and services from overseas, as these types of transactions currently included a currency conversion fee.¹⁵

3.13 For example, the transaction fees for transferring money from Australia to Samoa are around 12 per cent of the transaction value.¹⁶

3.14 APCA agreed that there was potential for digital currencies to assist with offshore transmission of money.¹⁷ mHITs Limited, an Australian-based mobile money service company, did not believe that it was likely that digital currencies alone would be used directly for cross-border remittances in the short term. While end-to-end digital currency remittances were unlikely, businesses such as BitPesa have used digital currencies to facilitate remittance services between Kenya and the UK.¹⁸

3.15 The RBA formed the view that international remittance may be an area where digital currencies might gain traction, noting currently they can be expensive and subject to delays in the receipt of funds.¹⁹ Even so, the RBA considered that the

12 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 3.

13 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 1.

14 Mr Jonathon Miller, Bit Trade Australia, *Committee Hansard*, 7 April 2015, p. 18.

15 Mr Jonathon Miller, Bit Trade Australia, *Committee Hansard*, 7 April 2015, p. 18.

16 Ms Rebecca Bryant, *Committee Hansard*, 7 April 2015, p. 30.

17 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 3.

18 mHITs Limited, *Submission 48*, p. 12.

19 Dr Anthony Richards, Reserve Bank of Australia, *Committee Hansard*, 7 April 2015, p. 45.

potential offered by digital currency was not significant and referred to the work being done through the New Payments Platform, a major industry initiative intended to establish 'new payments infrastructure that will spur innovation in the Australian payments industry'.²⁰ The RBA explained:

More broadly, however, many payment attributes of digital currencies are already available in the traditional payments system or will be available, in the case of the new services that may be facilitated by the New Payments Platform project. Accordingly, it remains to be seen what would drive their widespread use domestically, particularly in light of the price volatility of digital currencies observed to date.²¹

Financial inclusion

3.16 Ms Rebecca Bryant, Department of Foreign Affairs and Trade (DFAT), noted that while DFAT has not provided any funding to date for any initiatives involving digital currencies, some of its partners have. Ms Bryant noted that:

...the Consultative Group for Assisting the Poor [CGAP], and the World Bank—are actively considering the applicability of digital currencies to financial-inclusion initiatives. CGAP has looked closely at the BitPesa start-up, which, in 2014, launched a service using bitcoin to provide cheap and fast remittance services. BitPesa is focused on providing remittance services for the UK-to-Kenya corridor. The UK senders buy bitcoin. These are transferred to Kenya and immediately transferred into Kenyan shillings, which are then deposited into mobile wallets or bank accounts. BitPesa charges a variable rate of three per cent on the transfer. This compares to an average cost of a remittance from the UK to Kenya of nine per cent.²²

3.17 Ms Bryant advised the committee that DFAT was 'watching closely to see whether new business models, such as BitPesa, could have a wider application, thereby reducing the cost of simple transactions and increasing financial inclusion more broadly'.²³

Transparency

3.18 Ripple Labs, the San Francisco based developer of the Ripple protocol, an open-source distributed protocol that facilitates payments and funds transfers, suggested that the distributed ledger technology could substantially improve transparency in cross-border funds transfers. It suggested that this is 'particularly true of the Ripple distributed ledger system, which permits visibility of all transactions

20 Tony Richards, Head of Payments Policy Department, 'The Way We Pay: Now and in the Future', Speech to the Australian Savings & Deposits Conference 2014, Sydney, 4 June 2014, <http://www.rba.gov.au/speeches/2014/sp-so-040614.html> (accessed 29 May 2015).

21 Dr Anthony Richards, Reserve Bank of Australia, *Committee Hansard*, 7 April 2015, p. 45.

22 Ms Rebecca Bryant, Department of Foreign Affairs and Trade, *Committee Hansard*, 7 April 2015, p. 28.

23 Ms Rebecca Bryant, Department of Foreign Affairs and Trade, *Committee Hansard*, 7 April 2015, p. 28.

taking place through the protocol, and in which transaction histories of all accounts are available'.²⁴

3.19 The Australia Federal Police (AFP) noted that while distributed ledger or blockchain technology records all Bitcoin transactions, the identity of the persons involved in the transactions may not be easily traceable.²⁵ The identity of the individuals involved in transactions is discussed later in this chapter.

Risks

Taxation non-compliance risk

3.20 The ATO noted that digital currencies had similar compliance risks as those associated with the cash economy. In particular, the capacity for transactions to go unreported and be handled pseudo-anonymously. There was also the potential for digital currency to facilitate international profit shifting or to help hide transactions, as the nature of digital currencies means transactions can be highly mobile internationally.

3.21 Mr Michael Hardy, ATO, advised the committee that the ATO does 'not have a sense of an enhanced non-compliance risk with Bitcoin transactions.' He stated:

Of course, people do not put on their tax returns, 'This was my money from bitcoin.' It is just part of their assessable income. But our own monitoring has not indicated that there is a particularly high non-compliance risk from bitcoin transactions.²⁶

3.22 In addition to its assessment that the fiscal risk associated with Bitcoin was low, the ATO's submission noted that the total worldwide value of Bitcoin was relatively small at approximately AU \$5.96 billion when compared to Australia's GDP in 2012–13 which was \$1.5 trillion.²⁷

Financial stability

3.23 Researchers from the Finance Discipline Group, University of Technology, Sydney, analysed the Bitcoin public ledger and found that Bitcoin is currently held primarily for investment, rather than used as a medium of exchange. The researchers noted that the size of Bitcoin investments and transactions was relatively small compared to other assets. As such, they did not consider that Bitcoin is an immediate risk to financial stability or the Australian economy as a whole. However, they emphasised the level of risk was based on size, and may be affected by a significant increase in the acceptance of Bitcoin or similar digital currencies in the future.²⁸

24 Ripple Labs, *Submission 21*, p. 9.

25 Australian Federal Police, *Submission 34*, p. 3.

26 Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 15.

27 Australian Taxation Office, *Submission 8*, p. 7.

28 Finance Discipline Group, University of Technology, Sydney, *Submission 7*, p. [12].

3.24 Ripple Labs did not consider digital currencies to be a threat to financial stability and encouraged the committee to look at digital currencies as 'complementary currencies' rather than currencies that compete with government-issued currencies, stating:

While we believe that utilizing digital currencies could be particularly attractive for facilitating cross-border payments, Ripple Labs does not share the view that digital currencies should replace fiat currencies. For many reasons, including geo-political considerations, it is highly unlikely that any digital currency could pose a meaningful threat to monetary or fiscal stability for the foreseeable future.²⁹

3.25 Mr Shapiro from Promontory Financial Group LLC, a regulatory risk management and compliance consultancy, told the committee he did not believe digital currencies would replace national currencies:

It is simple. People understand their Australian dollars, their US dollars and their British pound, and I think a lot of the future of this is actually going to be allowing consumers to hold balances in the currencies they understand and use the back end of this for payments just as merchants today can use services.³⁰

3.26 APCA maintained that private currencies were not a new phenomenon and unlikely to affect the payment system adversely, so long as the bulk of activity continued to occur in fiat currencies.³¹ It also noted that while the distributed ledger technology has a lot of interesting potential, it did not necessarily follow that digital currencies would have a massive role in the Australian economy.³²

Price volatility

3.27 A number of submitters referred to the price instability of Bitcoin. Ripple Labs noted that as digital currencies involve volatile assets with inherent price volatility and risks, they may not be suited for direct consumer interaction.³³

3.28 Mr Christopher Guzowski, ABA Technology, observed, however, that there had been a downward trend in volatility of Bitcoin noting, the main reason for this development was that 'more exchanges are opening up around the world, there are more traders, there are more market makers, there is more market depth, more liquidity and therefore the spreads are being lowered and the volatility is reducing'.³⁴

29 Ripple Labs, *Submission 21*, p. 9.

30 Mr Adam Shapiro, Promontory Financial Group LLC, *Committee Hansard*, 26 November 2014, pp. 45–46.

31 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 1.

32 Mr Christopher Hamilton, Australian Payments Clearing Association, *Committee Hansard*, 7 April 2015, p. 10.

33 Ripple Labs, *Submission 21*, p. 3.

34 Mr Christopher Guzowski, ABA Technology, *Committee Hansard*, 26 November 2014, p. 24.

Pseudo-anonymity

3.29 Digital currencies such as Bitcoin do not provide complete anonymity for users. This type of digital currency is better described as offering pseudo-anonymity. The Attorney-General's Department explained:

To use Bitcoin as an example, every Bitcoin transaction is linked to a corresponding public key, which is then stored and made publicly available to view in the block chain. If a person's identity were linked to a public key, then it would be possible to look through the recorded transactions in the block chain and easily see all transactions associated with that key. In other words, Bitcoin offers users the ability to transact under the concealed identity of their Bitcoin address/public key, but all of their transactions are available for full public viewing and therefore for law enforcement scrutiny. When these transactions were examined and used to construct a pattern of behaviour, analysts in a simulated experiment were able to reveal the identities of approximately forty percent of Bitcoin users.³⁵

3.30 The AFP also noted that although the distributed ledger is public, the identity of persons involved in the transactions may not be readily traceable. The AFP was concerned that pseudo-anonymity and the ability to conduct digital currency transactions outside the regulated financial framework would make it difficult to determine the true owners of digital currencies.³⁶

Criminal activities

3.31 The nature of digital currencies, which can be traded online without face-to-face customer relationships, provides a greater degree of anonymity compared to traditional non-cash payments methods. The Attorney-General's Department observed that digital currencies provide 'a powerful new tool for criminals, terrorist financiers and sanctions evaders to both move and store illicit funds out of the reach of law enforcement and other authorities and purchase illicit goods and services'.³⁷

3.32 The Attorney-General's Department also noted that the risks associated with digital currencies were not hypothetical. In May 2013 the US Treasury and the Department of Justice undertook a coordinated enforcement action against Liberty Reserve, a centralised convertible digital currency system being used to facilitate US \$6 billion worth of illicit online activity, including identity fraud, credit card fraud, computer hacking and online scams. Liberty Reserve was designed to avoid regulatory and law enforcement scrutiny to assist criminals to distribute, store and launder the proceeds of illegal activities by enabling anonymous, untraceable financial transactions.³⁸

35 Attorney-General's Department, *Submission 42*, p. 8.

36 Australian Federal Police, *Submission 34*, p. 3.

37 Attorney-General's Department, *Submission 42*, pp. 6–7.

38 Attorney-General's Department, *Submission 42*, pp. 6–7; see also FATF, *Virtual Currencies—Key Definitions and Potential AML/CTF Risks*, June 2014, pp. 10.

3.33 Further, decentralised digital currencies such as Bitcoin, which do not have a central server or service provider, are of greater concern for law enforcement authorities and regulators than centralised convertible currencies such as Liberty Reserve. The Attorney General's Department explained that the now-defunct Silk Road website demonstrated features that make decentralised digital currencies attractive to criminals seeking to launder money and either purchase or accept payment for illicit goods and services. The Silk Road website was a black market site on the Dark Net, the portion of internet content that is not indexed by standard search engines. Silk Road took advantage of the pseudo-anonymous nature of Bitcoin and anonymising 'Tor' software to create a marketplace where mail-order drugs and other licit and illicit goods and services could be traded. The FBI shut down the Silk Road website in October 2013 following a two-year investigation.³⁹

3.34 The Attorney-General's Department advised that there appeared to be little evidence to date indicating the use of digital currencies as a means of financing terrorism. It noted that AUSTRAC concluded in its 2012 typologies and case studies report that while the 'anonymous nature of digital currencies may appeal to criminal groups and individuals, their overall utility for criminals at this point may currently be limited to niche crimes in the cyber environment and individual or smaller-scale illicit activity'.⁴⁰

3.35 The AFP noted in its submission that its main experience with digital currencies to date had been with Bitcoin. It identified four main areas of crime involving digital currency that had been investigated:

- the alleged theft of Bitcoin via hacking;
- Bitcoin exchanged as payment for the importation of illicit narcotics into Australia from major online black marketplaces such as Silk Road;
- domestic supply and trafficking of narcotics for payment in Bitcoin; and
- money laundering and dealing with the proceeds of crime via Bitcoin.⁴¹

Hacking

3.36 A number of submitters noted that custodial accounts pose a significant risk to consumers and should be the focus of regulation.⁴² Mr Antonopoulos stated:

In fact, any accounts that take control of Bitcoin keys, and therefore remove them from the protection and security of the Bitcoin network, create areas of centralisation. And we have seen before, many times, that such environments are prone to hacking, theft and, in many cases, what we suspect to be embezzlement and insider action. Those types of

39 Attorney-General's Department, *Submission 42*, p. 7.

40 Attorney-General's Department, *Submission 42*, p. 10.

41 Australian Federal Police, *Submission 34*, pp. 2–3.

42 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, pp. 2–3; Mr Chris Mountford, *Submission 40*, p. 4; Coinbase, *Submission 41*, p. 6.

organisations that have custodial access have all of the problems of traditional centralised financial networks. In short, if you give someone your money they will run away with it. So the need for regulation is paramount, as is the need for oversight, audit and all of the traditional financial controls that are imposed in those situations.⁴³

Organised crime, purchase of illicit drugs and avoiding detection

3.37 The committee reiterates ASIC's advice to consumers on the risks associated with digital currency, including the possibility of being hacked, fluctuations in value and money being stolen from a digital wallet.

3.38 Veda, a company best known for consumer credit reporting, is also a provider of online fraud, identity and credit risk services. It noted that 'wherever there is something of value, there will be fraud and money-laundering—regardless if it cash, property or a painting'.⁴⁴

3.39 Dr John Moss, Australian Crime Commission (ACC), commented that with every emerging technology criminal elements would be among the early adopters. Organised crime groups such as outlaw motor cycle gangs have used Bitcoins to store and move value.⁴⁵ He reported that the ACC was not currently seeing digital currency being used for large scale money laundering; however it was being used by 'mums and dads' to purchase illicit commodities, such as narcotics, over the internet.⁴⁶ Dr Moss noted that we have a unique window which should be seized for the regulation of digital currency before use escalates from purchasing a coffee to moving millions of dollars.⁴⁷

3.40 The Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church of Australia, was concerned that digital currencies, along with a range of other payments methods, are being used on commercial child abuse websites to help users avoid detection.⁴⁸

Scams

3.41 The ACCC advised that over the last three years there had been only about 100 complaints through its information centres regarding digital currencies. Mr Marcus Bezzi, ACCC, reported that the vast proportion of the complaints received were related to alleged scams. He stated:

What we have noticed in relation to those issues is that digital currencies have been alleged by the complainants to have been used in a way that

43 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, pp. 2–3.

44 Veda, *Submission 20*, p. [1].

45 Dr John Moss, Australian Crime Commission, *Committee Hansard*, 4 March 2015, p. 13.

46 Dr John Moss, Australian Crime Commission, *Committee Hansard*, 4 March 2015, p. 13.

47 Dr John Moss, Australian Crime Commission, *Committee Hansard*, 4 March 2015, p. 13.

48 Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church of Australia, *Submission 30*, pp. 9–12.

perhaps would have been able to be used by ordinary currencies. So it is just another tool used by a scammer to rip off—to use a colloquial expression—consumers.⁴⁹

3.42 With regard to another aspect of potential criminal activity, the AFP noted that the nature of digital currencies created challenges for the ability of law enforcement agencies to recover proceeds of crime.⁵⁰ The Centre for Internet Safety recommended that law enforcement should be resourced so they are able to 'innovate their investigative tools and techniques alongside this new technology in order to ensure investigations are not impeded by any improvement in criminals' ability to move funds anonymously'.⁵¹

Current level of risk

3.43 Despite the potential for digital currencies to be used for criminal activity, Mr Jared Taggart, AFP, noted that digital currencies were not currently a significant operational issue. He warned, however, that if the predictions were correct and digital currencies become more widely used, it could become an issue in the future.⁵²

3.44 Mr Antonopoulos argued that Bitcoin was a rather benign form of digital currency, noting:

There are other [digital currencies] that are much stealthier, much more anonymous, and may be encouraged to grow if onerous legislation is passed. Now, certainly bitcoin has been used for criminal purposes. That is a fact. To use a slightly humorous analogy, it has come to my attention that the vast majority of criminals also use shoes. That does not mean that shoes are the problem.⁵³

3.45 Mr Hamish Hansford, ACC, explained that from a law enforcement perspective, digital currency was just another type of encryption:

Encryption is used in a whole range of different areas, from communications, where we are seeing encrypted communications...right through to the use of darknets, or hidden parts of the internet, and payment through virtual currencies.⁵⁴

Conclusion

3.46 The committee acknowledges that digital currency presents opportunities, including the broader application of the distributed ledger technology, increased competition in the payments system, and especially in transactions involving international remittances and providing services in developing countries. There are,

49 Mr Marcus Bezzi, ACCC, *Committee Hansard*, 7 April 2015, p. 35.

50 Mr Tony Alderman, Australian Federal Police, *Committee Hansard*, 4 March 2015, p. 9.

51 Centre for Internet Safety, *Submission 29*, p. 2.

52 Mr Jared Taggart, Australian Federal Police, *Committee Hansard*, 4 March 2015, p. 9.

53 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 4.

54 Mr Hamish Hansford, Australian Crime Commission, *Committee Hansard*, 4 March 2015, p. 9.

however, risks associated with the use of this new technology requiring careful and constant monitoring.

Chapter 4

Tax treatment of digital currencies

4.1 On 20 August 2014, the ATO published a suite of draft public rulings expressing its preliminary view of the tax treatment of digital currency, specifically Bitcoin. The ATO's rulings were drafted after representatives of the digital currency industry asked the ATO to publish its position on the tax treatment of Bitcoin. The ATO called for public comment on the draft rulings, which closed on 3 October 2014.¹

4.2 In this chapter, the committee considers the tax arrangements for digital currencies and whether there is a need to make changes. The digital currency industry's primary concern regarding the ATO's rulings related to the GST treatment of digital currencies.

The Australian Taxation Office's rulings

4.3 The ATO's final public rulings on digital currency were published on 17 December 2014. The ATO advised the committee that while the final rulings provided additional information and clarification, there was not any material change between the draft and final rulings.² Details of the ATO's rulings were outlined in Chapter 2.

4.4 In its submission, the ATO explained that its guidance was based on an impartial consideration of existing law and 'issues associated with potential consumer risk, tax compliance risk, administrative difficulty, and potential criminal use were not determinative in settling the ATO's view'.³ The ATO explained that it had no role in determining whether digital currencies should or should not be treated as 'money' or 'currency', rather such decisions were a matter for government.⁴ At the public hearing on 4 March 2015, Mr Michael Hardy, ATO, explained:

The tax office came to this issue with the approach that bitcoin transactions are happening and we need to provide some certainty for the community about what the tax treatment is with the tools we have available to us under the existing law. So the approach we took was to understand the technology, understand the business models, see if the existing law could or did apply and then to provide the advice. We took the approach of being as collaborative as possible. We worked with experts, industry associations—banking, finance, tax—and accounting professionals as well.⁵

1 Australian Taxation Office, *Submission 8*, pp. 3–4.

2 Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 15.

3 Australian Taxation Office, *Submission 8*, p. 4.

4 Australian Taxation Office, *Submission 8*, p. 5.

5 Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 15.

4.5 Mr Hardy noted that the feedback the ATO had received from the business community was not necessarily in full agreement with the ATO's advice on the operation of the existing law, however, there was an appreciation for the degree of certainty the ATO had provided.⁶ Bitcoin Group, an Australian based Bitcoin company, for example, advised the committee that while it did not agree with the ATO's ruling on GST, its 'ambitions would have been more difficult to realise without the regulatory clarity provided through the ATO's digital currency tax guidances'.⁷

4.6 One submitter noted that while the tax treatment for digital currency had been unclear prior to the ATO rulings, 'it was nonetheless obvious to most participants that normal taxation rules applied. That is, tax must be paid on any profits made, either through general income tax arrangements or as capital-gains tax on Bitcoin investments'.⁸

Goods and services tax

4.7 The Bitcoin Foundation and Bitcoin Association of Australia confirmed that the GST treatment of Bitcoin was their main concern. They noted that by treating Bitcoin transactions as barter transactions, GST can effectively be applied twice to one transaction; GST would be applied to the goods or services being provided, in addition to the 'supply' of the digital currency used as payment.⁹

4.8 The ATO acknowledged that double taxation issues were a feature of barter transactions, but they were not very common or visible until the development of digital currencies. The ATO noted that:

...this particular issue of how bitcoin might be charged twice in a barter environment became a perhaps more prominent question. So that is nothing new and nothing confined just to bitcoin. As to whether that is a good or a bad thing, that is really a policy question...¹⁰

4.9 Mr Andrew Sommer, Clayton Utz, noted that the domestic tax treatment was the critical issue for digital currency businesses, stating:

Where GST or VAT is imposed on the acquisition of bitcoins as part of a trading transaction, it makes it much more difficult and much less economically viable for me to take my Australian dollars and convert them into bitcoin if one-eleventh of that transaction is going to be lost in GST at the point that I do that. For everyday consumers, that one-eleventh cost is a real cost. That is a consequence of treating bitcoin like a commodity rather than a currency.¹¹

6 Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 15.

7 Bitcoin Group Limited, *Submission 38*, p. [4].

8 Name withheld, *Submission 11*, p. [2].

9 Bitcoin Foundation and Bitcoin Association of Australia, *Submission 13*, p. 19.

10 Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 16.

11 Mr Andrew Sommer, Clayton Utz, *Committee Hansard*, 26 November, 2014, p. 10.

4.10 BitAwareAustralia, a non-profit organisation that promotes the practical advantages of digital currency, emphasised that the Bitcoin community was not looking for a 'free ride', or to use the currencies as a tax haven. It noted that for the most part, the Bitcoin community accepted their obligation to pay capital gains tax on any investment profits, and it was happy to pay GST on goods or services purchased using Bitcoin. However, the community's 'only point of contention to the ATO's ruling is to our industry being rendered uncompetitive because of additional GST levied over and above our fiat-based competitors and international Bitcoin-based competitors'.¹²

4.11 The Melbourne Bitcoin Technology Center argued that 'removing the double taxation of Bitcoin is required to support start-ups develop and capture a share of the emerging economic advantage of digital currency in this country'.¹³

4.12 The committee heard of the negative effect the GST ruling had already had on some businesses. One submitter observed that:

...Australian technology firms have or are planning to shift overseas. Operations, such as my own, have either shut down or significantly curtailed their activities. This is a very disappointing personal outcome for all the Australians involved, to see their efforts invalidated through no shortcoming of their own.¹⁴

4.13 CoinJar, an Australian digital finance start-up, noted that the ATO's GST ruling had rendered it 'uncompetitive against non-Australian rivals'.¹⁵ Mr Guzowski, ABA Technology, observed that applying GST to digital currency 'puts additional friction on transactions and it completely sets it apart from other types of currency and does not make it practical to purchase locally. So...it has sent a lot of businesses offshore. It is putting a brake on the industry, for sure'.¹⁶

4.14 Mr Antonopoulos argued that the decision to apply GST to digital currency 'fundamentally misunderstands the nature of the system, ascribing it the properties of a commodity, which it is not, and as a result having significant friction. That may be a major disadvantage for Australian Bitcoin companies'.¹⁷

4.15 Professor Miranda Stewart and Mr Joel Emery from the Tax and Transfer Policy Institute, Australian National University considered that the current GST treatment 'poorly reflects digital currencies' practical purpose'.¹⁸ Professor Stewart and

12 BitAwareAustralia, *Submission 17*, p. 15; Bitcoin Group Limited was concerned that capital gains tax treatment, as well as the GST treatment of digital currency, had slowed domestic adoption of the technology, *Submission 38*, p. [3].

13 Melbourne Bitcoin Technology Center, *Submission 36*, p. [2].

14 Name withheld, *Submission 11*, p. [2].

15 CoinJar, *Submission 12*, p. 8.

16 Mr Christopher Guzowski, ABA Technology, *Committee Hansard*, 26 November 2014, p. 23.

17 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 4.

18 Professor Miranda Stewart and Mr Joel Emery, The Tax and Transfer Policy Institute, Australian National University, *Submission 23*, p. 12.

Mr Emery noted that the UK's VAT ruling had created a 'jurisdiction with a relatively favourable tax regime to which intermediaries may relocate if the Australian regulatory framework is considered unfavourable'.¹⁹ In the UK, digital currencies are exempt from VAT. They suggested that a similar exemption to the application of the GST in Australia 'would promote simplicity and neutrality, as it treats sales using digital currency as payment largely the same as sales using traditional cash'.²⁰

4.16 The Institute of Public Affairs shared the views expressed by Bitcoin businesses that imposing a GST on Bitcoin and other digital currencies could stifle the development of this technology. It argued that treating digital currencies in the same way as fiat currencies would 'enable the continuing development of non-state forms of currency'.²¹

GST and different currency exchange services

4.17 There has also been some uncertainty surrounding the way GST is applied to different types of digital currency exchange services within Australia.

4.18 The ATO explained the way in which different business models for exchanging digital currency such as Bitcoin may attract different tax outcomes. For example:

- A principal or direct sales model of exchange: where Bitcoin is held in its own right, the business would need to charge GST on the supply of Bitcoin, as it is being bought or sold directly by the exchange.
- An agency type model of exchange: operating like a brokerage arrangement, where the exchange does not hold Bitcoin, but charges a fee to facilitate the purchase of Bitcoin between a buyer and seller. The business would not be required to charge GST on the supply of Bitcoin as it is being supplied through an introduction service. There may be GST on the transaction fee, but not the total Bitcoin transaction volume.²²

4.19 Mr Guzowski, ABA Technology, explained that his company's business model means they do not sell Bitcoin, but facilitate the purchase of Bitcoin from overseas vendors. He charges GST on the fee for providing the service, but not on the Bitcoin itself.²³

4.20 BitAwareAustralia noted that the principal or direct sales type model proved the 'most trouble-free way to trade bitcoins'. However, the added expense of GST being charged on the total purchase had turned a lot of users away from these sites.

19 Professor Miranda Stewart and Mr Joel Emery, The Tax and Transfer Policy Institute, Australian National University, *Submission 23*, p. 13.

20 Professor Miranda Stewart and Mr Joel Emery, The Tax and Transfer Policy Institute, Australian National University, *Submission 23*, p. 13.

21 Institute of Public Affairs, *Submission 10*, p. 6.

22 Mr Michael Hardy, Australian Taxation Office, *Committee Hansard*, 4 March 2015, p. 16.

23 Mr Christopher Guzowski, ABA Technology, *Committee Hansard*, 26 November 2014, p. 23.

BitAwareAustralia noted that some direct Bitcoin sales sites have closed down in the wake of the ATO's ruling on Bitcoin.²⁴

4.21 Bit Trade Australia is an exchange which holds Bitcoin and buys and sells directly to its customers. According to Bit Trade Australia the GST ruling has:

...increased the cost of the service we are providing to customers because they not only have to pay for our service provision, which is the supply of a spot contract, but we also have to levy GST on the good itself. So compared to, say for example, purchasing bitcoin from another provider based in another jurisdiction, the cost of our service provision to the customer is 10 per cent more. A lot of Australian businesses have left the jurisdiction to set up in other markets because they found it impossible to survive with the costs levied. The net effect has been the shutdown of some businesses and reduction in volume and trade in this jurisdiction, and we have experienced drops in trade and volume.²⁵

Committee view

4.22 The committee considers that the most immediate concern for Australian digital currency businesses is the current GST treatment of digital currencies. Proposed legislative changes to address these concerns are discussed later in this chapter.

Definitions of digital currencies for tax purposes

4.23 The ATO's role in developing its guidance for digital currencies was to interpret the way in which digital currency fits within the current tax legislation.

Definition of money in the GST Act

4.24 The current definition of 'money' in the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) includes:

- (a) currency (whether of Australia or of any other country); and
- (b) promissory notes and bills of exchange; and
- (c) any negotiable instrument used or circulated, or intended for use or circulation, as currency (whether of Australia or of any other country); and
- (d) postal notes and money orders; and
- (e) whatever is supplied as payment by way of:
 - (i) credit card or debit card; or
 - (ii) crediting or debiting an account; or
 - (iii) creation or transfer of a debt.

However, it does not include:

24 BitAwareAustralia, *Submission 17*, p. 8.

25 Mr Jonathon Miller, Bit Trade Australia, *Committee Hansard*, 7 April 2015, p. 12.

- (f) a collector's piece; or
- (g) an investment article; or
- (h) an item of numismatic interest; or
- (i) currency the market value of which exceeds its stated value as legal tender in the country of issue.²⁶

4.25 Mr Sommer, Clayton Utz, noted that he and others had made submissions to the ATO's consultation process to advise that an argument could be made that the definition of money, as it currently exists in the GST Act, could be extended to include digital currency. He stated:

One of the great things about tax law is that you can always argue both sides. In relation to this particular issue, there are two or three key definitions: there is money, currency and foreign currency. In relation to the GST law, the key definition for most of this will be the definition of money. That definition is an 'includes' definition. There is an argument to be made that the definition of money as it sits in section 1951 of the GST Act is capable, on its current terms, of extending to bitcoin.²⁷

4.26 The ATO confirmed that it had considered these arguments when making its determination.²⁸ Ms Preston noted that it was the ATO's role to interpret the law and that Treasury was satisfied with the way the ATO had dealt with digital currency.²⁹ As noted earlier, the ATO has stated that the question of whether digital currencies should be treated as 'money' or 'currency' was a matter for government.³⁰

Proposed changes to the definitions of 'money' and 'financial supplies'

4.27 The ATO advised the committee that in order to treat digital currencies as money for the purposes of GST would require changes to the definitions of 'money' and the 'financial supplies'. It advised that changing the definition of 'money' to include digital currencies would require a legislative change to the GST Act.³¹

4.28 The ATO noted the definition of 'financial supplies' is set out at regulation 40-5.09 of the *A New Tax System (Goods and Services Tax) Regulations 1999* (GST Regulations). Any change to this definition could be achieved by amendment to the GST Regulations, and would not require legislative change.³²

26 *A New Tax System (Goods and Services Tax) Act 1999* - Sect 195.1.

27 Mr Andrew Sommer, Clayton Utz, *Committee Hansard*, 26 November 2014, p. 11. See also Adroit Lawyers, *Submission 39*, p. 5.

28 Australian Taxation Office, *Submission 8*, p. 5.

29 Ms Kate Preston, Treasury, *Committee Hansard*, 4 March 2015, p. 17.

30 Australian Taxation Office, *Submission 8*, p. 5.

31 Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, p. [3].

32 Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, p. [3].

4.29 However, if the definition of 'financial supplies' were changed in the GST Regulations without also changing the definition of 'money' in the GST Act, there may be additional complexity and compliance costs for some businesses. The ATO explained:

This would make the supply of cryptocurrency input taxed. To the extent a business made acquisitions relating to the supply of Bitcoin (e.g. payments to a relevant point of sale provider) it would be blocked from claiming related input tax credits. This would not apply to businesses that are below the 'financial acquisitions threshold': see Division 189 of the Act.³³

4.30 An alternative approach would be to create specific exemptions or special rules, rather the definitions of 'money' and 'financial supplies'. However, the ATO's preliminary view is that such alternative approaches would require a change to the GST Act.³⁴

4.31 The ATO concluded that if the intention were to treat digital currency like money for GST purposes, the most straight forward approach would be to amend the definition of 'money' in the GST Act to this effect, in addition to defining digital currency as a financial supply in the GST Regulations to cater for exchange transactions.³⁵

4.32 Both the Treasury and the ATO noted that any change to the GST Act would require agreement by the states and territories.³⁶ The ATO stated:

The GST is levied by the Commonwealth, but the revenue from the GST is distributed to the states and territories. This arrangement is set out in the Intergovernmental Agreement on Federal Financial Relations...Clause A14 provides that any proposal to vary the GST base will require the unanimous support of the States and Territory Governments, the endorsement by the Commonwealth Government and the passage [of] relevant legislation by both Houses of the Commonwealth Parliament. The requirement for unanimous agreement by the states and territories is legislated in Section 11 of the *A New Tax System (Managing the GST Rate and Base) Act 1999*. The 'base' of the GST refers to the range of goods and services to which the GST applies.³⁷

33 Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, p. [3].

34 Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, p. [3].

35 Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, p. [3].

36 Ms Kate Preston, Treasury, *Committee Hansard*, 4 March 2015, pp. 17–18; Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, p. [3].

37 Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015, pp. [3–4].

4.33 Ms Preston, Treasury, noted that while it was unlikely that the states and territories would treat this as an issue of major concern, they would need to be consulted on any proposed changes to the GST Act.³⁸

Committee view

4.34 The committee considers that digital currency transactions should be treated in the same manner as national or foreign currency for the purposes of the GST. The current treatment of digital currency transactions as barter transactions, creates a double taxation effect that has placed an additional burden on Australian digital currency businesses. The committee received evidence from the ATO advising that amendments to both the legislation and regulations would be necessary in order to change the current GST treatment of digital currencies.

Recommendation 1

4.35 The committee is of the view that digital currency should be treated as money for the purposes of the goods and services tax. As such, the committee recommends that the government consults with the states and territories to consider amending the definition of money in the *A New Tax System (Goods and Services Tax) Act 1999* and including digital currency in the definition of financial supply in *A New Tax System (Goods and Services Tax) Regulations 1999*.

Other taxation concerns

4.36 Although there was general agreement that digital currencies should be exempt from GST, there was some disagreement in relation to other taxation concerns. Differing views were expressed in relation to whether digital currencies should be treated in the same way as foreign currencies for the purposes of income tax, fringe benefits tax (FBT) and capital gains tax (CGT).

4.37 Some submitters disagreed with the ATO's interpretation of the existing tax law, arguing that there was scope within the legislation to define digital currencies as foreign currencies, rather than as commodities.³⁹ The Tax Institute claimed that the existing tax law defines currency and money in broad enough terms to include Bitcoin, noting that the Income Tax Act defines foreign currency to be 'currency other than Australian currency', and pointing out that if a foreign country decided to adopt Bitcoin as legal tender, a situation would arise whereby Bitcoin would fall within the meaning of 'currency of a foreign country' and 'currency other than Australian currency'. It explained:

Bitcoin would then automatically be required to be recognised as foreign currency for income tax and GST purposes, and money for FBT purposes. It is anomalous that such a situation could arise independently and outside the control of the Australian legislature or government bodies.⁴⁰

38 Ms Kate Preston, Treasury, *Committee Hansard*, 4 March 2015, pp. 17–18

39 See for example: Taxpayers Australia Limited, *Submission 9*, pp. [2]–[6]; Name withheld, *Submission 11*, pp. [2]–[3].

40 The Tax Institute, *Submission 16*, p. 3.

4.38 A number of submitters raised concerns about the ATO's ruling that digital currencies should be treated as property, rather than money, in relation to paying wages and salaries and the application of FBT. The Bitcoin Foundation and Bitcoin Association of Australia were aware of a number of international businesses that have started paying their employees in Bitcoin. Australian businesses subject to FBT would face a further barrier when competing for global talent.⁴¹ The Tax Institute proposed a legislative change to clarify that salary and wages paid in digital currency is not a fringe benefit for tax purposes. Taxpayers Australia also raised concerns about the FBT regime applying to digital currency and expressed the view that 'further consideration of the degree of integration into the PAYG withholding system, the superannuation and other employment tax obligation regimes will need to be made in respect of digital currencies'.⁴²

4.39 The Australian Digital Currency Commerce Association (ADCCA), a group representing the Australian digital currency industry, argued that the definition of currency in both the Income Tax Act and the GST Act should be expanded to include digital currency. It noted that:

...including a definition of Digital Currency, and classifying it in the same way as foreign currency in Australian tax law will ensure that the use of Digital Currency as a method of payment alongside fiat currency is not rendered obsolete before it has had a chance to enter the mainstream payment system and be tested by the market.⁴³

4.40 Similarly, Mr Sommer, Clayton Utz, stated:

I think the best solution across the board is to introduce a new concept of 'digital currency' and include that within the concepts of currency. That would then flow through into the definition of money, and you would solve the problem that way. But we could include a new concept of 'digital currency' to that end.⁴⁴

4.41 Alternatively, Professor Stewart and Mr Emery from Tax and Transfer Policy Institute disagreed with the view that digital currencies should be treated as foreign currencies for the purposes of income tax, fringe benefits tax and capital gains tax. In their view:

It is unlikely that characterising digital currencies as money under the income tax regime would be particularly beneficial for users in respect of the application of ordinary income, capital gains tax and foreign currency rules. Indeed, treating digital currencies as foreign money under the income tax regime may add unnecessary complexity, with no gain for the ATO and digital currency users. This [is] because foreign currency is generally treated as a form of capital asset leading to CGT or income tax

41 Bitcoin Foundation and Bitcoin Association of Australia, *Submission 13*, p. 19.

42 Taxpayers Australia, *Submission 9*, p. [5].

43 Australian Digital Currency Commerce Association, *Submission 15*, p. 14.

44 Mr Andrew Sommer, Clayton Utz, *Committee Hansard*, 26 November, 2014, p. 12.

consequences in any event under the income tax law. The consequences of disposing of digital currency for foreign currency, and disposing of a commodity, are broadly similar.⁴⁵

4.42 Professor Stewart and Mr Emery did not consider that there was any clear policy basis for characterising digital currencies as money for income tax purposes at this point in time. Instead, they argued that further research and analysis were necessary before making any amendments to the income tax law in this regard.⁴⁶

4.43 Ms Kate Preston advised that Treasury was monitoring digital currencies, noting that:

[Treasury] will continue to assess the environment, but I would stress that it is an industry in its infancy. So I think that it is a little bit early in the process to jump in and suggest that there should be changes to the tax law to accommodate it.⁴⁷

Committee view

4.44 In the committee's view, further research and analysis should be conducted into whether digital currency should be treated in the same manner as foreign currencies for the purposes of income tax and fringe benefits. As noted in chapter 2, the Australian government is currently examining Australia's taxation system as part of the taxation white paper process.

Recommendation 2

4.45 The committee recommends that further examination of appropriate tax treatment of digital currencies should be included in the taxation white paper process, with particular regard to income tax and fringe benefits tax.

45 Professor Miranda Stewart and Mr Joel Emery, The Tax and Transfer Policy Institute, Australian National University, *Submission 23*, p. 15.

46 Professor Miranda Stewart and Mr Joel Emery, The Tax and Transfer Policy Institute, Australian National University, *Submission 23*, p. 15.

47 Ms Kate Preston, Treasury, *Committee Hansard*, 4 March 2015, p. 17.

Chapter 5

Regulatory frameworks

5.1 One of the concerns raised in evidence about digital currencies is that they are largely unregulated. This chapter examines the unique challenges that digital currencies have created for regulators, including how to maintain the integrity of the financial system while creating a regulatory environment that encourages innovation. This chapter will focus on two separate, but overlapping, regulatory issues:

- whether digital currency should be treated as a financial product for the purposes of the Corporations Act and ASIC Act; and
- how digital currency payments facilities fit within the current payments system regulations.

Concerns raised by submitters

Lack of clarity

5.2 A range of concerns were expressed about the lack of clarity around the regulation of digital currencies. PayPal, an online payments service, explained that the lack of regulatory clarity was one of the factors in its decision not to add Bitcoin as an additional type of currency in the PayPal wallet.¹

5.3 CoinJar noted that 'much of the uncertainty faced by digital currency companies is not the absence of a rulebook, but rather an abundance of possible existing rulebooks and no clarity on which one will ultimately apply'.²

5.4 ASIC advised that, as there was some uncertainty initially about the application of the Corporations Act and the ASIC Act to digital currencies, it had consulted with individual businesses as well as ADCCA to clarify the legal position of digital currencies.³

Appropriate level of regulation

5.5 A number of submitters expressed a range of view on the appropriate level of regulation, as well as which businesses should be included in any proposed regulatory framework.

5.6 Dr Rhys Bollen, Faculty of Law, Monash University, noted that 'a well designed and proportionate legal and regulatory regime will support user confidence in, and therefore growth of, innovative payment systems such as virtual currencies'.⁴

1 PayPal, *Submission 45*, p. 7.

2 CoinJar, *Submission 12*, p. 5.

3 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 39.

4 Dr Rhys Bollen, *Submission 46*, p. 37.

5.7 Mr Chris Mountford, a software engineer at Australian software company Atlassian, was worried that 'kneejerk reactions to regulation fuelled by headlines and hysteria will obviously endanger innovation in Australia and push FinTech companies offshore'.⁵ Similarly, mHITs Limited warned against overregulation.⁶

5.8 Mr Antonopoulos maintained that 'regulation of the protocol itself is not really possible at this time'.⁷ The Chamber of Digital Commerce outlined the importance of understanding the distinction between digital currencies and the underlying technology or protocol when developing public policy:

...not all that is labelled as a 'currency' in fact functions as a currency. In particular, it is important that we avoid imposing onerous and commercially unproductive burdens on those who work with the protocol, developing and deploying applications, and who do not use crypto-currencies as a medium of exchange.⁸

5.9 Ripple Labs also noted that 'as pure technologies, these protocols cannot themselves be regulated. However, the entities that make use of the protocols to buy, sell, or exchange those virtual or fiat currencies can be subject to regulation'.⁹

5.10 PayPal drew a distinction between digital currencies and the intermediary companies that trade or facilitate transactions in digital currencies:

While the currency itself should not be regulated, and transactions by individual users without the assistance of intermediaries should not be regulated, companies that provide a financial service for digital currency transmission, for issuance or sale of digital currency, or for exchange with other currencies such as the Australian Dollar, should be regulated in a manner similar to the existing regulations that apply to other payment services. Those regulations, however, should be adapted to recognise the specific details of how different digital currencies work, particularly 'decentralised' digital currencies that are not controlled by a specific issuer.¹⁰

5.11 Furthermore, PayPal observed that the distributed ledger technology has many potential applications that do not involve payments. As such the 'government should clarify that non-payments applications will not be subject to payments regulation'.¹¹

5 Mr Chris Mountford, *Submission 40*, p. 7.

6 mHITs Limited, *Submission 48*, p. 14.

7 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 5.

8 Chamber of Digital Commerce, *Submission 37*, p. 2.

9 Ripple Labs, *Submission 21*, p. 3.

10 PayPal, *Submission 45*, p. 9.

11 PayPal, *Submission 45*, p. 9.

Regulation of the sale and purchase of digital currency

5.12 The current Corporations Act financial services regulatory regime applies to 'financial products'. In broad terms, financial products are a facility through which a person:

- (a) makes a financial investment
- (b) manages financial risk; or
- (c) makes non-cash payments.¹²

5.13 ASIC's view is that digital currency does not fit within these legal definitions, and digital currencies are not financial products. This means that a person does not need:

- (a) an Australian market licence to operate a digital currency trading platform; and
- (b) an Australian financial services (AFS) licence in order to:
 - (i) trade in digital currency;
 - (ii) hold a digital currency on behalf of another person;
 - (iii) provide advice in relation to digital currency; and
 - (iv) arrange for others to buy and sell digital currency.¹³

5.14 Consistent with the ATO's view, ASIC does not consider that digital currencies are money or currency for the purposes of the Corporations Act or the ASIC Act, instead they are more akin to a commodity. As such, the exchanges of digital currency and national currency are not treated as foreign exchange contracts.¹⁴

5.15 Also, although digital currency is not considered to be a financial product under the ASIC Act, it does fall under the equivalent general consumer protection provisions administered by the ACCC in the *Competition and Consumer Act 2010*.¹⁵ The consumer protection obligations in both the ASIC Act and the *Competition and Consumer Act 2010* state that service providers must not make false or misleading representations or engage in unconscionable conduct.¹⁶

Should digital currencies be treated as currency?

5.16 Some submitters, such as CoinJar, suggested that many of the big regulatory questions surrounding digital currencies could be addressed by treating them in the same way as foreign currencies, rather than as commodities or assets. For example,

12 Australian Securities and Investments Commission, *Submission 44*, p. 8.

13 Australian Securities and Investments Commission, *Submission 44*, p. 3.

14 Australian Securities and Investments Commission, *Submission 44*, p. 12.

15 Australian Securities and Investments Commission, *Submission 44*, p. 12.

16 Australian Securities and Investments Commission, *Submission 44*, p. 8.

'imposing the same obligations on digital currency businesses as those for companies holding funds, lending [and] offering financial advice'.¹⁷

5.17 However, ASIC noted that if digital currencies were treated in the same way as foreign currency, they would not automatically be considered a financial product under the Corporations Act.¹⁸ For example, credit facilities and foreign exchange contracts that are settled immediately are considered financial products for the purposes of the ASIC Act, but not the Corporations Act.¹⁹

5.18 ASIC advised that its understanding was that contracts for exchanging national currency for digital currency through online platforms or ATMs are typically settled immediately, and the normal licensing and disclosure requirements under the Corporations Act would not apply to digital currency exchanges. However, if digital currencies were treated as foreign currencies, digital currency would be subject to the consumer protection provisions of the ASIC Act, as foreign exchange contracts that are settled immediately are considered financial products.²⁰ The definition of financial products varies slightly between the Corporations Act and the ASIC Act. This means that while a person may have to comply with the general consumer protection obligations under the ASIC Act, they may not be subject to the licensing, conduct and disclosure rules in the Corporations Act.

5.19 ASIC noted that there were no meaningful differences between the consumer protection provisions in the ASIC Act and the *Competition and Consumer Act 2010*.²¹ ASIC and the ACCC are able to refer powers to each other in cases of regulatory overlap, where it is considered more appropriate for matters within one regulator's jurisdiction to be dealt with by the other regulator.²²

Should digital currencies be treated as financial products?

5.20 As digital currency exchanges are generally settled immediately, even if the decision were made to treat digital currency as currency, they would not necessarily be considered financial products under the Corporations Act. ASIC explained that if digital currencies were subject to the licensing, conduct, and disclosure rules in the Corporations Act, they would need to be defined in the regulations of the Corporations Act as financial products, or something akin to financial products. Mr Saadat, ASIC, noted that under the current legal definition:

A digital currency, in and of itself, is not a financial product. Providing advice about a digital currency is not financial product advice, buying and selling digital currency means you are not making a market in a financial

17 CoinJar, *Submission 12*, p. 5.

18 Australian Securities and Investments Commission, *Submission 44*, p. 21.

19 Australian Securities and Investments Commission, *Submission 44*, pp. 8–9.

20 Australian Securities and Investments Commission, *Submission 44*, p. 21.

21 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, pp. 39, 43.

22 Australian Securities and Investments Commission, *Submission 44*, p. 12.

product. But some ancillary services you might provide that are associated with digital currencies could be regulated by ASIC.²³

5.21 ASIC advised the committee that extending the definition of financial products under the Corporations Act and the ASIC Act to digital currencies, such as Bitcoin, would not be straightforward as the decentralised framework means that the normal obligations on product issuers cannot be imposed.²⁴ For example, if digital currency were to be included in the financial services regulatory regime, product disclosure obligations may need to be tailored to clarify that digital currencies do not have an identifiable 'issuer'.²⁵

5.22 If digital currencies were declared financial products, trading platforms may need to hold Australian market licences. The compliance costs of obtaining and maintaining an Australian market licence may be too burdensome for digital currency trading platforms and encourage businesses to move offshore.²⁶ Mr Saadat explained:

I think the difficulty in regulating the trading platforms like traditional markets is that the compliance obligations that are associated with running a traditional financial market are quite high. The bar is set quite high. I think it is likely that if you were simply to apply the existing framework to platforms that sell digital currency, most would find it uneconomic to sustain in Australia. And because the market for these bitcoins is global, a lot of that activity would move offshore and Australian consumers would probably still end up being able to speculate with digital currency by buying and selling on foreign trading platforms.²⁷

5.23 Also, if digital currencies were declared financial products, a number of industry participants, including overseas entities that deal with Australian based buyers and sellers, may be required to obtain Australian financial services (AFS) licences as they would be providing financial products. This may cause difficulties for digital currency businesses, as well as ASIC, as it may be difficult to determine that a person does not require an AFS licence because they do not provide services to Australian clients.²⁸ Mr Saadat stated:

...it is not straightforward to regulate digital currencies like financial products. You would have to solve a number of unique issues associated with digital currencies, and also the industry would probably look for a

23 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 43.

24 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 44.

25 Australian Securities and Investments Commission, *Submission 44*, p. 24.

26 Australian Securities and Investments Commission, *Submission 44*, p. 23.

27 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 38.

28 Australian Securities and Investments Commission, *Submission 44*, pp. 2–3.

more tailored regulatory regime that makes the industry still commercially feasible in this country.²⁹

Consumer protections for buying and selling digital currencies

5.24 As noted earlier, the general consumer protection provisions of the *Competition and Consumer Act 2010*, which is administered by the ACCC, apply to digital currencies. Mr Bezzi, ACCC, noted that consumers ought be allowed to speculate, and be able to take risks with regards to investing in digital currencies. He noted:

We cannot wrap people up in cottonwool. They may be taking risks with the full knowledge that what they are doing has risk associated with it. I should compliment ASIC on the very useful advice they give to consumers on their MoneySmart website about these issues. It points out all the risks. If people are informed and they want to take the risks, then why should we stop them?³⁰

5.25 Mr Lucas Cullen, Bitcoin Brisbane, pointed out that consumers should take the care when purchasing digital currencies, particularly from offshore exchanges, the same way they would for any online purchase. His advice to people wanting to buy digital currency was that 'you have to work out who you are dealing with and if these companies are reputable. Perhaps you should start small and only risk the amount of money you can afford to lose—just like any transaction on the internet'.³¹

5.26 A chartered accountant and crypto-currency enthusiast, suggested that consumers should be encouraged to educate themselves about the risks of digital currencies. He stated:

Regulation and consumer protection should focus on education. Upon being approached by potential users, nodes of entry, e.g. online exchanges and ATMs, should be required to issue warnings about the risks involved in the digital currency space, including the potential for scams and financial loss and the irreversibility of transactions. This could be similar to the warnings that fund managers, brokerages and money transfer providers are required to issue for many of their products.³²

Committee view

5.27 The committee understands that digital currency is currently covered by the consumer protection provisions under the *Competition and Consumer Act 2010*. The committee considers that, as discussed later in this chapter, further research should be conducted before any change to this arrangement is made, such as designating digital currency as either a foreign currency or a financial product.

29 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 36.

30 Mr Marcus Bezzi, Australian Competition and Consumer Commission, *Committee Hansard*, 7 April 2015, pp. 38, 43.

31 Mr Lucas Cullen, Bitcoin Brisbane, *Committee Hansard*, 26 November 2014, p. 18.

32 Name withheld, *Submission 26*, p. [3].

Digital currency as a form of payment

5.28 While digital currency itself does not fit within the definition of financial products, ASIC considers that some digital currency businesses offer facilities, such as non-cash payment facilities, which may be financial products.³³ ASIC noted that where regulated financial services providers have expanded their product offerings to include the use of digital currencies, these products are considered financial products. For example, PayPal recently entered into an agreement with leading Bitcoin payments processors Bitpay, Coinbase and GoCoin, to enable its merchants to accept Bitcoin. In this instance, the usual financial services licensing, conduct and disclosure obligations for financial products in the Corporations Act apply.³⁴

5.29 ASIC noted that intermediary facilities for paying for goods and services may be providing a facility through which non-cash payments are made in digital currency, regardless of whether the merchant accepts digital currency. Non-cash payments are a type of financial product and this type of digital currency intermediary facility may require an AFS licence. An example of this kind of facility is the recently announced CoinJar Swipe card, which allows CoinJar customers to convert the value in their CoinJar Bitcoin wallet to Australian dollars loaded onto an EFTPOS card.³⁵

5.30 The regulatory framework is designed to maintain trust and confidence in the payments system. MasterCard noted that in order to achieve a level playing field, all participants in the payments system that provide similar services to customers should be regulated in the same way.³⁶ Any payment service, including payment facilities using digital currency, should have the same minimum standards and consumer protections 'that consumers and other stakeholders (regulators, governments, banks and merchants) have come to expect'.³⁷

5.31 Dr Carmody, Westpac, noted that regulation should be based on the nature of the services that different businesses provide, for example:

...there are online wallets that provide effective custody of bitcoin...You might say that, by analogy, some of the regulations that apply to traditional providers of custody or banking services might apply to those businesses but may not apply to a pure broker. I think it really goes to the nature of the activity that different businesses provide.³⁸

5.32 In relation to the payments system, the Australian Bankers' Association's (ABA) broad position on emerging technologies was that the authorities should consider whether the 'regulatory oversight that is already provided for the established

33 Australian Securities and Investments Commission, *Submission 44*, p. 12.

34 Australian Securities and Investments Commission, *Submission 44*, p. 15.

35 Australian Securities and Investments Commission, *Submission 44*, pp. 15–16.

36 MasterCard, *Submission 18*, p. [1].

37 MasterCard, *Submission 18*, p. [2].

38 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 24.

payment system should be extended to these emerging technologies—again to ensure the integrity of the system and confidence of consumers in operating the system'.³⁹

5.33 Mr Pearson, ABA, suggested that where digital currency businesses are providing complementary services to mainstream financial services, they should be brought within the regulatory framework. He suggested that digital currencies are likely to complement rather than replace the existing payments system. He noted:

If [digital currency] is just a complementary system that is outside the regulated system but does not really do much more than what you can do inside the system, perhaps the authorities should then be thinking, 'Maybe it would be appropriate to bring it within the house to make sure that all the protections that underpin our existing safe and secure system apply equally well to these new developments.'⁴⁰

5.34 APCA argued that it is 'prudent to ensure that the regulatory framework can respond to new payment methods as they develop'.⁴¹ APCA supported the conclusion of the Financial System Inquiry that regulators, such as the RBA, should review the extent to which:

...their current powers enable them to regulate system and service providers using alternative mediums of exchange to national currencies, such as digital currencies. The *Payment Systems (Regulation) Act 1998* empowers the [Payment System Board] PSB to regulate 'funds transfer systems that facilitate the circulation of money'. It is not clear that the PSB can regulate payment systems involving alternative mediums of exchange that are not national currencies. Currently, national currencies are the only instruments widely used to fulfil the economic functions of money—that is, as a store of value, a medium of exchange and a unit of account.⁴²

5.35 The RBA, under the regulatory framework of the *Payment Systems (Regulation) Act 1998*, 'does not automatically have to license payment systems—they can develop—but, at the point where the RBA thinks they represent a stability issue, it can then designate and regulate over the payment system'.⁴³

5.36 MasterCard submitted that any regulation should be technology neutral to ensure that with advancements in technology, regulations will apply to all new

39 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 20.

40 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 25.

41 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 1.

42 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 166.

43 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 7.

payment service providers.⁴⁴ The Financial System Inquiry also recommended that regulation should aim to be technology neutral.⁴⁵

Graduated regulation

5.37 The Financial System Inquiry supported broadening regulation to include services involving alternative mediums of exchange, such as digital currencies. It recommended graduated regulation for purchased payment facilities 'to enable market entry and ensure regulation is targeted to where it is most needed. At times, this may increase risks for some consumers, but it is expected to improve consumer outcomes overall'.⁴⁶

5.38 Mr Saadat, ASIC, noted that the current framework is already graduated in the way the Financial System Inquiry recommended. He advised the committee that there are already a number of exemptions for low-value facilities, for example:

...a non-cash payment facility where you can make and receive payments of digital currency—and if that facility only allows you to make...low-value payments, then there is relief in place that means that those kinds of providers do not need a licence from ASIC.⁴⁷

5.39 APCA supported the Financial System Inquiry's recommendation to develop a graduated regulatory framework.⁴⁸ Mr Hamilton, APCA, noted the 'idea is that you do not want to take something that is still very small and stifle it with the full protection appropriate to a system which touches millions of consumers'.⁴⁹

5.40 PayPal also supported the Financial System Inquiry's recommendation. It stated:

...regulation should be graduated so that new startup companies can introduce new services to the market without the full weight of regulation, but the companies would also know to begin planning right away to build out all the appropriate internal controls and compliance programs.⁵⁰

44 MasterCard, *Submission 18*, p. [1].

45 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 146.

46 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 146.

47 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 41. A low value non-cash payment facility is one where: a) the total amount available for making payments by any one person does not exceed \$1,000; b) the total amount available for making payments by all persons who hold a facility of that class does not exceed \$10,000,000; and c) the facility is not a component of another financial product; see ASIC, *Submission 44*, p. 16.

48 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 2.

49 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 6.

50 PayPal, *Submission 45*, p. 10.

5.41 Ripple Labs also supported a tiered regulatory regime to support innovation. It suggested:

Under such a scheme, smaller entrepreneurial companies could operate under a registration system, with lighter requirements than more established and larger players. Businesses operating above a certain threshold (in terms of risk and volume) could be required to obtain licenses to operate, with the full panoply of regulatory requirements, regular examinations and permissions.⁵¹

ePayments Code

5.42 The Financial System Inquiry recommended making the ePayments Code mandatory. The Code is currently voluntary and extending it to all service providers would 'help protect all consumers from fraud and unauthorised transactions'.⁵²

5.43 The ePayments Code provides a consumer protection regime, including:

- (a) provision for disclosure of the terms and conditions of the payment facility;
- (b) minimum expiry dates and disclosure of expiry dates;
- (c) provision of receipts for transactions;
- (d) disclosure of ATM fees;
- (e) provision of statements of transactions;
- (f) liability for unauthorised transactions; and
- (g) complaints procedures.⁵³

5.44 Mr Saadat noted that PayPal had 'recently come out and said that others should also be subscribing to the code from both a consumer protection perspective and a level playing field perspective'.⁵⁴

5.45 ASIC suggested if the ePayments Code was made mandatory, serious consideration would need to be given to how it would apply to services involving digital currency.⁵⁵ Mr Saadat noted that the application of the ePayments Code would depend on the nature of the digital currency business. For example the Code would not apply to digital currency trading platforms, but it may cover non-cash payments providers that facilitate online payments using digital currency.⁵⁶

51 Ripple Labs, *Submission 8*, p. 21.

52 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 167.

53 Australian Securities and Investments Commission, *Submission 44*, p. 25.

54 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 41.

55 Australian Securities and Investments Commission, *Submission 44*, p. 25.

56 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 42.

Self-regulation

5.46 Treasury noted that the digital currency industry is not objecting to regulation. Mr McAuliffe, Treasury, stated 'in fact, it is a situation where, the industry, domestically, is trying to do self-regulation that in some respects mirrors some of the actual legal requirements, because they see that there is benefit in having a self-regulatory model'.⁵⁷

5.47 ADCCA recommended a self-regulatory model for the digital currency businesses:

ADCCA believes a self-regulatory model enforced through its industry Code of Conduct, to which ADCCA members must adhere, is the ideal regulatory environment to support the Digital Currency industry. This framework will enable customers to have greater confidence in the entities providing Digital Currency FinTech services. The Code of Conduct comprises several best practice requirements benchmarked against requirements for Australian financial services institutions.⁵⁸

5.48 Mr Guzowski, ABA technology, noted that ADCCA's approach is to put standards on the industry and implement standards in the software, when the industry is starting. He explained that this approach would mean that digital currency businesses could be prepared 'rather than have some standards come in place or regulations come into place when the industry is already in full swing, which is much harder to implement and will cause disruption to services'.⁵⁹

5.49 Adroit Lawyers, a law firm specialising in Bitcoin and digital currency, supported the concept of self-regulation, given the unique characteristics of digital currency technology and the challenges it presents to the current regulatory framework. It cautioned, however, that:

...the ultimate regulatory framework needs to achieve a balance between mitigating risks to consumers and the wider market, and keeping the barriers to entry low enough to encourage innovation and growth in the digital currency industry.

This balance will only be achieved through ongoing consultation and collaboration between the industry, the government and regulatory bodies including ASIC.⁶⁰

5.50 The Bitcoin Foundation and Bitcoin Association of Australia noted that any regulatory framework would need to focus on regulating for innovation, regardless of whether it was industry based self-regulation or government regulation.⁶¹

57 Mr McAuliffe, Treasury, *Committee Hansard*, 4 March 2015, p. 23.

58 Australian Digital Currency Commerce Association, *Submission 15*, p. 3.

59 Mr Guzowski, ABA Technology, *Committee Hansard*, 26 November 2014, p. 23.

60 Adroit Lawyers, *Submission 39*, p. 7.

61 Bitcoin Foundation and Bitcoin Association of Australia, *Submission 13*, p. 11.

5.51 Ripple Labs believed that digital currency businesses should implement best practices, including terms of use, where appropriate, such as:

(1) any fees charged to consumers, (2) contact information and address, (3) the business's dispute resolution process, (4) description of protection against unauthorized transactions, (5) efforts around privacy and security, (6) customer services, and (7) chargeback policy.⁶²

5.52 Ripple Labs predicted that eventually 'the good actors (i.e., virtual currency businesses that comply with the regulatory regime on digital currency) will be distinguished from the bad actors (i.e., businesses that operate anonymous exchanges) and it will be easier for users to detect fraudulent scams'.⁶³

'Wait-and-see' approach to regulation

5.53 Treasury noted that it is monitoring the digital currency industry and 'waiting on this inquiry to finish its deliberations before coming back to look at it in a bit more detail'.⁶⁴

5.54 ASIC noted that it would be interested in better understanding emerging consumer adoption, particularly if the use of digital currency becomes more mainstream through online accounts such as PayPal or iTunes. ASIC was concerned about what this could mean for consumer protection in relation to loss of funds and unauthorised transactions. Mr Saadat stated:

Our view would be that transactions that are similar in substance should be regulated in similar ways. If someone is making a payment to Apple through their PayPal account, whether that is with Australian dollars, US dollars or a digital currency, then in principle it makes sense for those transactions to be regulated in similar ways and for consumers to be afforded the same protections. If there were a potential gap in ASIC's oversight based on the technical legal position, we would certainly bring that to the attention of Treasury and ensure that consumers were made aware of any gaps as well.⁶⁵

5.55 Mr Saadat noted that as digital currencies have not entered the mainstream a 'reasonable view might be to wait and assess whether further action is required'.⁶⁶ He stated:

...I suppose there is a bit of a chicken-and-egg issue around whether you wait for something like that to happen before you decide what regulatory framework you should apply, or you try and come up with a regulatory framework in anticipation of that occurring. I do not think there is an easy

62 Ripple Labs, *Submission 21*, p. 13.

63 Ripple Labs, *Submission 21*, p. 13.

64 Mr McAuliffe, Treasury, *Committee Hansard*, 4 March 2015, p. 23.

65 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 39.

66 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 38.

answer to that question because the risk in creating a regulatory framework in anticipation of something happening is that you get it wrong.⁶⁷

5.56 Mr Antonopoulos also argued for a 'wait-and-see' approach to regulation, similar to the approach to the internet in its early years which 'allowed the network to thrive and change and morph into various different models based on consumer adoption'.⁶⁸ He noted that the industry has solved many of the problems with digital currency itself, through innovation rather than regulation. For example, the developments in security mechanisms which allow individuals to control their Bitcoin holdings directly, 'so they do not give them to custodial exchanges and other organisations where they can be stolen'.⁶⁹

5.57 APCA recommended that the newly-formed Australian Payments Council has a 'critical role in advising how to deal with new entrants and new technologies to minimise the potential for ill-considered interventions by public regulators'.⁷⁰

Need for further information

5.58 Mr Antonopoulos explained that there is a lot of uncertainty surrounding digital currencies as 'we are dealing with a very disruptive and fast-moving technology that has only recently emerged into the limelight'. He noted:

We do not really know where Bitcoin coin will be in a couple of years, in terms of whether it will be used primarily as a long-term store value—akin to a digital gold—for transactions involving large parties or, as I would like to say, the kind of currency used to buy aircraft carriers with, or if it will turn into a currency that is used for microtransactions and retail transactions and consumer online commerce—the kind of currency you use to buy a cup of coffee—or perhaps fill in both of those at the same time. There are many unanswered questions at the moment.⁷¹

5.59 There has been research conducted using the Bitcoin distributed ledger to determine the nature of Bitcoin transactions. For example, Dr Dirk Baur, Dr KiHoon Hong and Dr Adrian Lee from the Finance Discipline Group, University of Technology, Sydney provided a submission outlining their research using the Bitcoin distributed ledger. Their research found that there was a trend towards investment with a minority of users using Bitcoin as a medium of exchange.⁷² Dr Carmody, Westpac, noted that research that has been conducted using the Bitcoin distributed ledger, suggested that 25 to 50 percent of the transactions that take place each day are

67 Mr Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 38.

68 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 6.

69 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 6; see also Mr Chris Mountford, *Submission 40*, pp. 4–7.

70 Australian Payments Clearing House, *Submission 43*, p. 3.

71 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 6.

72 The Finance Discipline Group, University of Technology, Sydney, *Submission 7*, p. [12].

made by people investing and trading in Bitcoin, rather than as payments for goods and services.⁷³

5.60 Mr Hamilton, APCA, noted the 'striking' lack of information about the levels of activity in digital currencies. APCA suggested that additional research in this area would be useful. Mr Hamilton noted that it would be a 'valuable undertaking to actually get a handle on how much volume and value there was relative to the mainstream payment system—what gets measured, gets managed'.⁷⁴

5.61 Similarly, Mr Pearson, ABA, noted that it is difficult to make a definitive statement on the most appropriate regulatory framework, until more information has been gathered.⁷⁵ He noted that 'you really need to understand the size and role of these emerging players vis-à-vis the established industry to be able to then make the next step, which is how to most appropriately regulate it'.⁷⁶ Mr Pearson commented that the UK government's approach seemed to be to invest 'the money into research to gather the information as a first step to see if it is appropriate to then move to the next step, which would be to bring these new technologies and new frontiers within the existing regulatory system'.⁷⁷ He suggested the RBA may be the appropriate agency to gather this information.⁷⁸

5.62 Mr Kendall, APCA, reasoned that 'the more data that we have available the better we will know what level the transactions might be of some concern'.⁷⁹ Ripple Labs view was that the government should seek to clarify the actual risks and opportunities presented by different digital currency businesses.⁸⁰

Committee view

5.63 The committee acknowledges the need for a clear regulatory approach for both consumers and the digital currency industry. The committee considered concerns raised by submitters about the negative effect overregulation would have at this early stage in the development of the industry. In this respect, the central concern was any regulatory framework should balance the need to mitigate risks facing consumers and the broader financial system, while still encouraging innovation and growth in the industry by keeping the barriers to entry low. As the digital currency industry is still in its early stages, the committee supports a 'wait-and-see' approach to government regulation. The committee believes that the relevant government agencies should closely monitor the development of the digital currency industry in Australia, and

73 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 21.

74 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 2.

75 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 23.

76 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 20.

77 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 22.

78 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 22.

79 Mr Kendall, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 8.

80 Ripple Labs, *Submission 21*, p. 13.

conduct further research to determine the actual risks and opportunities presented by different types of digital currency businesses, for example Bitcoin exchanges and ATMs, or payment facilities. The committee supports ADCCA's continued development of industry best practices based on the standards set for financial services and payments services. This self-regulation model should be developed in consultation with government agencies, as well relevant stakeholders in the banking, finance and payments sectors. The committee considers that this will ensure that businesses are prepared for regulatory oversight in the future, as the industry expands and grows.

Recommendation 3

5.64 The committee recommends that the Australian government consider establishing a Digital Economy Taskforce to gather further information on the uses, opportunities and risks associated with digital currencies. This will enable regulators, such as the Reserve Bank of Australia and ASIC, to monitor and determine if and when it may be appropriate to regulate certain digital currency businesses. In the meantime, the committee supports ADCCA's continued development of a self-regulation model, in consultation with government agencies.

Chapter 6

Anti-money laundering and counter-terrorism financing regime

6.1 The Attorney-General's Department is currently conducting a statutory review of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) which is considering the emergence of digital currencies and whether they should be brought within Australia's AML/CTF regime.¹

6.2 In this chapter, the committee considers whether digital currencies should be brought within the AML/CTF regime.

The relationship between digital currency businesses and banking services

6.3 A number of concerns were raised by digital currency businesses about access to banking services. One submitter, whose company was considering relocating its business overseas, in part because digital currencies are not regulated under the AML/CTF Act, noted that Australian banks had 'uniformly turned down any involvement with our company, citing the regulatory restraints imposed by the Australian government'.²

6.4 The Bitcoin Foundation and Bitcoin Association of Australia expressed concerns regarding the banking industry's approach to digital currencies. They noted:

The issue of access to banking services is also key to the growth of a local digital currency industry. Blanket classification of all bitcoin businesses and users as 'high risk' customers is both inappropriate and disproportionate.

Banking institutions should have a risk-based approach that is 'tailored to the nature, size and complexity of their business and proportionate to the level of money laundering and terrorism financing risk'.³

6.5 The Melbourne Bitcoin Technology Center noted that its members had indicated that many individuals and businesses had experienced discrimination and refusal of service by Australian banks. It proposed legislation to make it an offence for banks to discriminate against a customer on the basis that they are trading or transacting in Bitcoin.⁴

6.6 mHITs Limited, an Australian-based mobile money service company, was concerned that some banks and payment industry members were overstating the risks and downplaying the opportunities that digital currencies represent.⁵ It stated:

1 The currently regulatory framework and the statutory review were discussed in chapter 2.

2 Name withheld, *Submission 2*, p. [1].

3 Bitcoin Foundation and Bitcoin Association of Australia, *Submission 13*, p. 20.

4 Melbourne Bitcoin Technology Center, *Submission 36*, p. [2].

5 mHITs Limited, *Submission 48*, p. 12.

By definition new and emerging fintech startups including mHITs represent a potential threat to the status quo. In our 10 years of operation, we have observed the reluctance of Australian banks to embrace innovation outside the comfort of core business products of lending, cards and insurance.⁶

6.7 ASIC's submission noted that it was 'aware of a number of banks taking steps to cease dealing with Bitcoin related businesses due to concerns that digital currency providers pose an unacceptable level of risk to the banks' business and reputation'. ASIC advised that it 'does not have any power to intervene in decisions made by businesses in relation to digital currencies, and considers that this is a matter for the banks and businesses involved'.⁷

6.8 Mr Bezzi, from the ACCC, advised the committee that he was aware of one case in the ACCC's records where a company involved in digital currency transactions had had its accounts closed by a bank, because the business that the company was involved in was not consistent with the bank's policies. Mr Bezzi noted that the ACCC's view is that 'it is up to banks to determine who they want to have as their customers'. He noted further that the ACCC had no evidence of collusion between banks on the issue of providing banking services to digital currency businesses.⁸

6.9 Mr Miller, Bit Trade Australia, explained why his business complies with regulations that do not currently cover digital currencies:

We are dependent on our banking relationships. We have worked closely with them to achieve a level of comfort for them because we require the ability to bank in the Australian banking sector. We have mirrored their safe harbour practices. We will require you to provide photo ID. We will require you to provide proof of current residential address and date of birth.⁹

6.10 Dr Carmody, Westpac, was supportive of the approach by ADCCA to develop best practices for digital currency businesses that replicate, as far as they are able, the same sorts of safe-harbour obligations that would apply to a bank or to a foreign exchange broker. In his view, this approach assists banks comply with their obligations. He suggested that perhaps the 'sorts of businesses that have been unable to get access to banking accounts are those that have been unable to demonstrate that they are doing that level of due diligence'.¹⁰ He noted that these best practices were not in place when digital currency businesses were first opening up in Australia. He remarked that in the 'early days' the only thing that a customer may have been required to provide in order to purchase Bitcoin was a Bitcoin wallet address and an email address, which did not necessarily identify the customer. He noted:

6 mHITs Limited, *Submission 48*, p. 14.

7 ASIC, *Submission 44*, p. 16.

8 Mr Marcus Bezzi, ACCC, *Committee Hansard*, 7 April 2015, p. 40.

9 Mr Jonathon Miller, Bit Trade Australia, *Committee Hansard*, 7 April 2015, pp. 15–16.

10 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 26.

In that scenario, it is fair to say that there is not a whole lot of know-your-customer going on. A business operating like that would present a real challenge for a bank to provide banking services to because they cannot get satisfied that the underlying business is understood. I think there has been a lot of work from a number of businesses to try and move well beyond that and do the appropriate level of due diligence, which is something we would certainly support.¹¹

6.11 Dr Carmody further explained that he supported digital currency businesses coming under the AML/CTF regime. He noted:

From the point of view of a bank that is providing banking services, if we cannot satisfy ourselves that we can do all the things that we have to do under the legislation to understand the nature of the transactions and what is going on there, it puts us in a very difficult position to be able to provide those banking services. The issues are particularly intense when it comes to moving payments internationally, because obviously we have counterpart banks to deal with globally and they have got their own anti-money-laundering, counter-terrorism-finance obligations, and they will expect us to understand the nature of the payments as well.¹²

6.12 PayPal explained that it had chosen to partner with BitPay, Coinbase and GoCoin as all three companies had taken steps to develop anti-money laundering programs and to ensure they know their customers. PayPal noted that it was proceeding gradually in its approach to digital currencies, so it could ensure that while embracing innovation it remained committed to making payments safer and more reliable for customers. PayPal noted that while all users of PayPal were linked to a specific named PayPal account, with consumer protection for buyers, these standards were not currently required for payments using Bitcoin.¹³

6.13 The ABA noted that banks and other participants that operate within the regulated payments systems have made significant investments in processes and technologies in order to meet their requirements under the AML/CTF regime. As digital currency does not currently come under this regime they are not required to meet these standards and operational requirements.¹⁴ MasterCard maintained that any regulation should include 'obligations to perform KYC [know your customer], maintain an Anti-Money-Laundering and Counter Terrorist Financing program, file suspicious activity reports, and address cybersecurity.¹⁵

6.14 Dr Carmody, Westpac, noted that digital currency intermediaries are providing similar services to businesses that are regulated under the AML/CTF regime. He observed:

11 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 26.

12 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 22.

13 PayPal, *Submission 45*, p. 6.

14 Australian Bankers' Association, *Submission 14*, p. 3.

15 MasterCard, *Submission 18*, p. 3.

I would see a very close analogy between the business a foreign exchange broker is carrying on, and a company that is in the business of buying and selling Bitcoin for cash. It is just that under the definitions of the current AML framework foreign currency broking is included as a designated service but Bitcoin broking is not.¹⁶

6.15 In its submission the Attorney-General's Department noted that the ABA and the Australian Financial Conference (AFC) had made submissions to the statutory review of the AML/CTF Act. Both the ABA and the AFC expressed concern that financial institutions were being placed in a vulnerable position when offering designated services to digital currency businesses, and recommended that trading in digital currencies should be listed as a designated service under the AML/CTF Act.¹⁷ The ABA also recommended that the statutory review consider whether all digital currency payments mechanisms should be brought under the AML/CTF regime.¹⁸

Know your customer programs

6.16 Under the AML/CTF regime, businesses must ensure that they know their customers and understand their customers' financial activities. Under the AML/CTF business must monitor transactions and collect and verify customer identification information—for example, documents, data or other information obtained from a reliable and independent source. The 'know your customer' (KYC) and customer due diligence processes increase the ability of businesses to better identify and mitigate money laundering and terrorism financing risks in the conduct of their transactions.¹⁹

6.17 Dr Carmody explained the advantages of digital currencies coming under the AML/CTF regime, in relation to know your customer requirements:

There was an example given about a bitcoin broker who might have had a bank account with the Commonwealth Bank. If a cash payment came in then the bank would know, presumably, with the purchase of bitcoin. That is about all we would know. That is why there are a lot of advantages in the know-your-customer and due-diligence obligations also sitting with the broker, because the broker who has facilitated that purchase for the customer would also know, for example the wallet address that the customer used. Where they received that bitcoin that is not something the bank would know. If that did prove to be associated with suspicious activity, that would then be something that could be provided under requests from law-enforcement authorities.

I think the phrase that has been used in some of the previous inquiries is on-ramps and off-ramps. It is very much that. If you are relying on trying to get visibility of the on-ramps and off-ramps only, through the bank part of the

16 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 24.

17 Attorney-General's Department, *Submission 42*, p. 16.

18 Australian Bankers' Association, *Submission 14*, p. 3.

19 AUSTRAC, 'Part B of an AML/CTF program (customer due diligence procedures)' <http://www.austrac.gov.au/part-b-amlctf-program-customer-due-diligence-procedures#dvs> (access 21 May 2015).

transaction, you do not really see that linkage to the bitcoin wallet. I know Bit Trade and others like them are endeavouring to put that same sort of know-your-customer monitoring within their activities as well. That makes a lot of sense.²⁰

Document Verification Service

6.18 Veda expressed concern that the current lack of regulatory certainty meant that digital currency businesses have limited access to identity verification services. Veda noted that access to the best identity verification sources—the electoral roll, Document Verification Service (DVS), and credit reporting information—is restricted to those entities verifying identity for an AML/CTF purpose.²¹

6.19 The Attorney-General's Department manages the DVS. It is a secure, real-time on-line, electronic document verification system. Identity documents that can be verified using the DVS include: birth, marriage and change of name certificates; citizenship certificates; drivers' licences; Medicare cards; passports; and visas.²² In order to access the DVS, organisations must meet strict eligibility criteria and abide by the terms and conditions of use, including having an approved reason for using the DVS, obtaining client consent and information and communications technology security.²³ The current access rules for the DVS require an applicant to cite a Commonwealth legislated requirement, such as the AML/CTF Act.²⁴

6.20 Mr Miller, Bit Trade Australia, advised the committee that as they do not have access to the DVS at this point in time, in order to verify documents his business has to 'go to each of the individual document providers—for example, driver's licence from each state'.²⁵ He explained that they currently use a service provider to verify identities. However, without access to the DVS, 'the information is patchy' and when information cannot be verified electronically his business has to verify it manually. Mr Miller stated that as his business is already paying for access to a service which is suboptimal, it would happy to pay for access to the DVS.²⁶

6.21 ADCCA maintained that digital currency businesses should be given access to the DVS in order to better facilitate KYC practices.²⁷

20 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, pp. 23–24.

21 Veda, *Submission 20*, pp. [1]–[2].

22 Attorney-General's Department, 'Document Verification Service', <https://www.ag.gov.au/RightsAndProtections/IdentitySecurity/Pages/DocumentVerificationService.aspx> (accessed 18 May 2015).

23 Document Verification Service, 'Businesses', <http://www.dvs.gov.au/users/Pages/Businesses.aspx> (accessed 10 June 2015).

24 Veda, *Submission 20*, p. [2].

25 Mr Jonathon Miller, Bit Trade Australia, *Committee Hansard*, 7 April 2015, p. 16.

26 Mr Jonathon Miller, Bit Trade Australia, *Committee Hansard*, 7 April 2015, p. 16.

27 Australian Digital Currency Commerce Association, *Submission 15*, p. 4.

The AML/CTF regime

6.22 Mr Mossop, Attorney-General's Department, noted that when the AML/CTF regime came into force in 2006, e-currency was covered as it was backed by bullion or backed by fiat currency, but digital currencies are backed by mathematically based formulas. He stated:

First and foremost, digital currency and cryptocurrencies have evolved in a way that is not currently covered by Australia's anti-money-laundering regime. That is an issue for us in that, at the time the act was drafted, we did not really think about these types of currencies.²⁸

6.23 Mr Mossop noted one of the difficulties with digital currencies is peer-to-peer transfers as it means transactions using digital currencies can be made directly to people anywhere in the world. He explained that this creates a particular challenge when working out how to regulate digital currencies:

While we might have some visibility of the on-ramps and off-ramps in the places where they intersect directly with the financial sector, short of having everybody who has a bitcoin and makes a transaction report to AUSTRAC, it is going to be very difficult to find a point where all those transactions are co-located in a way they can be reported.

So that is a big challenge for us, because we are going to lose visibility of how these bitcoins move around once they are inside the bitcoin system. We can see people buying them, we can see people selling them to a large extent, but we lose visibility of what happens within the system.²⁹

6.24 Mr Mossop explained that there was still work to do to determine exactly which digital currency businesses should be brought under the AML/CTF regime.³⁰ Internationally, countries such as Canada, Singapore and the UK have decided to bring digital currency exchanges under their equivalent AML/CTF regimes. Mr Mossop noted that one of the considerations in the statutory review is how to define digital currency exchanges, and whether they should be defined as businesses that buy and sell digital currency, or if the definition should also include businesses that facilitate peer-to-peer exchanges, such as Bitcoin ATMs.³¹

Finding the right balance

6.25 Mr Mossop explained that an additional challenge was figuring out how to regulate digital currencies without stifling the growth of the industry. Regulators need to find a balance between trying to mitigate risks while allowing the more positive uses of digital currency to develop.³²

28 Mr Daniel Mossop, Attorney-General's Department, *Committee Hansard*, 4 March 2015, p. 8.

29 Mr Daniel Mossop, Attorney-General's Department, *Committee Hansard*, 4 March 2015, p. 8.

30 Mr Daniel Mossop, Attorney-General's Department, *Committee Hansard*, 4 March 2015, p. 13.

31 Mr Daniel Mossop, Attorney-General's Department, *Committee Hansard*, 4 March 2015, p. 13.

32 Mr Daniel Mossop, Attorney General's Department, *Committee Hansard*, 4 March 2015, pp. 8–9.

6.26 DFAT was concerned about the application of AML/CTF regulations worldwide on small-value transactions that are predominantly made by people in poverty. Ms Rebecca Bryant, DFAT, explained that these small-value transactions are being made by:

...itinerant workers who want to send money across specific corridors home to family and friends. In many instances they are unable to do that because they cannot show adequate identification. It is worse than that in a sense, because even people with identification today are having trouble transferring money across corridors that are considered risky.³³

6.27 Ms Bryant, raised concerns that this would lead to people using black-market providers, outside the regulatory framework:

And that is the danger: the more money you push into those corridors the less transparency you have. You do not know how much it is. You do not know who it is being transferred from and to. So, if money is pushed out of the formal system—I am not suggesting that it is excessive regulation—you will not see it. You cannot see it; you do not know where it is going. And that is the real concern.³⁴

6.28 The Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church of Australia supported the regulation of digital currencies under the AML/CTF regime to ensure they are not used for serious criminal activities. It also noted potential benefits for financial inclusion. It noted that the FATF is an intergovernmental body that develops and promotes policies to protect the global financial system against money laundering and terrorism financing. In particular, the FATF aims to support countries and financial institutions in designing AML/CFT measures that meet the national goal of financial inclusion, without compromising the measures that exist for the purpose of combating crime. It noted that:

FATF has stated that it recognises that applying an overly cautious response to AML/CFT safeguards can have the unintended consequence of excluding legitimate businesses and consumers from the financial system, thereby compelling them to use services that are not subject to regulatory and supervisory oversight. They argue the AML/CFT controls must not inhibit access to formal financial services for financially excluded and unbanked persons. The FATF recognises that financial exclusion could undermine the effectiveness [of] an AML/CFT regime. Hence, financial inclusion and AML/CFT should be seen as serving complementary objectives.³⁵

33 Ms Rebecca Bryant, Department of Foreign Affairs and Trade, *Committee Hansard*, 7 April 2015, p. 29.

34 Ms Rebecca Bryant, Department of Foreign Affairs and Trade, *Committee Hansard*, 7 April 2015, p. 29.

35 Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church of Australia, *Submission 30*, p. 3.

Legislative changes

6.29 AUSTRAC advised that in order to cover digital currency in the AML/CTF regime, it would be necessary to change the Act not just the regulations.³⁶ Ms Jane Atkins, AUSTRAC, explained that although designated services can be added to the AML/CTF Act by regulation there would be other more complex consequential changes to be made if the decision was made to cover digital currencies. 'Obviously, the [statutory] review is the logical place to be looking at that and looking at what needs to be done'.³⁷

6.30 AUSTRAC recognised that digital currency may pose a potential risk in the future, noting 'but right now we are not seeing that there is the sort of risk that has us saying to government, "It is imperative that you give us sight over this"'.³⁸ Ms Atkins, AUSTRAC, outlined the requirements for designated services under the AML/CTF regime:

The sort of obligations in our act then are for them to have an anti-money laundering and counter-terrorism financing program, which means that they need to assess the risks of money laundering for their customers and the types of transactions that they are dealing with. They have to have a program in place to mitigate those risks. They have to carry out know your customer procedures with their customers. They have to have ongoing due diligence programs around watching whether their customers risk is going up and down and whether they need to do more than they have done before.

They need transaction monitoring systems so that they can report whatever equivalent—perhaps you would have an equivalent of \$10,000 digital currency. You might have a report about that and you might have a report where they were transmitting internationally, as we talked about. If they are going to transact in the same way as what we would call remittance providers transact, then there would seem to be at the moment—off the top of my head—no policy reason why you would not cover them in the same way. We would certainly want suspicious matter reporting.³⁹

6.31 Mr Mossop, Attorney-General's Department, noted that the pace of innovation makes it difficult to anticipate where the technology will go and where it will lead. 'We need to regulate in a way that prevents having to come back and regulate again in a relatively short amount of time for a new product that comes out'.⁴⁰

36 Ms Jane Atkins, Australian Transaction Reports and Analysis Centre, *Committee Hansard*, 7 April 2015, p. 57.

37 Ms Jane Atkins, Australian Transaction Reports and Analysis Centre, *Committee Hansard*, 7 April 2015, p. 57.

38 Ms Jane Atkins, Australian Transaction Reports and Analysis Centre, *Committee Hansard*, 7 April 2015, p. 52.

39 Ms Jane Atkins, Australian Transaction Reports and Analysis Centre, *Committee Hansard*, 7 April 2015, pp. 56–57.

40 Mr Daniel Mossop, Attorney General's Department, *Committee Hansard*, 4 March 2015, p. 9.

6.32 ADCCA outlined the views of Australian digital currency businesses. It stated:

In Australia the vast majority of Digital Currency businesses and users are law-abiding and desire the enhanced legitimacy of appropriate legal oversight and recognition. Incorporating Digital Currency into law enforcement legislation, particularly through the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*, is a necessary step toward guaranteeing the security and legitimacy of Digital Currencies in Australia.⁴¹

6.33 Bitcoin Group Limited stated that it fully anticipates the 'costs associated with being subject to compliance protocols and the likelihood of the obligations from national laws requiring access to our records and compelling our company to actively monitor and proactively report suspicious transaction activity'.⁴²

6.34 Given that digital currencies are a global phenomenon, the Attorney-General's Department emphasised the importance of ongoing international cooperation through forums such as the Financial Action Task Force. It argued international cooperation was essential to developing a consistent international approach to regulation to avoid the risk of regulatory arbitrage, where businesses take advantage of more favourable regulations in other jurisdictions.⁴³

Committee view

6.35 In order to help manage relationships with banking services and be prepared for future regulation, some digital currency businesses have tried to mirror the obligations that are required by designated services under the AML/CTF regime, such as implementing know your customer programs. However, the AML/CTF Act currently does not cover digital currencies that are not backed by precious metal or bullion.⁴⁴ Consequently, digital currency businesses are not able to access the Document Verification Service which would better facilitate identity checking to meet AML/CTF requirements. Furthermore, they currently stand outside this robust regulatory regime designed to detect and deter money laundering and terrorism financing.

6.36 The committee strongly supports applying AML/CTF regulation to digital currency exchanges, noting that similar steps have been taken in Canada, the UK and Singapore. The committee notes that the Attorney-General's Department is currently conducting a statutory review of the AML/CTF Act which is examining whether digital currency businesses should be brought under the AML/CTF regime, and if so which businesses should be included.

41 Australian Digital Currency Commerce Association, *Submission 15*, p. 14.

42 Bitcoin Group Limited, *Submission 38*, p. [2].

43 Attorney-General's Department, *Submission 42*, p. 17.

44 Attorney-General's Department, *Submission 42*, p. 10; see chapter 2 of this report.

Recommendation 4

6.37 The committee recommends that the statutory review considers applying AML/CTF regulations to digital currency exchanges.

**Senator Sam Dastyari
Chair**

Appendix 1

Submissions and additional information received

Submission Number	Submitter
1	Mr Virgil Hesse
2	Name Withheld
3	Dr Shann Turnbull <ul style="list-style-type: none">• Additional Information
4	Mr Robert Vong
5	Dr Pj Radcliffe
6	Mr Dario Di Pardo
7	Finance Discipline Group, University of Technology, Sydney
8	Australian Taxation Office
9	Taxpayers Australia Limited
10	Institute of Public Affairs
11	Name Withheld
12	CoinJar Pty Ltd
13	Bitcoin Foundation and Bitcoin Association of Australia
14	Australian Bankers' Association
15	Australian Digital Currency Commerce Association
16	The Tax Institute
17	BitAwareAustralia
18	MasterCard
19	Reserve Bank of Australia
20	Veda
21	Ripple Labs Inc
22	Ms Kelly McConnell
23	Professor Miranda Stewart and Mr Joel Emery, Tax and Transfer Policy Institute
24	Mr Daniel Wilczynski
25	Mr Michael Asher
26	Name Withheld
27	Mr Frederick Malouf
28	Mr Michael Kean

29	Centre for Internet Safety
30	Justice and International Mission Unit, Synod of Victoria and Tasmania, Uniting Church in Australia
31	COEPTIS
32	Diamond Circle Ltd
33	Crypto-Economy Working Group
34	Australian Federal Police
35	Bit Trade Australia Pty Ltd
36	Melbourne Bitcoin Technology Center
37	Chamber of Digital Commerce
38	Bitcoin Group Limited
39	Adroit Lawyers
40	Mr Chris Mountford
41	Coinbase <ul style="list-style-type: none">• Supplementary Submission 41.1
42	Attorney-General's Department
43	Australian Payments Clearing Association
44	Australian Securities and Investments Commission
45	PayPal <ul style="list-style-type: none">• Attachment 1
46	Dr Rhys Bollen
47	Mr Michael Haines <ul style="list-style-type: none">• Attachment 1• Supplementary Submission 47.1
48	mHITs Limited

Answers to questions on notice

1. Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Australian Taxation Office on 19 March 2015.
2. Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from The Treasury on 25 March 2015.
3. Answers to questions on notice from a public hearing held in Sydney on 7 April 2015, received from the Australian Payments Clearing Association on 15 April 2015.
4. Answers to questions on notice from a public hearing held in Canberra on 4 March 2015, received from the Attorney-General's Department on 24 July 2015.

Appendix 2

Public hearings and witnesses

CANBERRA, 26 NOVEMBER 2014

BORING, Ms Perianne, President and Founder, Chamber of Digital Commerce (USA)

CULLEN, Mr Lucas, Chief Executive Officer, Bitcoin Brisbane Pty Ltd

GUZOWSKI, Mr Christopher, Managing Director, ABA Technology Pty Ltd

PESCE, Mr Mark, Private capacity

SHAPIRO, Mr Adam, Director, Promontory Financial Group LLC

SOMMER, Mr Andrew, Partner, Clayton Utz

TUCKER, Mr Ronald, Chairman, Australian Digital Currency Commerce Association

ZHOU, Mr Kevin, Chief Economist, Buttercoin

CANBERRA, 4 MARCH 2015

ALDERMAN, Mr Tony, Acting Manager, Strategic Policy, Australian Federal Police

ANTONOPOULOS, Mr Andreas, Private capacity

HANSFORD, Mr Hamish, National Manager, Strategic Intelligence and Strategy, Australian Crime Commission

HARDY, Mr Michael, Assistant Commissioner, Tax Practitioner and Lodgement Strategy, Australian Taxation Office

McAULIFFE, Mr Daniel Thomas, Manager, Banking and Capital Markets Regulation Unit, Treasury

MOHR, Ms Jessica Grace, Acting Manager, Revenue Group, Treasury

MOSS, Dr John, National Manager, Operational Intelligence, Australian Crime Commission

MOSSOP, Mr Daniel, Director, Financial Crime Section, Attorney-General's Department

PETERSON, Mr Brett, Assistant Commissioner, Tax Counsel Network, Australian Taxation Office

PRESTON, Ms Kate, Acting General Manager, Revenue Group, Treasury

TAGGART, Mr Jared, Team Leader, Criminal Asset Confiscation Taskforce,
Australian Federal Police

SYDNEY, 7 APRIL 2015

ATKINS, Ms Jane Elizabeth, Executive General Manager, Corporate, AUSTRAC

BEZZI, Mr Marcus, Executive General Manager, Competition Enforcement,
Australian Competition and Consumer Commission

BRYANT, Ms Rebecca, Assistant Secretary, Economic Engagement and Resources
and Energy Branch, Department of Foreign Affairs and Trade

CARMODY, Dr Sean Michael, Head of Credit Risk, Enterprise Risk, Westpac

EMERY, Mr David William, Senior Manager, Payments Policy Department, Reserve
Bank of Australia

HAMILTON, Mr Christopher, Chief Executive Officer, Australian Payments Clearing
Association

HAWKINS, Mr David, Acting Director, Strategic Analysis Unit, AUSTRAC

KENDALL, Mr Arun, Industry Policy, Australian Payments Clearing Association

MILLER, Mr Jonathon, Co-founder, Bit Trade Australia

PEARSON, Mr Tony, Executive Director, Industry Policy, Australian Bankers'
Association

PRAGNELL, Dr Bradley, Head, Industry Policy, Australian Payments Clearing
Association

RICHARDS, Dr Anthony John, Head, Payments Policy Department, Reserve Bank of
Australia

SAADAT, Mr Michael, Senior Executive Leader, Deposit Takers Credit and Insurers,
Australian Securities and Investments Commission