THE GLOBE AND MAIL

CESTNICK

TAX MATTERS

CRA's views on cryptocurrencies can lead to tax surprises

SPECIAL TO THE GLOBE AND MAIL
PUBLISHED DECEMBER 13, 2023

Our youngest son is still in university. This semester he's been taking a course called Geographical Information Systems, and the professor was reviewing the measurements of longitude, latitude, degrees and minutes. She asked the class "What if I asked you to meet me for lunch at 27 degrees, 6 minutes north latitude and 45 degrees, 17 minutes east longitude?" The confused class just sat there until one student finally said "Well, I guess you'd be eating alone."

Another course he's taking is called an Introduction to Digital Assets and Securities. Apparently, students don't find this class as confusing. Well, if they start to study the views of the Canada Revenue Agency (CRA) on cryptocurrencies, their heads might start spinning. And if you happen to own cryptocurrencies, you need to understand comments made recently by CRA about these assets. Let me explain.

Bitcoin defies its doubters in 2023

The Comments

Last month, the CRA was asked some questions about cryptocurrencies at an annual conference of the Association de planification fiscale et financière in Quebec City. One question revolved around the depositing of crypto with a cryptocurrency trading and lending platform. Specifically, it was asked if a deposit like this would be considered a taxable event – that is, a disposition for tax purposes.

The example given was one where an individual transfers bitcoin to an account opened at a cryptocurrency trading platform (CTP). The CTP offers a variable return of about 4 per cent annually, payable in bitcoin. In addition, the terms and conditions for opening an account with the CTP looked like this:

- the CTP can hold the bitcoin in its own name and can pledge, sell, lend or otherwise transfer or use the bitcoin deposited, at its discretion, without informing the depositor;

- the profit from use of the bitcoin by the CTP belongs to the CTP;

- the depositor can withdraw up to an equivalent amount of the bitcoin balance at any time; and

- the bitcoin to be paid to the depositor upon withdrawal can be paid from a cryptocurrency wallet holding bitcoin received from the CTP's various customers.

When looking at these facts – and according to the CRA – it would seem that the individual opening the account with the CTP no longer owns the bitcoin that was deposited. The CRA concluded that the individual likely transferred ownership of the bitcoin to the CTP when making the deposit.

If this is true, it would be considered a disposition for tax purposes, and could result in the profits being taxed in the hands of the individual if the bitcoin is worth more on the day of the deposit than when it was acquired. This news might shock a lot of investors in cryptocurrencies. Whether the profit is taxed as a capital gain or business income will depend on the facts and whether the crypto is a capital asset, or business inventory (a topic for another day).

A second question about cryptocurrencies was asked at the conference and is worth noting. It was asked whether a loss on cryptocurrencies that results from a fraud against the CTP could be claimed. The example given was one in which an individual purchased bitcoin through a CTP so that she could pay for items online. There was then fraud committed against the CTP and her bitcoin was lost. You'd expect that CRA would immediately agree that a loss could be claimed by the individual in this case. But not so fast.

CRA said that the facts would have to be examined to see if the individual actually owned the cryptocurrency. If, for example, the contractual relationship between the individual and the CTP was such that the platform owned the crypto, it's possible that the individual would not be able to claim a loss. CRA did suggest that it would be important to review the arrangement between the individual and the CTP to understand the individual's rights and potential loss.

In a situation where the CTP was merely acting as a custodian of the cryptocurrency, holding the crypto on behalf of the individual, the loss would be available to the individual for tax purposes.

Crypto market eyes interest rates and expected bitcoin ETFs in 2024

The Moral

Based on CRA's comments, there could be significant tax consequences to an investor in cryptocurrencies depending on who actually owns the crypto when it's on the cryptocurrency trading and lending platform. Further, these comments have big implications for CTPs and how they structure their agreements with customers.

CTPs should consider changing their agreements to, for example, expressly state that the platform will not acquire the right to use, profit from, or dispose of assets deposited on their platforms (these were factors CRA raised in concluding there was a change of ownership).

As an investor, pay careful attention to the terms and conditions when you open an account with a CTP, especially when you're depositing crypto you already own.

Tim Cestnick, FCPA, FCA, CPA(IL), CFP, TEP, is an author, and co-founder and CEO of Our Family Office Inc. He can be reached at tim@ourfamilyoffice.ca