

# Made crypto losses? Don't assume the taxman will subsidise you

Liu Hern Kuan and Vincent Ooi

For The Straits Times

As cryptocurrency markets reel from what is being called the "Crypto Crash 2022" last month, investors are likely to be taking stock of their losses and considering whether to continue to hold or liquidate their portfolios.

The potential losses could be massive, with TerraUSD and Terra (Luna) losing virtually 100 per cent of their value overnight, the latter suffering a US\$40 billion (S\$55 billion) collapse. Other more established cryptocurrencies such as Bitcoin and Ethereum took significant hits as well.

What would be the Singapore tax treatment on losses realised by a cryptocurrency investor who decides to sell his holdings?

## TAX APPLIES TO THEM, TOO

The same tax provisions which

apply to other asset classes also apply to transactions involving cryptocurrencies.

This means that activities such as mining, trading or lending money through Decentralised Finance may generate taxable income that will have to be reported in the same way as other non-cryptocurrency-related gains.

One might think that because income from transactions involving cryptocurrencies is taxable, the losses from such transactions would also be deductible. Unfortunately, the situation is not quite so straightforward.

## WHAT ABOUT TAX LOSSES?

The starting point is not to assume that losses can necessarily be set off against income from other sources, such as a business selling shoes.

Nor should one assume that losses can be carried back and set off against income from the same source, such as from selling cryptocurrencies in the previous year, or carried forward and offset against income that might occur in

the future by selling cryptocurrencies. In fact, one cannot even assume that losses from selling Cryptocurrency A can be offset against income from selling Cryptocurrency B in the same year.

While this may appear harsh, it arises due to the different tax treatments that apply depending on the classification of the gains and losses arising from dealings in cryptocurrency under the Income Tax Act 1947. The gains could be regarded as "gains or profits from any trade, business, profession or vocation" ("trade or business income"); or just gains or profits of an income nature ("miscellaneous income").

A third possibility is where the gains from cryptocurrency dealings are not regarded as income, but capital gains and not subject to the Singapore income tax regime at all.

Where the gains are regarded as "trade or business income", the tax treatment of losses from this category are far more generous than if the activities fall under the "miscellaneous income" category.

On the other hand, if the gains do not fall under either "trade or business income" or "miscellaneous income" because they are regarded as capital gains, losses cannot be deducted against other categories of income for that year or against future income. This is because, generally, capital gains and losses fall completely outside the Singapore tax net.

The consequences of gains or losses falling under "miscellaneous income" as opposed to "trade or business income" are also significant. While trade or business losses can generally be set off against income from any other category in the same year,

miscellaneous losses can be set off only against income from the same category.

In fact, it is arguable that losses from miscellaneous income are subject to source-by-source matching requirements, where the losses must be scrupulously matched against each source.

For example, if a gain was made from Cryptocurrency A earlier in the year, then the losses from Cryptocurrency A later in the year can be used to set off the earlier gain with the net gain being subject to income tax. But one may well be unable to offset losses from Cryptocurrency B against the gains made from Cryptocurrency A.

No such restriction applies to trade or business losses – so as long as a trade or business in cryptocurrency is established, gains or losses from different cryptocurrencies can be set off against each other, as long as the gains or losses can be seen as arising from the same trade or business.

Subject to legal requirements, trade or business losses can also be "carried back" and used to offset income earned in the previous year (only). They can also be "carried forward" and used to offset income earned in future years (indefinitely). Miscellaneous losses can neither be "carried back" nor "carried forward".

## THE TRADE TEST

Essentially, an investor wishing to offset cryptocurrency losses against other income would want his activities to be regarded as a trade or business.

To determine if a trade exists, the "Badges of Trade" test recognised by the Singapore courts must be applied. This looks

at factors such as how long the crypto was held for, how many trades there were and what was the intention of the investor when purchasing it.

A trade or business is, under the law, likely to exist if there are activities that are commercially undertaken, with habitual and systematic operations, and with elements of continuity and repetition of acts. The difficulty is that the law presumes – this presumption being rebuttable – that while companies buying and selling cryptocurrencies are engaged in a trade or business, individuals doing so are not.

It would thus be challenging for an individual to argue that he should be able to utilise his cryptocurrency losses under the more generous "trade or business income" rules.

Investors including their cryptocurrency losses in their tax returns this year are likely to find the Inland Revenue Authority of Singapore (Iras) unimpressed.

Gains and losses from cryptocurrency dealings are not subject to a separate tax regime. There may be sufficient similarities between shares and cryptocurrencies as asset classes in this context to surmise that Iras may well take a similar approach for cryptocurrencies as well.

The general approach of the Iras is to treat losses incurred by individual investors buying and selling shares as either being in the nature of miscellaneous losses or capital losses. It can be challenging to convince the Iras that an individual investor has made trade or business losses from buying and selling shares. As a result, it is not common for investors to succeed in offsetting such losses against other categories of income.

## POLICY CONSIDERATIONS

Cryptocurrency as an asset is difficult to value based on conventional methods of valuation. From a tax perspective, however, a cryptocurrency loss may be quantified by comparing the costs of acquisition against the costs of sale.

With investors suffering significant losses, the question arises as to whether the authorities should step in to offer some kind of relief for losses that can be regarded as mainly speculative.

In our opinion, this is most unlikely to happen and, in fact, should not happen. Any relief provided by the authorities would come at the expense of taxpayers in Singapore generally, who should not be asked to subsidise private investments.

There is an element of moral hazard here as well, in that investors may well be less cautious in the future if they think that the Government will bail them out should their investments go south.

Crypto Crash 2022 will not be the last and it is but a matter of time before another, possibly greater, crash occurs. The tax system should not be stuck with the bill every time there is a crash and investors should not assume that the taxman will subsidise their losses.

stopinion@sph.com.sg

• Liu Hern Kuan is director and head of tax at ZICO Insights Law and was previously Iras chief legal officer for 10 years. Vincent Ooi is a lecturer at the Yong Pung How School of Law, Singapore Management University. The views are the authors' and do not represent those of ZICO Insights Law or SMU.