Cryptoassets – Accounting and tax

What's the impact on your financial statements?

April 2019

Digital assets or so-called cryptoassets are becoming increasingly common but what are they and how might you record them in your financial statements?

With limited-scope guidance starting to emerge under IFRS® Standards, it's key that you understand their form and substance, and the rights and obligations they convey.

If you hold
- Cryptocurrencies – e.g. Bitcoins, Ether etc
- Other cryptoassets – e.g. tokens

Or if you are a
- Broker-trader
- Miner

It could impact
- Profit or loss
- Assets
- Tax
- KPIs – e.g. EBITDA

IFRS guidance is emerging
- IFRIC has issued its draft agenda decision[1].
- Regulators and tax authorities have also started to engage.

Your next steps
- With a diverse range of cryptoassets conveying different rights and obligations, the first step in your accounting analysis is to understand the rights and obligations in each case.

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1. IFRIC issued its tentative agenda decision Holdings of Cryptocurrencies in March 2019, which is open for comment until 15 May 2019.

Determining the impact

Holding cryptocurrencies – e.g. Bitcoin, Ether etc

What are the characteristics?

– Cryptocurrencies – e.g. Bitcoin and Ether – typically exhibit some similarities to traditional currencies in that they can be traded for goods or services. They can also be held as a longer-term investment or for trading or speculation. But IFRIC and other commentators do not consider current cryptocurrencies to be cash or currency because:

  - they are a poor store of value, because their value is based on demand and supply and is highly volatile;

  - they are not sufficiently widely accepted as a medium of exchange; and

  - they are not issued by a central bank.

– With cryptocurrencies also failing to meet the definition of a financial asset, the question is, what type of asset are they?

How might they impact your financial statements?

– Because of their high volatility in value, many believe that cryptocurrencies are akin to derivatives and should be measured at fair value through profit or loss (FVTPL). However, IFRIC's tentative conclusions on accounting for cryptocurrencies do not support this approach.

– IFRIC proposes that cryptocurrencies are generally intangible assets under IAS 38 *Intangible Assets* – i.e. non-monetary items with no physical substance that convey economic benefits to the holder.

– Measurement would be at cost – or potentially at fair value with movements through other comprehensive income (OCI) if, and only if, there is an active market.

– If the cryptocurrency is held for sale in the normal course of business – e.g. if you are a broker-trader (see below) – then IAS 38 does not apply and, instead, IFRIC proposes that the cryptocurrency would be accounted for as inventory under IAS 2 *Inventory*.

Holding or issuing cryptoassets – e.g. tokens/coins

What are the characteristics?

– A cryptoasset – e.g. a token – is a digital asset that can be stored, transferred or traded electronically using distributed ledger technology (DLT) or blockchain[2].

– Tokens can differ according to the nature of underlying asset over which they convey rights – e.g:

  - security-type[2] – which give the holder an economic interest in an entity (e.g. voting rights or rights to dividends); and

  - utility-type[2] – which give the holder access to goods or services, which are often blockchain-based.

– Tokens are commonly generated through initial coin offerings (ICOs), which are used as a means for entities to raise funds by receiving either cash, cryptocurrencies or other assets in return for issuing cryptoassets. Not all tokens offered in ICOs are security-type tokens: they can be utility-type tokens, too.

– Anyone with a private key can transact in these assets. The private key is unique and cannot be reproduced if it is lost or stolen.

How might they impact your financial statements?

– IFRIC's proposals deal only with cryptocurrencies. There is currently no specific accounting guidance on other cryptoassets, such as tokens.

– In the absence of formal guidance, accounting for tokens is based on the rights and obligations attached to them. For example, depending on the nature of the underlying asset, you might account for them as:

  - security-type – under IAS 32 *Financial Instruments: Presentation* or IFRS 9 *Financial Instruments* (e.g. an equity interest of less than 20% held at fair value); or

  - utility-type – when the token represents a right to receive future goods or services, it may be a prepayment for the holder and a contract liability for the issuer, under IFRS 15 *Revenue from Contracts with Customers*.

– However, is there a contract as defined under IFRS 15: i.e. are the rights and obligations enforceable?

– Although it is not a direct impact on the financial statements, it's critical that there are adequate systems and controls in place to restrict access to and safeguard the private keys.

Holding cryptocurrency and cryptoassets as a broker-trader

What are the characteristics?

– A broker-trader typically buys and sells cryptocurrency to make a trading margin.

– Broker-traders may also hold other cryptoassets for sale in the normal course of business.

How might they impact your financial statements?

– IAS 38 specifically scopes out assets held for sale in the normal course of business.

– Under the IFRIC analysis, broker-traders would therefore look to IAS 2 *Inventories* for guidance. Under IAS 2, broker-traders measure cryptoassets at fair value less costs to sell with the changes in FVTPL.

– A broker-trader may also face challenges around identifying if/when it gains control of a cryptoasset, particularly when it transacts on its client's behalf using the client's private key.

– It might do this by looking at the definition of control in the Conceptual Framework and the indicators of control in IFRS 15.

– The lack of an active market in cryptoassets may also prove challenging when determining fair value.

Crypto mining

What are the characteristics?

–   Miners add blocks to the existing blockchain by solving complex algorithms. They are often rewarded with cryptocurrency – e.g. Bitcoin – when they successfully create a new block.

–   The reward received on solving the algorithm – i.e. the Bitcoin – represents an inflow of future economic benefit in the form of an increase in assets.

–   The challenge for sole miners is determining how to account for the cryptocurrency that they have received.

What are the potential accounting impacts?

–   Views are mixed on how to account for the cryptocurrency received. Some see an exchange transaction that creates income whereas others see an internally generated intangible asset. In the latter case, the costs incurred would, if they are eligible, be capitalised.

–   If the cryptocurrency is treated as income, then it might be revenue (as opposed to other income) only if there is an enforceable contract with a customer, as required under IFRS 15. However, it's not always clear who the customer is.

–   If a sole miner concludes that it has income, then it will measure it at the fair value of the consideration received – e.g. the market value of the cryptocurrency (e.g. Bitcoin) received.

–   This would be recognised when the algorithm is solved – i.e. when another block is added to the chain.

Tax

What are the characteristics?

–   Tax authorities are now starting to engage with the tax implications of digital assets. Different tax authorities may take different approaches and therefore it will be important to consider the rules in the jurisdictions involved.

–   In general, the tax classification is expected to largely follow the accounting treatment.

–   For broker-traders of digital assets that might be exposed to volatility in their profit or loss from fair value movements, tax volatility may also occur.

–   It is likely that tax authorities will treat the selling of one cryptocurrency/asset for another as a taxable event. It will be important to retain records of transactions throughout the year.

What are the potential impacts?

–   Holders of cryptocurrency as a longer-term investment at cost (less any impairment losses) are likely to be subject to a *capital* tax regime in which a tax event arises only on sale of the investment (not on the accounting write-down due to impairment).

–   For holders of cryptoassets such as tokens, the tax position is likely to be more complex – similar to the accounting. They will need to understand the rights and obligations of the underlying asset as well as how the cryptoasset is being used to determine whether it might be subject to tax on an *income* or *capital* basis. Further, holders of cryptoassets may need to consider their deferred tax position if the tax does not follow the entries in profit or loss.

–   Broker-traders holding cryptocurrency/assets for sale in the normal course of business held at FVTPL are likely to be subject to an *income* tax regime in which tax gains and losses should occur in line with the accounting gains and losses.

–   Broker-traders are therefore likely to be subject to profit or loss and tax volatility in their income statement.

–   The income generated from mining is likely to be subject to an *income* tax regime on generation. It will then be necessary to consider the ongoing tax implications of holding the cryptocurrency/asset based on the above.

–   As well as direct taxes on income/profits from holding cryptocurrency/assets, it will also be necessary to consider other tax matters – e.g. using cryptocurrency assets to remunerate staff, VAT and sales tax implications.

2.   The terminology used here is consistent with that used by the UK's Financial Conduct Authority.

How KPMG member firms can help

| Assess the impacts | → | Design a tailored approach | → | Help implement a future state |

KPMG professionals have developed a cross-functional framework to help organisations integrate crypto as part of their business. KPMG's framework includes the following activities.

Activities	Actions	Deliverables
Accounting diagnostic	– Identify accounting policy choices and judgements for specific cryptoassets held by the entity – Document accounting policies and conclusions – Identify disclosure requirements based on the accounting policy judgements	Technical accounting memorandums, accounting policy documents and disclosure templates
Valuation support[3]	– Identify appropriate valuation methods based on the type of cryptoassets held – Provide valuation support and advice on the entity's selected valuation methodology	Valuation memorandum or reports
Business impact assessment (including systems, processes and data)	– Assess existing system functionality and gaps – Identify data requirements and gaps – Determine new process and controls requirements – Assess other business impacts, including tax, operations, financial planning and analysis (FP&A), investor relations, regulation, contracting, HR, dividends and treasury	Business requirements document, process, technology and data gap analysis report
Implementation plan	– Determine a robust implementation timeline and establish governance to achieve it	Implementation plan

3. Subject to our assessment of the contractual terms, purpose and nature of the cryptoasset.

KPMG's global cryptoasset practice

KPMG's global cryptoasset practice is dedicated to supporting businesses with accounting, tax and consulting advice focused on all cryptoassets including cryptocurrencies. KPMG's extensive network of member firms combine a global perspective with in-depth industry knowledge to help companies adjust to today's evolving technology and rapidly changing markets.

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