Mischaracterised “Personal-Use” Crypto Assets

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In an environment lacking specific legislative guidance for crypto assets and with limited court cases testing the legal framework surrounding them, taxpayers often turn to the Australian Taxation Office (ATO) website for guidance. However, concerns arise regarding the ATO’s approach to characterising personal-use assets on its website, as it relies on unprecedented legal principles. This article provides a principles-based interpretation of the tax law for crypto transactions involving personal-use assets, including collectables, which are a subset of personal-use assets. The article explores the conceptual underpinnings of tax policy and rationalises the complex capital gains tax (CGT) provisions designed to exclude consumption once it has been taxed based on income. It also examines the special tax provisions applicable to collectables and the measures in place to prevent the exploitation of tax exemption thresholds. After considering the tax policy and design aspects of Australian tax law pertaining to personal-use assets, this article suggests limiting the characterisation of crypto assets as personal-use assets. Specifically, the characterisation should be based on the nature and use of the assets traded in crypto transactions, with the mechanism to remove double-counted values. Cryptocurrencies and crypto assets that are CGT assets used for trading non-wasting intangible assets should be presumed as non-personal-use assets, except in exceptional circumstances. These recommendations aim to align the tax treatment of crypto assets with tax policy and principles, thereby minimising unaccounted costs to revenue. However, further analysis is necessary to address interpretative challenges associated with characterising various emerging types of crypto assets.

I. Introduction

The Australian Taxation Office (ATO) website has played a crucial role in providing tax guidance and information, contributing to the effective operation of Australia’s self-assessment system since the late 1980s.[1] However, the substantial growth in website guidance may lead to certain aspects being insufficiently explored. It is important to note that the website guidance does not serve as an administrative safe harbour. Unlike official rulings issued by the Commissioner, it offers limited legal protection, such as remission of administrative penalties and interest on tax liabilities or shortfalls, but not against the tax liabilities or shortfalls themselves.[2] Therefore, relying solely on the ATO website to establish a reasonable tax position or make significant economic decisions, such as starting a new business, is not advisable.

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[1] See Ken Henry, *Report on Aspects of Income Tax Self Assessment: August 2004* (CanPrint Communications Pty Ltd, 2004) 2. A self-assessment tax system, which has been in operation in Australia since the 1986–1987 income year, accepts taxpayers’ returns at face value in the first instance.

[2] See the level of protection by product in Australian Taxation Office, *How Our Advice and Guidance Protects You* <https://www.ato.gov.au/general/ato-advice-and-guidance/how-our-advice-and-guidance-protects-you>. A tax liability is the tax imposed for a specific year of income, and any additional tax liability resulting from an amendment for that year is known as a tax shortfall. Administrative penalties can be imposed for various reasons, including a lack of reasonable care, absence of a reasonably arguable position, reckless behaviour or intentional disregard of the law. More information on penalties related to failure to lodge documents on time can be found in *Taxation Administration Act 1953* (Cth) Sch 1 Div 286. General interest charges are calculated based on the late payment of a tax liability (*Taxation Administration Act 1953* (Cth) Pt IIA); shortfall interest charges are calculated based on the late payment of any tax shortfall (*Taxation Administration Act 1953* (Cth) Sch 1 Div 280).

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Regarding the characterisation of crypto assets in relation to the personal-use asset rules,[3] the ATO’s approach appears fragmented, lacking comprehensive legal analysis. According to the ATO, a crypto asset kept or used for buying personal items may be considered a personal-use asset, particularly if it was owned for a short period.[4] Although no specific timeframe is provided for determining the characterisation of a crypto asset as a personal-use asset, one might assume that bitcoin bought and sold on the following day would qualify as a personal-use asset, even if the primary motive for its use was a significant overnight increase in its unit price. If the bitcoin was acquired for no more than $10,000, then like other personal-use assets,[5] the gain from the bitcoin transaction would be excluded from tax.

In this context, the tax outcome is peculiar because bitcoin can be as lucrative as an investment asset as shares. The ATO’s approach to characterising personal-use assets raises concerns, especially considering that many crypto acquisition transactions fall within the $10,000 threshold. It is unlikely that the government would support the ATO’s characterisation, as it would significantly impact revenue without clear policy objectives.[6] No specific subsidy has been announced to favour crypto asset investments over other types of investments.

To address potentially unsound public information regarding crypto assets from both legal and tax policy perspectives, this article examines the tax treatment of personal-use assets. Part II delves into income tax principles, establishing an accepted benchmark based on the Haig-Simons-Schanz definition of income, which adopts a consumption-based approach. This approach aims to prevent double-counting of personal expenditure or consumption in tax liability calculations. Part III highlights the challenges posed to the ATO’s interpretation of the statutory definition of ‘personal-use asset’ within the capital gains tax (CGT) framework.

Part IV explores the income tax treatment of personal-use assets. It begins by discussing design principles aimed at addressing the complexities of recording and assessing small-value transactions, as well as eliminating subsidy effects by disallowing deductions for capital losses associated with personal-use assets. The section then introduces “collectables” as a distinct category of personal-use assets, characterised by both investment and personal use or enjoyment. Detailed rules pertaining to personal-use assets and collectables in the context of crypto assets are evaluated.

Part V presents several recommendations, including the suggestion that the characterisation of crypto assets should be based on the nature and use of assets traded in crypto transactions. Cryptocurrencies lacking underlying assets and crypto assets exchanged for trading non-wasting intangible assets should be presumed, with the possibility of rebuttal, as non-personal-use assets.

In conclusion (Part VI), while acknowledging the need for further analysis, particularly due to the interpretative ambiguity introduced by new and emerging forms of crypto assets, this article proposes a more robust framework for the tax treatment of personal-use assets.

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[3] The characterisation of personal-use assets in relation to crypto assets is discussed in Australian Taxation Office, *Crypto as a Personal Use Asset* <https://www.ato.gov.au/individuals/investments-and-assets/crypto-asset-investments/crypto-as-a-personal-use-asset> (*Crypto as a Personal Use Asset*); Australian Taxation Office, “Crypto Assets as Personal Use Assets”, *Crypto Asset Investments and Tax* <https://www.ato.gov.au/General/Other-languages/In-detail/Information-in-other-languages/Crypto-asset-investments-and-tax/#:~:text=In%20most%20situations%2C%20crypto%20is,than%20%2410%2C000%20to%20acquire%20it.&text=A%20fiat%20currency%20is%20a,country’s%20government%20regulation%20or%20law> (*Crypto Asset Investments and Tax*); Australian Taxation Office, *Non-Fungible Tokens* <https://www.ato.gov.au/individuals/investments-and-assets/crypto-asset-investments/transactions---acquiring-and-disposing-of-crypto-assets/non-fungible-tokens> (*Non-Fungible Tokens*).

[4] *Crypto as a Personal Use Asset*, n 3. However, the ATO also states that “[i]n most situations, crypto is not a personal use asset and is subject to capital gains” in *Crypto Asset Investments and Tax*, n 3.

[5] *Income Tax Assessment Act 1997* (Cth) s 118-10(3).

[6] Some taxpayers may argue that crypto assets purchased for a unit price of no more than $10,000 should be classified as personal-use assets. However, the Commissioner warns against artificial fragmentation and considers each lot of crypto assets purchased as a separate CGT asset, whether 0.45 bitcoin or 6 bitcoins. This approach is outlined in Australian Taxation Office, *Income Tax: Is Bitcoin a CGT Asset for the Purposes of Subsection 108-5(1) of the Income Tax Assessment Act 1997?*, TD 2014/26, 17 December 2014, fn 18. However, taxpayers have the option to purchase crypto assets in different lots, effectively circumventing any integrity rule that may prevent artificial fragmentation.

II. THE CONCEPT OF CONSUMPTION

The Schanz-Haig-Simons definition of income serves as a foundational principle for establishing the income tax benchmark in Australia.[7] According to this definition, income is defined as the increase in the purchasing power accrued to the taxpayer over a specific period. This concept, as articulated by Simons, encompasses both "the market value of rights exercised in consumption" and "the change in the value of the store of property rights between the beginning and end of the period in question".[8] In essence, it combines consumption and savings, reflecting the notion that both ultimately contribute to lifetime consumption.[9] The disparity lies in the timing of accruing purchasing power, which consumption referring to *current* consumption within the same year and savings referring to *future* consumption beyond the year of accrual. As per Simons' formula, income is subject to taxation in the year in which it is accrued.

However, no income tax system operates solely on an accrual basis.[10] Realisation taxation is widely implemented to account for gains and losses associated with property, primarily justified by valuation and liquidity challenges.[11] It is practically impossible to require taxpayers to value all assets held at the end of each year, and the valuation of unrealised gains and losses would introduce uncertainty. Taxing unrealised gains and losses is deemed unfavourable as it can influence the economic decision of whether to sell or retain assets.[12] Realisation taxation allows for the recognition of income and deductions that may not align with the judicial concept of income, particularly within the Anglo tradition.[13] It is worth noting that common law judges, while endeavouring to interpret the meaning of income for income tax purposes, have drawn parallels to the principles established in trust law, distinguishing income from the concept of capital.[14]

While realisation taxation has its advantages, it is not without complications.[15] Income, defined in terms of purchasing power, is typically measured by the inflow of funds (incomings)[16] and takes into account any deductions for losses and outgoings that diminish the taxpayer's purchasing power.[17] However,

[7] This is evident in Australia's tax expenditure statements. See the most recent statement: Australian Government, *Tax Expenditure and Insights Statement* (Commonwealth of Australia, 2023) 195.

[8] Henry C Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938) 49. See also Robert M Haig, "The Concept of Income" in Robert M Haig (ed), *The Federal Income Tax* (Columbia University Press, 1921) 27 (describing income as "the money-value of the net accretion to economic power between two points in time"); Georg von Schanz, "Der Einkommensbegriff und die Einkommensteuergesetze" (1896) 13 *Finanzarchiv* 1 (describing income as the sum of consumption and change in net worth).

[9] When an individual pays taxes based on their lifetime income, without considering inheritance at birth or death, both consumption and savings represent cumulative lifetime consumption.

[10] Simons has also endorsed the concept of realisation taxation (see Joseph M Dodge, "Deconstructing the Haig-Simons Income Tax and Reconstructing It as Objective Ability-to-Pay 'Cash Income' Tax" (Public Law Research Paper No 633, FSU College of law, 5 April 2013)).

[11] See, eg, Commonwealth of Australia, *Reform of the Australian Tax System* (Draft White Paper, 1985) 78 [7.8]–[7.9] (*Draft White Paper*).

[12] *Draft White Paper*, n 11, 78.

[13] Many court case examples are provided in Christina Allen, "Neutrality Matters: Lease Payment in Australian Taxation" (2022) 49(1) ABLR 1; "Ambiguous Doctrines and Legislative Responses to No Lasting Assets and Benefits" (2021) 50(2) *Australian Tax Review* 105.

[14] In the absence of a legislative definition of income, Australian courts have traditionally relied on English precedents to narrowly define income distinct from capital gains. See Ross W Parsons, "Income Taxation: An Institution in Decay" (1991) 13 *Sydney Law Review* 435; (1986) 12 *Monash University Law Review* 77; (1986) 3(3) *Australian Tax Forum* 233.

[15] Se further policy considerations of CGT in Ari Glogower, "Taxing Capital Appreciation" (2016) 70(1) *Tax Law Review* 111.

[16] Australia's federal income tax legislation initially taxed income generally based on its sources, such as personal exertion and business. This approach is evident in the *Income Tax Assessment Act 1915* (Cth) s 14, which explicitly includes in income profits from a business, dividends, interest, royalties and any like return from investment, remuneration from employment or the services rendered.

[17] Losses and outgoings incurred in gaining or producing income are generally deductible if they lead to a decline in the taxpayer's purchasing power. These deductions can be claimed through immediate deductions or depreciation deductions. This tax treatment has remained in place even with the introduction of CGT. For example, depreciating assets used in deriving assessable income

in realisation taxation, losses and outgoings are only recognised upon the disposition of an asset. To illustrate, assume a person's purchasing power increases by $100 in Year X. This $100 represents the person's net income taxable in Year X, which can be used for (current) consumption or savings. If the taxpayer incurs $20 in expenses for deriving $120, the increase in purchasing power ($100) is calculated as the gross receipts of $120 minus the related expenses of $20.

However, a different scenario arises when a tax liability is reduced by allowing a deduction of $20 from the purchasing power of $100. This spending becomes a subsidy for personal expenditure or consumption. Nevertheless, as realisation taxation encompasses a wide range of assets with economic value, it may also encompass assets unrelated to incomings. Unless a subsidy is intentionally implemented with clear policy objectives, such assets should not be considered for tax purposes. Tax incentives are generally less effective than direct subsidies.[18]

Income can be received in various forms, including money or any form representing value such as property or legal or equitable interests. If money received is subsequently lost, stolen or given to family and friends, the outgoing of money would not be considered for tax purposes. Similarly, if an item of property received as remuneration declines in value while in the taxpayer's possession, the decrease in value would not be tax deductible. However, under the realisation tax system, such property may still be subject to tax assessment. To address this anomaly, a distinction is necessary between personal-use assets and taxable assets.

III. Consumption Ringfenced with the Statutory Definition

The Australian income tax law provides a statutory definition of "personal-use asset". The definition was introduced in 1986 for removing consumption inappropriately included in the newly introduced comprehensive CGT regime.[19]

Currently, the CGT regime applies broadly to "any kind of property" or "a legal or equitable right that is not property".[20] Examples include an option, a debt owed to a taxpayer, a right to enforce a contractual obligation, foreign currency, and any interest in property, a legal or equitable right, goodwill, an asset

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of a non-capital nature are deductible outside the CGT regime by virtue of s 118-10(1) and (3) of the *Income Tax Assessment Act 1997* (Cth). Furthermore, since 2001, any gain resulting from the disposal of a depreciating asset is also treated as revenue on the account outside the CGT regime. See *Income Tax Assessment Act 1997* (Cth) s 40-285 (operating in conjunction with s 118-24 that disregards the gain for CGT purposes).

[18] Stanley S Surrey, "Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures" (1970) 83(4) *Harvard Law Review* 705. See also his subsequent publication: "Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance" (1970) 84(2) *Harvard Law Review* 352.

[19] Since the inception of the federal income tax law in 1915, the Australian government had consistently made amendments to the legislative provisions to prevent tax avoidance and expand the tax base. Prior to 1986, capital gains were subject to piecemeal taxation, particularly focusing on profits generated from the purchase and sale of property within 12 months and profits made from the sale of property acquired for profit-making purposes or from a profit-making undertaking or scheme (*Income Tax Assessment Act 1936* (Cth) ss 26AAA, 25A (formerly, s 26(a)). However, with the introduction of the CGT regime, these provisions became obsolete and were officially made redundant by the *Taxation Laws Amendment Act (No 4) 1988* (Cth) (s 16 that abolished s 26AAA, effective from 25 May 1988) and the inclusion of subs (1A) in s 25A, which states that the CGT regime prevails s 25A. The CGT regime was introduced by the *Income Tax Assessment Amendment (Capital Gains) Act 1986* (Cth).

[20] *Income Tax Assessment Act 1997* (Cth) s 108-5(1). The original definition of an asset subject to the CGT regime encompassed any form of property and included, among other things, an option, a debt, a chose in action and any other right under s 160A of the *Income Tax Assessment Act 1936* (Cth). In *Hepples v Commissioner of Taxation (Cth)* (1991) 173 CLR 492, the Full High Court of Australia held that consideration received for a restraint of trade did not constitute a capital gain. In this case, the taxpayer, who was an employee, received $40,000 in exchange for an agreement that prohibited restricted divulgence or utilisation of the employer's trade secrets, prohibited competition with the employer, and prevented employment with the employer's competitor. Following the court's decision, s 160A was amended by the *Taxation Laws Amendment Act (No 4) 1992* (s 23). The amendment aimed to clarify that options, debts, choses in action and any other rights were indeed forms of property, regardless of whether they were legal or equitable. It also aimed to ensure that a legal or equitable option, debt, chose in action or right would not be required to qualify as a form of property.

of partnership or a partnership.[21] The Commissioner provides that bitcoin – a type of crypto asset – is a CGT asset because it is a kind of property,[22] though not a foreign currency.[23] By virtue of the definition, a crypto asset is a CGT asset, whether a kind of property or a legal or equitable right.[24]

The broad definition of a CGT asset is intended to encompass passive investments.[25] However, it also catches not only previously non-deductible expenses incurred in connection with income-producing assets, particularly non-wasting intangible assets,[26] but also assets acquired for consumption against the tax policy intent. The latter is defined as personal-use assets.

A personal-use asset means:

- a CGT asset used or kept mainly for the personal use or enjoyment of the taxpayer or an associate of the taxpayer;
- an option or right to acquire such an asset; or
- a debt arising from a CGT event (1) in relation to such an asset or (2) other than during gaining or producing assessable income or from carrying on a business.[27]

However, a personal-use asset excludes land, stratum units, or fixtures (buildings or structures) that are considered separate CGT assets for tax purposes, but are not regarded as such under property law.[28] It acknowledges, regardless of tax policy theory, the distinctive social and economic imperatives associated

[21] *Income Tax Assessment Act 1997* (Cth) s 108-5; formerly, *Income Tax Assessment Act 1936* (Cth) s 160A. In *Brooks v Commissioner of Taxation (Cth)* (2000) 100 FCR 117; [2000] FCA 721, the Full Federal Court noted that s 160A included "currency of a foreign country' but did not explicitly mention Australian currency. The court said that 'by implication Australian currency, being a means of exchange, is excluded from the definition" (122 [11]). In *Cannavo v Commissioner of Taxation* (2010) 79 ATR 756; [2010] AATA 591, the taxpayer was required to include debts when calculating the asset threshold for the purposes of small business tax concessions. This was because debts were undeniably considered CGT assets.

[22] Australian Taxation Office, n 6.

[23] Australian Taxation Office, *Income Tax: Is Bitcoin a "Foreign Currency" for the Purposes of* Division 775 *of the Income Tax Assessment Act 1997?* TD 2014/25, 17 December 2014.

[24] The questions as to whether a crypto asset is a CGT asset or an asset acquired with a profit-making intention has been considered in Christina Allen and David G Chamberlain, "Lost and Found Coins: Cryptocurrency Chain Splits in Australia" (2023) 38(4) *Australian Tax Forum* 509.

[25] During the 1970s, the government faced the emergence of notorious tax avoidance schemes, notably the "bottom-of-the-harbour" scheme. This scheme involved stripping off assets and profits before liquidation, effectively leaving nothing for the ATO to collect in taxes. Under this scheme, assets and profits were transferred and characterised as capital, resulting in no tax liability. The business would then continue operating with the transferred assets and profits from the liquidated company. In line with the proposals put forth by Simons, Haig and Schanz, the Taxation Review Committee, chaired by Kenneth W Asprey, recommended the adoption of comprehensive CGT. See Taxation Review Committee, *Full Report 31 January 1975* (Parliamentary Paper No 136, 1975) 59 (especially, [7.3]–[7.5] discussing the concept of income) (*Asprey Report*). The imposition of tax on limited kinds of income was considered non-neutral and inequitable. It favoured passive investments over the capital invested in running a business. Additionally, it disproportionately burden low-income groups, as high-income groups had greater ability to invest in assets and multiply their purchasing power. Finally, in 1986, the government enacted the *Income Tax Assessment Amendment (Capital Gains) Act 1986* (Cth) to establish a comprehensive CGT regime.

[26] Generally, wasting intangible assets do not qualify for deductions based on a decline-in-value basis. Section 40-30(1) of the *Income Tax Assessment Act 1997* (Cth) specifies that depreciating asset, which can be deducted based on decline in value, do not include intangible assets, unless they are specifically listed in s 40-30(2). For example, mining and prospecting rights are considered exceptions and can be treated as depreciating assets. See further Christina Allen, "Statutory Depreciation Regimes for Intangible Assets" (2021) 36(2) *Australian Tax Forum* 131.

[27] *Income Tax Assessment Act 1997* (Cth) s 108-20(2) (formerly, known as "non-listed personal-use assets"). In the original CGT provisions of the *Income Tax Assessment Act 1936* (Cth), personal-use assets were categorised into "listed" personal-use assets and "non-listed" personal-use assets under s 160B of the Act. However, in the late 1990s, the Australian government initiated the Tax Law Improvement Project with the aim of simplifying the language and structure of the income tax legislation. While the project was not fully completed, it resulted in the rewriting of the CGT provisions relating to personal-use assets. As part of this rewrite, the terms "listed" and "non-listed" personal-use assets were replaced with the terms "collectables" and "personal-use assets" respectively. The broader category previously referred to as "personal-use assets" was removed. See Explanatory Memorandum, *Tax Law Improvement Bill (No 1) 1998* (Cth) Ch 2.6.

[28] *Income Tax Assessment Act 1997* (Cth) s 108-20(3); formerly, *Income Tax Assessment Act 1936* (Cth) s 160B(1) (excluding land or a building from a personal-use asset). The concept of a "stratum unit" was introduced into the tax legislation and its meaning can be found in s 124-190 of the *Income Tax Assessment Act 1997* (Cth).

with those assets, thus justifying a more targeted approach to their taxation.[29] A personal-use asset also excludes cars, motorcycles and similar vehicles,[30] which generally do not yield capital gains in nearly all cases. Additionally, decorations awarded for valour or brave conduct are excluded,[31] likely due to their recognition of value and significance beyond monetary worth, while avoiding their taxation as a potential detriment.

The following further discuss the definition of "personal-use asset". The definition of a personal-use asset also excludes collectables, but collectables will be later discussed as a special category of personal-use assets.[32] Then, an evaluation of the ATO interpretation regarding crypto assets follows.

A. Category 1 – Principled Definition

The first category in the definition of "personal-use asset" guides how to find consumption in principle. It states that a personal-use asset is a CGT asset, whether any kind of property or a legal or equitable right to which the CGT regime applies or whether tangible or intangible. A personal-use asset is then distinguished from other CGT assets based on the condition that it is used or kept mainly for the personal use or enjoyment of the taxpayer or an associate of the taxpayer.[33] This condition can be understood in four parts: "used or kept", "mainly", "personal use or enjoyment" and "the taxpayer and an associate of the taxpayer".

First, an asset can be characterised as a personal-use asset even if it is not actively used but merely kept in possession. The distinction of an asset as a personal-use asset is not determined by whether it is used or kept. To illustrate this point, consider a scenario where a taxpayer purchases an exercise bike but struggles to find the self-motivation to utilise it. The fact that the taxpayer has not used the bike does not negate its classification as a personal-use asset if it would have been categorised as such under the same circumstances but for the non-utilisation. Similarly, if a taxpayer acquires marble floor tiles at an auction for the purpose of using them in their main residence, but subsequently sells them to multiple buyers after seven years, while still retaining some tiles in possession, all of the tiles, whether sold or retained, would still be regarded as personal-use assets.[34] The characterisation of an asset as a personal-use asset generally remains independent of its realisation; the occurrence of realisation is a separate matter from the classification of an asset as a personal-use asset in this definitional category.

Second, no Australian authority is available to provide a specific interpretation of the word "mainly" or "primarily" in the original definition,[35] which presumably did not alter the essence of the definition.[36] Nevertheless, it is worth noting that Lord Morton of Henryton once stated that "mainly" probably meant

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[29] For example, special CGT provisions apply to exempt main residence distinct from a holiday house or an investment property that falls under the general CGT provisions. See the policy considerations surrounding the main residence exemption in Gerald Auten and Jane G Gravelle, "The Exclusion of Capital Gains on the Sale of Principal Residences: Policy Options" (2009) 102 *National Tax Association* 103.

[30] Under s 118-5 of the *Income Tax Assessment Act 1997* (Cth), any capital gain or loss arising from the disposal of a car, motor cycle or similar vehicle that is used or kept for personal purposes or otherwise is disregarded for tax purposes. Section 995-1(1) of that Act defines a car as "a motor vehicle (except a motor cycle or similar vehicle) designed to carry a load of less than 1 tonne and fewer than 9 passengers" and a motor vehicle as "any motor-powered road vehicle (including a 4 wheel drive vehicle)". The Commissioner clarifies that the exemption rule applies to antique cars, veteran cars and vintage cars (Taxation Determination TD 2000/35, 3 September 2000). Section 118-5 replaced the former s 160A of the *Income Tax Assessment Act 1936* (Cth), which had a similar effect.

[31] *Income Tax Assessment Act 1936* (Cth) s 118-5.

[32] Section 108-20(2)(a) of the *Income Tax Assessment Act 1997* (Cth) states that a personal-use asset excludes a collectable. However, collectables (former listed personal-use assets) and personal-use assets (former non-listed personal-use assets) were formerly subsets of the broader category of "personal-use assets".

[33] *Income Tax Assessment Act 1997* (Cth) s 108-20(2).

[34] This example is based on the scenario provided in the ATO Interpretative Decision (ATO ID) 2002/795 (issued 22 August 2022; withdrawn 12 March 2010).

[35] *Income Tax Assessment Act 1936* (Cth) s 160B(1)(a).

[36] No change in meaning was indicated in the explanatory memorandum to the *Tax Law Improvement Bill (No 2) 1997* (Cth).

"more than half".[37] This understanding finds support in the Canadian case of *Mid-West Feed Ltd v Canada (Minister of National Revenue)*,[38] where the Canadian Tax Court considered the meaning of personal-use property for Canadian income tax purposes. In that case, it was determined that the company taxpayer's aircraft did not meet the criteria for personal-use property, as personal use or enjoyment constituted no more than 50% (the majority) of the aircraft's total use.

In contrast to the drafting of Australian legislation, the Canadian tax law provision addressed the meaning of personal-use property by examining whether an asset was *used* primarily for personal use or consumption.[39] This distinction highlights a difference in approach. While Australian legislation considers whether an asset is used or kept mainly (or primarily) for personal use or enjoyment, the Canadian provision focuses on the primary use for personal purposes or consumption. In situations where the exact percentage of actual use cannot be objectively determined, as demonstrated in the aforementioned Canadian case, one might question if the term "mainly" pertains to the duration of an asset's use or possession. However, such an inquiry can lead to an impractical exercise of ascertaining the taxpayer's intention, which would be arduous to establish on an objective basis, particularly when dealing with assets that are maintained but not actively used.[40] Considering the underlying tax policy intent of excluding consumption, it appears more reasonable to interpret "mainly" as a standard of proof, requiring that an asset be primarily intended for consumption based on the balance of probabilities.

Third, the term "personal use or enjoyment" primarily denotes consumption. In *Favaro v Commissioner of Taxation (Cth)*,[41] Branson J remarked that the phrase "personal use (or enjoyment)" was used "in contradistinction to use for business or profit-making purposes".[42] This particular case revolved around the translation of Italian currency to Australia following the closure of an Italian bank account. The taxpayer argued that the Italian currency should be classified as a personal-use asset and, to support his claim, submitted affidavit evidence stating that his intention was to utilise the Australian currency to purchase machinery from Italy for his business, and the Italian currency was solely retained for the purpose of foreign currency exchange at a favourable rate. However, the court determined that the Italian currency was not used or kept primarily for the taxpayer's personal use, thereby concluding that it did not qualify as a personal-use asset.

The Commissioner acknowledges that the scope of "in the course of carrying on business" was widely interpreted in *Commissioner of Taxation (Cth) v Cooling*,[43] particularly in relation to lease incentives and fit-outs.[44] One might assume that a broad interpretation of carrying on business would consequently lead to a narrower definition of personal-use assets. This narrower definition would minimise the risk of incorrectly identifying assets as personal-use assets, ensuring their eligibility for tax-exempt status.

[37] *Fawcett Properties Ltd v Buckingham County Council* [1961] AC 636, 669. According to the Oxford English Dictionary, "primary" means original or principal. Delany rejects both meanings for the purposes of the personal-use asset rules because the term "original" misleads the intention of the legislation definition that seeks the actual use of an asset whereas the interpretation with "principal" raises administrative difficulties. An example is provided to illustrate such administrative problems: "Take, for example, a professional golfer who uses his golf clubs partly for playing in professional tournaments and partly when playing for relaxation. Not only would he have to keep his score card, he would also have to keep a record of the use of each club." See Thomas P Delany, "CGT Issues: Disposal of Personal-Use Assets" (1995) 3(4) *Taxation in Australia (Red Edition)* 199, 200.

[38] *Mid-West Feed Ltd v Canada (Minister of National Revenue)* [1987] TCJ 565.

[39] *Income Tax Act*, RSC, 1985, c 1 (5th Supp) s 54 (definition of "personal-use property" which includes "property owned by the taxpayer that is used primarily for the personal use or enjoyment of the taxpayer [or an associate of the taxpayer]").

[40] Several questions can be raised in this context, such as how to determine the intention at the time of acquiring an asset, identifying the specific moment when the intention changed during the possession of the asset, and finding ways to rebut if the asset was ultimately used for investment purposes.

[41] *Favaro v Commissioner of Taxation (Cth)* (1996) 34 ATR 1. The decision was subsequently appealed to the Full Federal Court in *Favaro v Commissioner of Taxation (Cth)* (1997) 36 ATR 55, but the characterisation of a personal-use asset was not further discussed in the appellant court.

[42] *Favaro v Commissioner of Taxation (Cth)* (1996) 34 ATR 1, 15.

[43] *Commissioner of Taxation (Cth) v Cooling* (1990) 22 FCR 42; 21 ATR 13, 21 (Hill J).

[44] Australian Taxation Office, *Income Tax: Capital Gains: Implications of a Guarantee to Pay a Debt*, TR 96/23, 31 July 1996, [151].

However, it is important to note that merely not utilising an asset for business or profit-making purposes does not automatically qualify it as personal use. Considering that the CGT regime encompasses investment assets, assets associated with wealth accumulation, including those used or kept mainly for capital appreciation, must not be classified as personal-use assets.[45]

Personal-use assets include items such as "clothing, white goods, furniture, sporting equipment, caravans, boats, etc." and any interest in them, which generally depreciate in value rather than appreciate.[46] If such items are not used or kept for consumption, general tax principles come into effect. For instance, tangible wasting assets employed in generating assessable income are typically subject to deductions over the period they are used,[47] while trading stock adheres to its own specific regime.[48] Consequently, a horse can be classified as a personal-use asset rather than trading stock or a depreciating asset,[49] provided it is acquired by a taxpayer engaged in horse racing as a hobby rather than as a business pursuit.[50] Similarly, gold nuggets can also be considered personal-use assets if they are used or kept for consumption,[51] although distinguishing between personal use and investment purposes may present challenges.

Fourth, consumption must be attributed to either the taxpayer or an associate of the taxpayer. The term "associate" holds a defined meaning, typically serving as a reference point to evaluate transactions conducted on a non-arm's length basis.[52] In the case of an individual, associates include relatives, partners and the spouse or child of a partner.[53] The income tax law acknowledges that an individual may utilise a non-natural person entity for consumption purposes. In such instances, associates of a company include partners and the spouse or child of a partner, while associates of a trustee of a trust include entities benefitting from the trust and entities that are associates of individuals benefiting from the trust.[54] Additionally, associates of a partnership include all partners in the partnership and entities that are associates of any partner in the partnership.[55] The inclusion of associates of the taxpayer in the definition

[45] This stands in contrast to the interpretation of s 8-1(2)(b) of the *Income Tax Assessment Act 1997* (Cth), where the term "private or domestic" was construed to refer to non-business relations, as established in *Commissioner of Taxation (Cth) v Cooper* (1991) 29 FCR 177 (see Delany, n 37, 2201).

[46] This list is given in the explanatory memorandum to the *Income Tax Assessment Amendment (Capital Gains) Bill 1986* (Cth) 21. In *LDGL v Commissioner of Taxation* [2017] AATA 2779, both parties agreed that a boat was a personal-use asset on the face value. It was stated that "boats are not generally known to be sound investments or the subject matter of profit making by sale schemes" ([35]). Similarly, in *Ramsey v Ramsey* [2021] FamCA 405, the court noted that boats were treated as personal-use assets for income tax purposes. Both husband and wife met the running costs for their personal use of the boats ([171]).

[47] *Income Tax Assessment Act 1997* (Cth) s 40-23 (allowing tax deduction of the decline in value). See also s 40-30, which defines "depreciating asset" to which the uniform capital allowance regime (Div 40) applies.

[48] See *Income Tax Assessment Act 1997* (Cth) s 70-35 (including assessable income and allowing tax deductions based on the difference between the value of trading stock on hand at the start of the income year and the value of trading stock on hand at the end of that income year).

[49] The characterisation of an asset as trading stock or a depreciating asset depends on its specific usage and purpose. The Australian government released Taxation Ruling TR 93/26, titled *Income Tax: Issues Relating to the Horse Industry*, on 12 August 1993, discussing the distinction between live stock and plant ([16]–[23]). However, over time, this ruling has undergone modifications. The current version, last consolidated on 22 August 2007, no longer includes the text previously found in [16]–[23].

[50] See Australian Taxation Office, *Income Tax: Capital Gains: Hobbyists – Acquisition and Sale of Non-Listed Personal-Use Assets*, TR IT 2585, 10 May 1990. The ruling was withdrawn on 5 April 2017 without replacement. No change to the ATO's interpretation has been noted in the notice of withdrawal issued on 5 April 2017.

[51] The Australian government released the ATO Interpretative Decision (ID) 2003/451 on 30 May 2003, which stated that gold nuggets would be considered personal-use assets if they were collected as part of a hobby and not for business or profit-making purposes. However, this interpretative decision did not address the investment use of gold nuggets. On 29 August 2019, the decision was officially withdrawn, and the withdrawal notice issued on that date mentioned the possibility of misleading reasons for the decision.

[52] The definition of "associate" is currently found in the Controlled Foreign Companies (CFC) regime, specifically in s 318 of the *Income Tax Assessment Act 1936* (Cth). This provision was originally a rewrite of s 160E, one of the CGT provisions in the *Income Tax Assessment Act 1936* (Cth).

[53] *Income Tax Assessment Act 1936* (Cth) s 318.

[54] *Income Tax Assessment Act 1936* (Cth) s 318.

[55] *Income Tax Assessment Act 1936* (Cth) s 318.

of "personal-use asset" is logical because consumption on behalf of the taxpayer's family member holds the same personal nature as consumption for the taxpayer themselves. However, the delineation of who should be encompassed within the definition of "associate" for the purpose of delineating consumption may remain subject to debate.

B. Categories 2 & 3 – Consumption upon Realisation

Personal-use assets within the first category of the definition can encompass both tangible and intangible assets. However, personal-use assets falling under the second and third categories exclusively pertain to intangible assets. The Explanatory Memorandum to the *Income Tax Assessment Amendment (Capital Gains) Bill 1986* (Cth) states that these intangible assets "might not otherwise be regarded as personal-use assets".[56] Nevertheless, their inclusion can be justified within the context of consumption, much like the assets in the first category. While the value of intangible assets may not exhibit an apparent decline during the ownership period, the depreciation in value of assets within the second and third categories of the definition becomes evident upon realisation. Therefore, treating these intangible assets in a similar manner as the assets in the first category aligns with the notion of consumption and can be considered reasonable.

The second category includes in the definition of "personal-use asset" an option or right to acquire a personal-use asset from the first category. An option can be defined as "a right in one party unilaterally to require another party to enter a new set of jural relations or to extend or continue in an existing jural relationship".[57] This category distinguishes between the option or right to acquire and the personal-use asset that can be obtained through exercising that option or right. The distinction is appropriate because the two categories of assets are different in nature. Upon the expiration or exercise of an option or right to acquire, any expenses incurred in acquiring it will result in a capital loss. However, this loss is typically non-deductible for personal-use assets.

It is preferable for the cost of acquiring an option or right to acquire a personal-use asset from the first category to be excluded from the cost base of the personal-use asset from a revenue collection perspective. For example, if an individual spends $500 to acquire an option for purchasing an expensive handbag for personal use, the $500 expenditure is recognised as a capital loss disregarded for tax purposes when the option is exercised. If the purchase price of the handbag is discounted by $400 as an incentive for taking the option, the discounted purchase price is presumed to be consumed and is not recognised for tax purposes. However, if the handbag is subsequently sold, the discounted purchase price will be considered when calculating any gain or loss. While capital losses from disposing of personal-use items are generally disregarded, capital gains may be subject to taxation as they cannot represent consumption.

The third category of personal-use assets encompasses personal debts, confirming that fungible assets such as money can be classified as personal-use assets. These debts must be owed to the taxpayer, either in connection with an asset that was formerly a personal-use asset (a former personal-use asset) or unrelated to income generation or business activities. The first type of debt arises when a personal-use asset is transferred to another person without receiving full consideration in return. In this scenario, there is no immediate change occurs in the taxpayer's purchasing power as the asset is exchanged for a debt. Since a debt is considered a CGT asset, it can result in a capital loss when forgiven or partially waived.[58]

[56] Explanatory Memorandum, *Income Tax Assessment Amendment (Capital Gains) Bill 1986* (Cth) 22.

[57] *Federal Commissioner of Taxation v Guy* (1996) 96 ATC 4520, 4526 (which also provides common examples such as "put options, call options, options to purchase and options to renew leases").

[58] CGT event C2, as described in s 104-25 of the *Income Tax Assessment Act 1997* (Cth), is a specific realisation event that applies to intangible CGT assets. This event occurs when the taxpayer's ownership of the asset ends due to various reasons, such as cancellation, release, discharge, satisfaction, expiration, abandonment, surrender or forfeiture. *Flood v Federal Commissioner of Taxation* (2013) 90 ATR 757; [2013] AATA 96 involved a private ruling related to debt forgiveness that was not considered a personal-use asset. On the other hand, in *Priestley v Federal Commissioner of Taxation* [2015] AATA 893, the taxpayer's evidence was insufficient to support a capital loss arising from unrecoverable debts under CGT event C2. The Commissioner argued that even if there was a loss, it would be disregarded because the debts should be correctly classified as personal-use assets. See further Dean Crossingham, "Forgive But Don't Forget: CGT Event C2 and Related Party Loans" (2015) 50(3) *Taxation in Australia* 143.

By including the debt associated with a former personal-use asset, the taxpayer is deemed to have consumed the debt.[59] This aligns with the notion that the debt represents consumption upon realisation.

A capital loss arising from a personal debt unrelated to a personal-use asset of the first category is also not deductible.[60] For example, if a parent lends money to their child, the debt is considered personal in nature, and the parent is not allowed a deduction upon forgiveness or waiver of the debt. This outcome is reasonable from a tax perspective as the debt signifies the parent's consumption.

Determining whether a debt is personal in character requires an objective assessment on all relevant circumstances.[61] This characterisation can be particularly challenging for debt guarantees, as they create a guarantor's right of indemnity.[62] The asset acquired by a guarantor has a proprietary nature and comprises subrogation rights.[63] The crucial question is whether the right of indemnity has a private or domestic nature, rather than an expectation of potential income.[64] Considering a guarantee as a personal-use asset is disadvantageous for the taxpayer since payments made under a guarantee characterised as a personal-use asset are not recognised as deductible capital losses.

The Commissioner states that a debt guarantee, as the genesis of the debt, should be characterised at the time of giving the guarantee, regardless of when payments are made.[65] In cases where observing the actual use of the debt is difficult for a debt guarantee, the Commissioner suggests applying a purpose test. This test examines whether the guarantee is provided primarily for purposes other than income generation or business activities.[66] The use of the term "primary" aligns with the language used in the first category of personal-use assets, emphasising that an asset must be intended "mainly" (formerly, "primarily") for personal use or enjoyment.[67] This approach supports the idea that the word "mainly" should be used as a standard of proof to determining consumption, in contradistinction to use related to income generation.

As practical guidance, the Commissioner explains that a debt guarantee provided by a holding company for its subsidiary's debts is generally not considered a personal-use asset due to expected dividend distributions.[68] However, this approach becomes challenging when dealing with cross-guarantees between subsidiary companies, in which case the grantor is tested based on whether the guarantee is given in the course of its business.[69] When the grantor is an individual shareholder of a private company, a similar primary purpose test can be applied to ascertain whether the guarantee is given for potential

[59] The Commissioner supports this tax position. See Australian Taxation Office, *Capital Gains: What Are the CGT Consequences for the Lender (Creditor) When a Debt is Waived?* (CGT Determination Number 2 (TD 2), 10 September 1991) [4].

[60] The Commissioner supports this tax position: see Australian Taxation Office, n 59, [4].

[61] Indeed, in tax cases, the court often takes a holistic approach and considers all relevant circumstances in making inferences. For example, in *Reuter v Commissioner of Taxation (Cth)* (1993) 27 ATR 256, the Full Federal Court examined a situation where a received money under a covenant that restricted him from suing a party for his service fees. Despite the formal terms of the covenant, the court concluded that the receipt was, in fact, service fees paid to the taxpayer for his assistance in the takeover. The court emphasised that the character of the receipt should not be determined solely based on the formalities of the covenant but should consider all relevant circumstances.

[62] *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245, 254 (Mason CJ).

[63] Huston explains subrogation rights as that "once the guarantor has wholly satisfied his share of the principal debt or obligation, the guarantor has the right to take under or to stand in the shoes of the lender in recovering against the borrower and enforcing any securities held by the lender against the borrower". See Peter E Huston, "Cause and Effect: CGT Aspects of Guarantees" (1992) 27(2) *Taxation in Australia* 89.

[64] The explanatory memorandum states "[i]n short the subparagraph applies to debts of a private or domestic nature" (22).

[65] Australian Taxation Office, *Income Tax: Capital Gains: Implications of a Guarantee to Pay a Debt*, TR 96/23, 31 July 1996, [145].

[66] Australian Taxation Office, n 65, [47].

[67] Australian Taxation Office, n 65, [146].

[68] Australian Taxation Office, n 65, [150].

[69] Australian Taxation Office, n 65, [152].

income, such as future dividends.[70] However, a guarantee involving a fee is not considered a personal-use asset unless the fee does not align with the risk undertaken by the grantor.[71] This guidance aligns with the policy objective of identifying assets that represent consumption.

C. ATO Guidance against Statutory Definition

The ATO asserts that traditional cryptocurrencies, such as bitcoin, which are distinguishable from non-fungible tokens, can be classified as personal-use assets.[72] However, the rationale provided by the ATO raises concerns as it challenges the legal interpretation of the statutory meaning of "personal-use asset". Two primary issues are associated with the terms "kept" and "mainly" within the definition of "personal-use asset".

According to the ATO, crypto assets can be classified as personal-use assets "if they is [sic] kept or used mainly to purchase items for personal use or consumption".[73] Further, the ATO provides that the duration of ownership plays a significant role in determining whether a crypto asset can be categorised as a personal-use asset. The ATO's position on this matter is outlined as follows:

> A crypto asset you acquire and use in a short period of time to buy items for personal use or consumption is more likely to be a personal use asset.
>
> A crypto asset you acquire and hold for some time before you use it, or only use a small proportion of it, to buy items for personal use or consumption is less likely to be a personal use asset.[74]

The ATO adds that, in most cases, a crypto asset qualifies as a personal-use asset when it is exchanged for Australian dollars (or another crypto asset) and used to acquire personal items directly, or when a payment gateway or similar intermediary is utilised to indirectly obtain personal items using the crypto asset.[75]

While the ATO ostensibly presents its interpretation of the first definitional category of personal-use assets, it overlooks the crucial distinction between the purchased asset and the crypto asset, treating them as one and the same. However, it fails to acknowledge that these are distinct assets, each possessing unique characteristics and perhaps a separate bundle of rights, serving different purposes for the taxpayer. This approach, which seeks to equate the nature of the acquired asset with that of the crypto asset used for its acquisition, contradicts the legislative definition of a personal-use asset that does not necessitate the characterisation of assets obtained subsequent to the utilisation of a crypto asset. Furthermore, this line of reasoning implies that money received as income and subsequently expended on personal items should also be classified as a personal-use asset. However, this treatment is unorthodox. A gain or loss from money such as a foreign currency is recognisable upon realisation.[76] An exception is the Australian

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[70] Australian Taxation Office, n 65, [154]–[155]. This principle was applied in *Applicant 6115 of 2013 v Federal Commissioner of Taxation* (2015) 101 ATR 201; [2015] AATA 244. In this case, an individual taxpayer gave an indemnity to the ATO for the tax debt of his related company. The taxpayer argued that the indemnity was given to support the company in its business operations. However, the tribunal characterised the indemnity as a personal-use asset since the taxpayer failed to prove, in an objective manner, that the debt arose during the process of gaining or producing assessable income.

[71] Australian Taxation Office, n 65, [156].

[72] *Crypto as a Personal Use Asset*, n 3. See also *Crypto Asset Investments and Tax*, n 3.

[73] *Crypto as a Personal Use Asset*, n 3.

[74] *Crypto as a Personal Use Asset*, n 3. This reasoning was used in the ATO's private ruling issued on 1 October 2020 about "cryptocurrency – non-fungible tokens" (authorisation no 1051694175099).

[75] *Crypto as a Personal Use Asset*, n 3. See also the example on this website ("Josh pays $50 each fortnight to acquire crypto assets, all of which he uses in the same fortnight to buy computer gains. He doesn't hold any other crypto assets. In one fortnight, Josh sees a computer game through an online retailer who doesn't accept crypto assets. Josh uses an online payment gateway that accepts crypto assets to buy the game. Under the circumstances in which Josh acquires and uses the crypto assets, the crypto assets (including the amount he uses through the online payment gateway) are personal use assets.").

[76] For example, a forex realisation gain arising from the disposal of foreign currency or a right to receive foreign currency is assessable upon disposal, and a forex realisation loss resulting from the disposal of foreign currency or a right to receive foreign currency is deductible also upon disposal under s 775-40 of the *Income Tax Assessment Act 1997* (Cth).

currency held in passing, as the Australian dollar serves as the measurement unit for tax liabilities in Australia.

By emphasising that crypto assets kept without active use can still qualify as personal-use assets, the ATO aims to determine the underlying purpose behind the keeping of such assets at the time of disposal (the assessment time). Varying viewpoints have been expressed on this matter. In Denmark, the assessment of a speculative purpose of personal property is made at the time of acquisition, whereas in Sweden, the intended use of an asset at the time of acquisition may serve as a presumption for its primary use, whether for personal purposes or as an investment.[77] When proposing a purpose test for debt guarantees, the Commissioner highlights that the characterisation of debts and debt guarantees should be based on their nature at the time they are granted.[78] While, in principle, the taxpayer's use of an asset should be evaluated as accurately as possible, typically at the assessment time, there may be circumstances that necessitate variations in the assessment. It is worth noting that the legislative definition of "personal-use asset" does not specify a particular assessment time.

The ATO's interpretation regarding the ownership period introduces further ambiguity. The ATO states:

> During a period of ownership, the way you keep or use a crypto asset may change. For example, you may originally acquire a crypto asset to buy items for personal use and enjoyment, but ultimately keep it as an investment or use it in carrying on a business. It is the main use, that you determine when you dispose of a crypto asset, that dictates whether a crypto asset is a personal use asset.[79]

The main use test appears to draw inspiration from the term "primarily" in the legislative definition of the first category of personal-use assets. However, as previously discussed, accurately quantifying the actual use is often challenging, especially when dealing with assets that are simply kept without active use. Determining the intended purpose of use for such assets becomes highly subjective and arbitrary. In cases where a crypto asset is eventually used for non-personal purposes, it would be arduous to provide evidence that the asset was mainly kept for personal use. Additionally, pinpointing a precise moment of transition in the intended purpose of use further complicates matters.

Overall, the ATO's interpretation of personal-use assets deviates from the statutory definition provided for the first category. If the ATO were to proceed with its current interpretative approach, there would be a potential risk to tax revenue, as investment assets could be reclassified as personal-use assets, allowing taxpayers to claim tax-exempt status. Furthermore, the ATO's aforementioned guidance focuses primarily on traditional cryptocurrencies like Bitcoin, while failing to address the second and third categories of personal-use assets.[80]

IV. The Tax Treatment of Personal-Use Assets

The statutory definition of "personal-use asset" presents challenges in effectively distinguishing assets that solely represent consumption. In theory, personal-use assets do not contribute to income generation or facilitate business activities, and they are expected to experience a decline or depletion in value. However, this theoretical framework does not fully align with reality. Certain assets classified as personal-use assets may retain or even appreciate in value. Moreover, collectables such as jewellery, coins and artworks, which are used or kept for personal purposes, can possess investment value. In fact, establishing a clear distinction between personal-use assets that purely signify consumption and those that can serve as investment assets is exceedingly complex (eg, wine collections).

[77] See Louise Fjord Kjærsgaard and Autilia Arfwidsson, "Taxation of Cryptocurrencies from the Danish and Swedish Perspectives" (2019) 47(6–7) *Intertax* 620, 626–623.

[78] Australian Taxation Office, *Income Tax: Capital Gains: Implications of a Guarantee to Pay a Debt*, TR 96/23, 31 July 1996. The Commissioner's position is similar to the tax position in Sweden, where the Swedish tax law ultimately seeks to determine the actual main use of assets.

[79] Australian Taxation Office, n 78.

[80] The second and third categories of personal-use assets would apply to crypto assets used for trading other types of assets or serving as personal debt arrangements.

The inherent complexity involved in the characterisation of a personal-use asset is embedded within the Australian income tax law. The tax rules governing personal-use assets are designed in a complex manner, treating personal-use assets and collectables separately. While capital gains from personal-use assets should be supposedly taxable, capital gains from small-value transactions are exempted to ease administrative burdens. Conversely, to avoid subsidising personal expenditure, capital losses are generally disregarded. However, in the case of collectables, capital losses can be offset against capital gains from collectables, subject to conditions, to ensure symmetrical treatment. Detailed taxation rules elucidate the underlying rationale for classifying personal-use assets, including collectables, and provide a comprehensive framework for their taxation treatment.

A. Two-pronged Approach

The Australian tax rules for personal-use assets are guided by two principles. First, to avoid subsidising personal expenditure, any capital loss from a personal-use asset is disregarded in calculating net capital gain or loss.[81] However, certain personal-use assets that have both investment and consumption purposes are treated differently (see Part IVB). In the case of a personal-use asset owned by a non-natural person entity, such as a company or trust, the decline in value of the asset will result in reduced proceeds for the individuals holding shares in the company or having an interest in the trust when the non-natural person entity is sold. To prevent individuals from benefiting from what is essentially a loss on the disposal of a personal-use asset, the consideration will be determined as if the market value of the asset had not decreased.[82] This measure ensures that the diminished value of the personal-use asset does not result in unintended financial advantages for the individuals involved.

The second principle guiding the Australian tax rules for personal-use assets pertains to small-value transactions and their impact on the taxation of capital gains.[83] In situations where a capital gain is realised, it signifies that the asset should not have been categorised as a personal-use asset, and the capital gain should be treated as an increase in the taxpayer's purchasing power. However, this can impose a significant administrative burden.

Various approaches can be employed to address small-value transactions. One approach is to provide an exemption for all capital gains when the total proceeds from the sale of personal-use assets fall below an annual threshold limit.[84] However, this approach does not ease the administrative burden, as taxpayers would still be required to maintain records until the sale of all personal-use assets is completed.

Alternatively, small-value personal-use assets can be excluded based on their acquisition cost.[85] Under the original CGT provisions, a special rule was established, deeming personal-use assets costing less than $5,000 to have been acquired for $5,000, and the proceeds below $5,000 were also deemed to be $5,000.[86] Costs incurred more than 12 months ago were permitted to be indexed to account for inflation[87] and align with the general operation of the CGT regime.[88] For example, if the cost base or the indexed cost base was $3,000 and the sale proceeds were $5,100, the cost base was deemed as $5,000, resulting in a capital gain of $100. The threshold was safeguarded against abuse by considering a set of articles,

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[81] Explanatory Memorandum, *Income Tax Assessment Amendment (Capital Gains) Bill 1986* (Cth) 21. This was also concerned in *Draft White Paper* (n 11) 79 (especially, [7.14]); *Asprey Report*, n 25, 427 (especially, [23.63]). The relevant provision that grants an exemption for capital losses concerning personal-use assets, other than the assets specifically treated similarly to investment assets (currently known as collectables), was formerly s 160Z(7) of the *Income Tax Assessment Act 1936* (Cth) and is now s 108-20(1) of the *Income Tax Assessment Act 1997* (Cth).

[82] *Income Tax Assessment Act 1997* (Cth) s 116-80; formerly, *Income Tax Assessment Act 1936* (Cth) s 160ZD(5).

[83] Explanatory Memorandum, *Income Tax Assessment Amendment (Capital Gains) Bill 1986* (Cth) 21.

[84] This method was considered in *Draft White Paper*, n 11, 82 [7.28].

[85] This method was considered in *Draft White Paper*, n 11, 82 [7.28]; *Asprey Report*, n 25, 428 [23.64].

[86] *Income Tax Assessment Act 1936* (Cth) ss 160ZE, 160ZG. This tax treatment was considered in *the Asprey Report*, n 25, 428 [23.64] and *Draft White Paper*, n 11, 82 [7.28] with the thresholds of $500 and $1,000, respectively.

[87] *Income Tax Assessment Act 1936* (Cth) s 160Z.

[88] *Income Tax Assessment Act 1936* (Cth) s 160ZH(2).

ordinarily disposed of in a single transaction, as a single asset, with each disposal treated as a disposal of a portion of that asset.[89]

In 1995, the threshold for deeming the (indexed) cost and proceeds of a personal-use asset was doubled to $10,000.[90] This adjustment was made to account for the erosion of the threshold's value over time due to inflation since its initial introduction almost a decade earlier.[91] Subsequently, in 1998, the exemption for small-value transactions was restructured to exclude personal-use assets costing $10,000 or less at the time of acquisition.[92]

Currently, any capital loss arising from the disposal of a personal-use asset is disregarded,[93] while a capital gain resulting from the sale of a personal-use asset originally acquired for more than $10,000 is subject to taxation.[94] To determine the cost base of a taxable capital gain, any non-capital costs associated with ownership, such as interest on borrowed funds for asset acquisition and maintenance, repair and insurance expenses, are excluded to prevent artificial reduction in taxable gains.[95] The application of cost indexation ceased for assets acquired after 11.45 am (by legal time in the Australian Capital Territory) on 21 September 1999 (the relevant time).[96] However, individuals, trusts and complying superannuation funds may be eligible for exemptions on capital gains derived from personal-use assets. Specifically, individuals and trusts may exempt half of the gain realised from a personal-use asset acquired at least 12 months before the relevant CGT event that occurred after the aforementioned time; complying superannuation funds, on the other hand, may exempt one-third of the gain generated from a personal-use asset.[97]

The recognition of a capital gain or loss typically occurs when a personal-use asset is transferred from one person to another. Nonetheless, certain circumstances permit the availability of rollover relief. For example, rollover relief can be applied when transferring a personal-use asset to the deceased's legal personal representative, a beneficiary of the deceased estate[98] or, in the event of a marriage breakdown, a (former) spouse.[99] Additionally, the transfer of a personal-use asset between companies within the same group does not trigger a CGT event.[100] Regardless of the transferee, the personal-use asset retains its classification as such, assuming economic reality remains indifferent to whether the transferor or transferee owns the personal-use asset. This approach aligns with the general principles of the Australian tax law.[101]

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[89] *Income Tax Assessment Act 1936* (Cth) s 160B(4); currently, *Income Tax Assessment Act 1997* (Cth) s 108-25. The Commissioner provides that boxes of identical floor tiles are not a set of collectables for the purpose of s 108-25 of the *Income Tax Assessment Act 1997* (Cth) in the ATO Interpretative Decision (ATO ID) 2002/796 (issued 19 June 2002). This interpretative decision was withdrawn on 12 March 2010 as being a simple restatement of the law.

[90] *Taxation Laws Amendment Act (No 4) 1995* (Cth) ss 29, 30 (substituting $5,000 with $10,000 in ss 160ZE, 160ZG of the *Income Tax Assessment Act 1997* (Cth)).

[91] Explanatory Memorandum, *Taxation Laws Amendment Bill (No 4) 1995* (Cth) 1–2 (also stating that the financial impact of a cost to revenue was expected to be up to $2 million per year).

[92] The *Tax Law Improvement Act (No 1) 1998* (Cth) rewrote the CGT provisions in the *Income Tax Assessment Act 1936* (Cth) into the *Income Tax Assessment Act 1997* (Cth), including s 118-10(3) that exempted personal-use assets acquired for $10,000 or less. Sections 160ZE and 160ZG of the *Income Tax Assessment Act 1936* (Cth) were rendered redundant.

[93] *Income Tax Assessment Act 1997* (Cth) s 108-20(1).

[94] *Income Tax Assessment Act 1997* (Cth) s 118-10(3).

[95] *Income Tax Assessment Act 1997* (Cth) s 108-30 (in which the 'third element' refers to non-costs of ownership).

[96] *Income Tax Assessment Act 1997* (Cth) s 110-36(1).

[97] *Income Tax Assessment Act 1997* (Cth) ss 115-10, 115-15, 115-25, 115-100. The exemption of capital gains, which applies to individuals and trusts, has been subject to debate against equity, efficiency and simplicity. See, eg, Chris Evans, John Minas and Youngdeok Lim, "Taxing Personal Capital Gains in Australia: An Alternative Way Forward" (2015) 30(4) *Australian Tax Forum* 735.

[98] *Income Tax Assessment Act 1997* (Cth) s 128-15(6); formerly, *Income Tax Assessment Act 1936* (Cth) s 160X(5)(b)(iii).

[99] *Income Tax Assessment Act 1997* (Cth) s 126-5(7); formerly, *Income Tax Assessment Act 1936* (Cth) s 160ZZM.

[100] *Income Tax Assessment Act 1997* (Cth) s 126-60(4); *Income Tax Assessment Act 1936* (Cth) s 160ZZO(9).

[101] See Sandra Rodman, "Splitting Up: The Tax Consequences of Family Breakdown" (1996) 30(7) *Taxation in Australia* 348 (providing tax consequences of different types of assets).

B. Special Provisions for Collectables

Certain personal-use assets are specifically categorised as having been used for investment, and the resulting capital gains from their disposal are subject to tax. The original list of such assets was "(i) a print, etching, drawing, painting, sculpture or other similar work of art, (ii) jewellery, (iii) a rare folio, rare manuscript or rare book, (iv) a postage stamp or first day cover, (v) a coin or medallion, (vi) an antique and (vii) an interest in an asset referred to in any of the proceeding assets".[102] These assets were previously referred to as "listed-personal-use assets" but are now labelled as "collectables".

The current arrangement of the collectables list is as follows:

(1) artwork, jewellery, an antique, or a coin or medallion;
(2) a rare folio, manuscript or book; or
(3) a postage stamp or first day cover.[103]

An artwork means "(a) a painting, sculpture, drawing, engraving or photograph; (b) a reproduction of such a thing; or (c) property of a similar description or use".[104] However, the Commissioner has not provided a clear explanation of what constitutes an artwork, although it has stated that artwork held as a long-term investment falls under the category of collectables.[105]

On the other hand, the Commissioner has provided guidance on the definition of an antique in Taxation Determination TD 1999/40. According to this determination, an asset qualifies as an antique if it is "an object of artistic and historical significance that is of an age exceeding 100 years" at the time of a CGT event.[106] This means that even if an asset did not possess the characteristics of an antique at the time of acquisition, it can still be classified as an antique if it is over 100 years old at the time of a CGT event. Conversely, if an asset with the characteristics of an antique is no more than 100 years old at the time of a CGT event, it may not be considered an antique for tax purposes.[107] The determination of who or what establishes the artistic or historic significance remains uncertain.[108]

Certain personal-use assets are classified as collectables, which include an interest in any of the listed assets, a debt related to such assets, or an option or right to acquire them.[109] Collectables form a subset of personal-use assets that are distinct from those subject to tax treatment in Part IVA.[110] Similar to personal-use assets in the other category, collectables must be used or kept mainly for the personal use or enjoyment of the taxpayer or an associate of the taxpayer.[111] For example, if an individual holds a 50% ownership interest in an antique, it will be considered a collectable only if the interest is used or kept mainly for personal use or enjoyment. If personal use or enjoyment cannot be established, the interest

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[102] *Income Tax Assessment Act 1936* (Cth) s 160B(2)(a).

[103] *Income Tax Assessment Act 1997* (Cth) s 108-10(2). In *Prekh v Federal Commissioner of Taxation* [2020] AATA 3756, the Commissioner raised default assessments treating gold jewellery and small pieces of gold as "collectables (or otherwise)" ([96]), against which the taxpayer failed to discharge the onus of proof.

[104] *Income Tax Assessment Act 1997* (Cth) s 995-1(1) (definition of "artwork").

[105] See ATO Interpretative Decision (ATO ID) 2011/9 (issued 11 February 2011; withdrawn 23 February 2018). The withdrawal notice stated that the publication was a simple restatement of the law and not an interpretative decision.

[106] Australian Taxation Office, *Income Tax: Capital Gains: What Is an "Antique" for the Purposes of the Definition of "Collectable" in* Subsection 108-10(2) *of the Income Tax Assessment Act 1997?*, TD 1999/40, 4 August 199; formerly, Australian Taxation Office, *Income Tax: Capital Gains Provision: Antiques*, TR IT 2539, 15 June 1989 (withdrawn on 4 August 1999 to reflect the change in the legislative drafting with no change in the views).

[107] In *Buzadzic v Federal Commissioner of Taxation* [2021] AATA 4820, the Commissioner did not argue against the fact that the taxpayer characterised heritage number plates as an antique. The exact ages of the number plates are unknown but unlikely to be more than 100 years old.

[108] See, eg, the interpretative difficulty of determining whether a firearm is an antique in *Walkingshaw (Francis) v Wallace* 1990 SCCR 203; *Richards v Curwen* [1977] 1 WLR 747; 3 All ER 426.

[109] *Income Tax Assessment Act 1997* (Cth) s 108-10(3); formerly, *Income Tax Assessment Act 1936* (Cth) s 160B(2)(b)–(c).

[110] Specifically, the definition of a personal-use asset excludes a collectable in s 108-20(2) of the *Income Tax Assessment Act 1997* (Cth).

[111] *Income Tax Assessment Act 1997* (Cth) s 108-10(2).

defaults to being a CGT asset that is not a personal-use asset. However, when the Commissioner requires that an antique must be over 100 years old, the interest will be considered a personal-use asset if personal use or enjoyment can be shown.

Collectables are generally expected to appreciate in value due to factors such as historical significance, celebrity association or rarity. While capital losses are not the norm, there is still a possibility of losses, as an investment asset declines in value. In alignment with these principles, the Australian government has designed the tax rules for collectables with two primary objectives: considering the subsidy effect related to capital losses and ensuring administrative simplicity for small-value transactions concerning capital gains.

When the CGT provisions were introduced in 1986, assets like artworks were considered collectables only if they were acquired for more than $100.[112] The threshold was increased in 1995 to $500 to account for the inflationary impact on the Consumer Price Index, which was also the basis for increasing the general personal-use asset threshold from $5,000 to $10,000.[113] The purpose of the threshold was to simplify administrative procedures by excluding small-value transactions, rather than being a condition for defining a collectable.[114] Thus, the inclusion of the $100 and later $500 thresholds in the definition was a drafting oversight,[115] although it was unlikely to impede the intended operation of the law.[116]

In conjunction with the threshold increase, two safeguard measures were introduced to prevent potential exploitation. First, the deeming rule applied to personal-use assets was extended to collectables. This means that a set of collectables that would typically be disposed of in a single transaction is treated as a single asset, and each disposal is considered a disposal of a portion of that asset.[117] Second, the scope of collectables was expanded to include personal-use assets that would be categorised as collectables if the interest in the assets had been acquired for more than $500 or if their market value exceeded $500.[118] For example, if two taxpayers jointly acquire an artwork with a market value of $600, each interest in the artwork was initially classified as a collectable. However, under the new measure, each interest in the artwork is treated as a collectable[119] to prevent potential exploitation of the threshold.[120] Similar to ordinary personal-use assets, collectables do not include non-capital costs of ownership in their cost base, such as interest on borrowed funds used to acquire the asset.[121]

When the deeming rules for the (indexed) cost base and proceeds related to personal-use assets were modified to exclude personal-use assets costing $10,000 or less from CGT subjects, similar treatment

[112] *Income Tax Assessment Act 1936* (Cth) s 160B(2)(a).

[113] *Taxation Laws Amendment (No 4) 1995* (Cth) s 22 (substituting $100 with $500 in s 160ZB(2) of the *Income Tax Assessment Act 1997* (Cth)).

[114] For example, the *Asprey Report*, n 25, suggested in principle that all gains from collectables be taxable in the same manner as non-personal use property (427 [23.63]). See similarly *Draft White Paper*, n 11, 82 [7.28].

[115] This discrepancy was duly highlighted and addressed in the explanatory memorandum to the *Taxation Law Improvement Bill (No 2) 1997* (Cth) 53 (noting that, where the existing law "gives rise to the possibility that a collectable that is not a 'listed personal-use asset' because it was acquired for $500 or less, could be treated as a 'non-listed personal-use asset'", the rewritten law would prevent this situation.).

[116] For the purpose of simplicity, if an artwork costing less than $100 was classified as a collectable, it was deemed appropriate to disregard any resulting capital gain. Similarly, any capital loss associated with such an artwork should also be excluded from tax calculations to ensure symmetric treatment. By characterising the artwork as a personal-use asset, its cost was deemed to be $5,000 (or $10,000 following the threshold update). Unless the proceeds from selling the asset exceeded $5,000 (or $10,000), which would be uncommon given its low acquisition value, any capital loss or gain would be disregarded.

[117] *Taxation Laws Amendment Act (No 4) 1995* (Cth) s 24 (amending s 160B(4) of the *Income Tax Assessment Act 1936* (Cth), later transferred to s 108-15 of the *Income Tax Assessment Act 1997* (Cth)).

[118] *Taxation Laws Amendment Act (No 4) 1995* (Cth) s 23 (inserting s 160B(2A) in the *Income Tax Assessment Act 1936* (Cth)).

[119] *Income Tax Assessment Act 1997* (Cth) ss 108-10(3), 118-10(2).

[120] Explanatory Memorandum, *Taxation Laws Amendment Bill (No 3) 1995* (Cth) [2.17].

[121] *Income Tax Assessment Act 1997* (Cth) s 108-30 (in which the 'third element) refers to non-costs of ownership).

was introduced to exempt collectables costing $500 or less.[122] Therefore, any capital gain or loss arising from a collectable costing $500 or less is not subject to CGT.

Where capital gains arising from collectables are generally taxable, subject to the $500 threshold, the capital loss rules for collectables are more complex. Unlike capital losses from personal-use assets, which are disregarded, capital losses from collectables are recognised at the outset due to collectables being treated as assets with an investment nature. For the general operation of the CGT regime, there are two main methods for quarantining capital losses. The first method is to deny the deduction of capital losses against income other than capital gains. The second method, which can be used in conjunction with the first or solely without the first, involves limiting the deduction of capital losses up to a certain annual threshold. This threshold can be expressed as a nominal amount or a fixed percentage of the total capital losses in the income year.[123] Under Australian income tax law, only the first method is adopted, where a net capital gain accrued to the taxpayer during the income year is included in assessable income.[124] Capital losses are deferred until there is an offsetable capital gain in a future income year.[125] Furthermore, capital losses arising from the disposal of collectables are subject to additional regulations. They can only be offset against gains made from other collectables. In the current income year, capital losses from collectables can be utilised in any order against capital gains from collectables.[126] Any remaining capital gain, after offsetting the capital losses from collectables in the current year, can be further offset by unused net capital losses from collectables from previous years, following the order in which they arose.[127]

The general loss quarantine rule, which is part of the CGT regime, aims to prevent potential misuse of realisation taxation. In theory, income tax should be imposed on an accrual basis, considering both capital gains and losses. However, in practice, symmetric treatment is not achieved due to the timing of capital losses being capable of manipulation to move from a higher to a lower marginal tax rate.[128] On the other hand, the offsetting rule allowed between collectables is based on the recognition of considerable difficulties in clearly distinguishing between collectables and other personal-use assets.[129] This means that not all personal-use assets, even those used for both investment and personal use, are categorised as collectables. The Taxation Review Committee, led by Asprey, recommended the introduction of a comprehensive CGT and suggested that "while such property as jewellery should be subject to the tax, furniture, even though it may be antique furniture, should be altogether exempt".[130]

[122] *Income Tax Assessment Act 1997* (Cth) s 118-10(1) (introduced by the *Tax Law Improvement Act (No 1) 1998* (Cth)).

[123] This method was illustrated in *Draft White Paper*, n 11, 82 [7.28].

[124] *Income Tax Assessment Act 1997* (Cth) s 102-5(1).

[125] *Income Tax Assessment Act 1997* (Cth) s 102-10(2).

[126] *Income Tax Assessment Act 1997* (Cth) s 108-10(1).

[127] *Income Tax Assessment Act 1997* (Cth) s 108-10(5). Under the previous provisions of the *Income Tax Assessment Act 1936* (Cth), there existed a single figure for unused net capital losses at any given time. To illustrate, if a net capital loss of $100 arose from collectables in Year 1, this amount would be carried forward to Year 2 for the purpose of calculating a new net capital loss. Assuming that a net capital loss of $300 arose from collectables in Year 2, the total net capital loss to be carried forward to Year 3 would be $400. However, if no net capital loss from collectables occurred in Year 2, the amount carried forward to Year 3 would be $100. This approach was inconsistent with the general loss-offsetting rules that required the recording of net capital losses incurred in specific years. To achieve consistency with the general loss-offsetting rules outlined in s 102-15 of the *Income Tax Assessment Act 1997* (Cth), the current loss-offsetting rules for collectables were introduced, thereby replacing the previous inconsistent application.

[128] Taxpayers also have the ability to strategically time the realisation of their assets to achieve tax-preferred outcomes. In the case of progressive tax rates, taxpayers may find themselves facing higher tax liabilities when unrealised capital gains are accumulated and become taxable in a single year. Such accumulation, known as bunching, is less likely increase tax revenue, as taxpayers are expected to take measures to mitigate the impact of bunching. Conversely, a situation arises when taxpayers intentionally refrain from realising assets in years of high income. This practice undermines tax neutrality as it incentivises taxpayers to lock in their assets despite potential profit-making or business opportunities. While rollover relief measures may discourage asset retention to some extent, they come with the trade-off of accepting preferential treatment for reinvested assets. Moreover, these rollover concessions enable eligible taxpayers to accumulate capital gains over time.

[129] *Asprey Report*, n 25, 428 [23.64].

[130] *Asprey Report*, n 25, 428 [23.64].

Given the imprecise characterisation of collectables, which results in losses from collectables being offset only against gains from collectables, it would be reasonable to expect that such losses should also be offset against gains from any personal-use asset. The fact that a personal-use asset generates a gain implies that it should have been characterised as a collectable in principle. Although collectables are defined based on asset types, the assets that should be classified as collectables based on general tax policy principles are those used for both investment and personal use. The reason why losses from collectables can only be offset against gains from collectables rather than personal-use assets as a whole remains unknown, although it may be justifiable based on revenue collection.[131] It is possible that taxation has been considered separately once assets are labelled as personal-use assets or collectables. Similar to ordinary personal-use assets, if the sale of a company or trust results in reduced proceeds due to the decline in value of a collectable owned by the entity, this reduction is disregarded when calculating capital gains tax for the sale of shares in the company or an interest in the trust.[132]

V. Crypto Asset Considerations

Earlier, the author raised concerns about potential legal characterisation issues in the ATO’s interpretation of characterising crypto assets, specifically traditional cryptocurrencies like bitcoin. Additionally, the ATO provides separate guidance on non-fungible tokens, stating that their treatment depends on all relevant circumstances, such as the taxpayer’s circumstances, how the taxpayer uses a token and their reasons for holding and transacting with it.[133] The overall nature of the taxpayer’s activities matters (eg, business or hobby). Depending on these factors, a non-fungible token may be considered trading stock. The ATO’s guidance regarding the tax treatment of non-fungible tokens simply states that general tax principles apply to them. Furthermore, the ATO does not appear to regard non-fungible tokens as collectables.[134]

The ATO distinguishes between cryptocurrencies and non-fungible tokens.[135] However, the legislative definition of “personal-use asset” does not necessitate such a differentiation.[136] Take personal debts, for

[131] This aspect was not addressed in the *Draft White Paper*, n 11, 79 [7.14], 82-83 [7.29], nor was it discussed in the *Asprey Report*, n 25, 427 [23.63]. Furthermore, the explanatory memorandum to the *Income Tax Assessment Amendment (Capital Gains) Bill 1986* (Cth), as well as other explanatory memoranda pertaining to the amendments concerning collectables and personal-use assets, did not provide any clarification or insights into this particular matter.

[132] *Income Tax Assessment Act 1997* (Cth) s 116-80; formerly, *Income Tax Assessment Act 1936* (Cth) s 160ZD(5).

[133] *Non-Fungible Tokens*, n 3. If a non-fungible token gives the right to an annual private viewing of a specific paining, its classification as a personal-use asset would depend on the purpose of the private viewing. If the private viewing is primarily for personal enjoyment, such as for hosting a birthday celebration with family and friends, the token is likely to be considered a personal-use asset. Conversely, if the private viewing is used in the operation of a tour business or any such commercial activities, the token would not be regarded as a personal-use asset.

[134] These examples can be found in Australian Taxation Office, “Selling NFT Artwork – When Does It Become Taxable Income?”, *ATO Community* <https://community.ato.gov.au/s/question/a0J9s0000001ILmEAM/p00046840>; Australian Taxation Office, “NFTs and NBA Topshot”, *ATO Community* <https://community.ato.gov.au/s/question/a0J9s0000001IKJEA2/p00046749>; Australian Taxation Office, “NFT Trading Stock Election ERC #721”, *ATO Community* <https://community.ato.gov.au/s/question/a0J9s0000001II9EAM/p00046615>. Based on the analysis of the ATO’s private rulings, Lim anticipated that the ATO would be unlikely classify non-fungible tokens such as CryptoKitties and NBA Top Shot videos as personal use assets (or collectables). See Wendy Lim, “Taxation of Non-Fungible Tokens” (2021) 50(4) *Australian Tax Review* 270. On the ATO Community website, the ATO advises that non-fungible tokens are not considered collectables for tax purposes. See Australian Taxation Office, “Are Fractionalised NFTs Considered Collectables by the ATO?”, *ATO Community* <https://community.ato.gov.au/s/question/a0J9s0000001IPw/p00047098>.

[135] According to the ATO, the term “crypto asset” means “a form of digital asset that include cryptocurrencies, digital or virtual currencies, virtual assets and non-fungible tokens that use cryptography to secure transactions and don’t rely on a financial intermediary” and the term “non-fungible token” refers to “a digital file or asset stored on a digital ledger where each token is unique and not interchangeable”. See Australian Taxation Office, *Crypto Asset Glossary* <https://www.ato.gov.au/individuals/Investments-and-assets/crypto-asset-investments/crypto-assets-glossary>. However, the ATO provides no definition for the terms such as “crypto coin”, “crypto token” and “cryptocurrency”.

[136] The concept of fungibility is elusive. While the ATO provides an example of a non-fungible token granting the right to an annual private viewing of a specific paining (*Non-Fungible Tokens*, n 3), it is important to consider the broader context. For example, if the paining owner also provides the same right to another person through a paper ticket, and both the token and the paper ticket

instance, which can be considered fungible.[137] In South Africa, tax legislation prohibits crypto assets from being classified as personal-use assets.[138] However, this measure is extreme in the absence of clear policy justifications. Instead, crypto assets can be characterised based on the substance of their transfers, emphasising their role in recording transactional details, such as the parties involved and the specifics of each transaction.[139] If a crypto asset is utilised in the trading of an asset mainly used or kept for personal use or enjoyment, or an interest in such an asset, its characterisation should align with that of the traded asset. This principle also extends to options or rights to acquire such assets, as well as debts related to formerly held such assets and personal debts. However, if the traded asset is already recognised for tax purposes, the tax recognition of the crypto asset can be eliminated to avoid duplication.

This approach proves beneficial in cases where a crypto asset is designed to facilitate the exchange of an asset that differs from its original purpose. For example, a token previously used for trading movie tickets can be repurposed as a voucher for candy bars at the cinema.[140] However, it necessitates further consideration of three following scenarios: (1) where crypto assets lack underlying assets, (2) where crypto assets involve the trading of intangible assets, and (3) where crypto assets may be categorised as collectables.

Scenario 1. No Underlying Asset

Crypto assets do not always involve trading underlying assets. The exponential growth of Bitcoin transactions, for example, is driven by its speculative value. Some crypto assets exist solely as a medium of exchange on specific online platforms for goods and services (eg, ether bought for use as a gas fee for smart contracts) or retain value by social consensus, such as meme coins created and shared by individuals on social media platforms, forums and other online communities.

The tax treatment of such assets can be likened to that of foreign currencies, as crypto assets are used in a manner similar to money.[141] The Australian currency is not an apt comparison, as it serves as the standard unit for calculating tax liabilities in Australia. Both crypto assets and foreign currencies are CGT assets and may be categorised as personal-use assets or even as collectables, depending on the facts and circumstances of each case. In *Favaro v Commissioner of Taxation (Cth)*, the Italian currency was held not to be a personal-use asset, although this decision offers limited guidance on characterising

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can be freely exchanged and serve as perfect substitutes for one another, the token in this context may demonstrate fungibility. The determination of fungibility cannot be solely based on labelling as an asset as fungible or non-fungible. It depends on the actual substitutability of assets and can vary based on subjective factors.

[137] A simple borrowing of $100 can be easily substituted with another borrowing of $100. However, debt guarantees cannot be easily characterised as fungible due to the unique particulars associated with each debt guarantee. These distinct particulars hinder their direct interchangeability with one another.

[138] Namhla Vumazonke and Shaun Parsons, “An Analysis of South Africa’s Guidance on the Income Tax Consequences of Crypto Assets” (2023) 26(1) *South African Journal of Economic and Management Sciences* 1, 6 (stating that the prevention was effected by including crypto assets within the definition of financial instruments in 2019).

[139] This approach aligns with the general taxation principles of taxation, which aim to be technology-neutral. Ooi emphasises that treating crypto assets as a monolithic class is a misconception (Vincent Ooi, “A Framework for Understanding the Taxation of Digital Tokens” (2021) 50(4) *Australian Tax Review* 260). To illustrate this point, the tax consequences should remain unchanged when transitioning from a paper ledger, which uses paper-based certificates to record ownership, to a digital ledger. The shift in the form of the recording system should not impact the tax implications.

[140] Certain assets, such as five-year cloud computing voucher, a first-class plane ticket or permanent website access, possess distinct legal attributes from the tokens used for their trade. Tokens can have a perpetual existence even if the original asset they were traded for ceases to exist. In other words, they can be used to trade a different asset once the original asset is depleted or replaced with new programming. For example, consider a token granting access to a single movie. The token may solely record, on the blockchain, the right to enter a cinema without requiring further verification for subsequent viewings. The programming of a token does not necessarily encompass precise legal terms and conditions. Once a token is used for admission, it can be repurposed to facilitate the sale of vouchers for popcorn and coke. As such, it is reasonable to determine the tax characterisation of a token on the goods or services exchanged for its transfer.

[141] Note, however, cryptocurrency is not widely recognised as money in substance or nature. See, eg, OECD, *Taxing Virtual Currencies: An Overview of Tax Treatments And Emerging Tax Policy Issues* (OECD Publishing, 2020) 20; Reserve Bank of Australia, *Digital Currencies* <https://www.rba.gov.au/education/resources/explainers/cryptocurrencies.html>.

crypto assets.[142] While personal-use assets are typically defined in contradistinction to use for a business or the like, the nature of crypto assets may challenge such categorisation when it is used primarily for investment purposes. Part IIIC highlighted the need to independently characterise a crypto asset separate from the item subsequently purchased with it.

Alternatively, one could argue that such crypto assets with dual functionality for investment and personal use should be treated as collectables. However, this argument is weakened by the fact that foreign currencies with similar characteristics are not treated as collectables. Similar to foreign currencies, cryptocurrencies such as bitcoin should be considered non-collectables. Although certain non-fungible tokens may possess inherent desirability, such as the initial token minted within a specific blockchain, drawing a general conclusion that they are primarily intended for personal use or enjoyment, rather than speculative purposes, proves challenging. Even if their predominant use is established to be for personal purposes, unless their appreciable value is widely acknowledged and accepted by the general public, it is unlikely for the government to incorporate them within the definition of collectables.

Scenario 2. Intangible Underlying Assets (Not: Collectables)

To qualify as a personal-use asset, an asset must mainly serve personal use or enjoyment, except in the case of personal debts.[143] This classification encompasses both digital assets, such as digital pictures and graphic arts, and tangible assets like books and wall art. However, determining personal use or enjoyment for intangible assets presents challenges.

Unlike tangible assets, which typically depreciate due to wear and tear, intangible assets do not always decline in value through use. Some intangible assets, like licences and access rights,[144] have limited lifespans and may be classified as personal-use assets due to their diminishing value. However, certain intangible assets can last indefinitely (eg, lifetime membership access to a website) or fluctuate in value based on market conditions, raising questions about the element of consumption for tax-exemption status.

Demonstrating personal use or enjoyment presents administrative difficulties. While physical access or frequency of inspections can serve as indicators for tangible assets,[145] they are impractical to apply to intangible assets. The complexity increases when considering the threshold “mainly” in determining personal use or enjoyment. Moreover, this determination extends not only to the taxpayers but also to their associates, significantly broadening the scope of tax exemption for capital gains derived from crypto transactions.

Scenario 3. Collectables

The category of collectables serves to expand the scope of taxable personal-use assets, but they are treated differently from ordinary CGT assets. The determination of personal use or enjoyment can be ambiguous,[146] leading to the characterisation of a crypto asset as an ordinary CGT asset for utilising

[142] *Favaro v Commissioner of Taxation (Cth)* (1996) 34 ATR 1.

[143] An asset can be possessed partially, indicated by an interest that represents ownership in terms of a percentage or fixed value, or encompasses a collection of rights attached to that interest. Additionally, an option or right to acquire such an asset, as well as any debt related to the asset once used or kept as such, are considered distinct personal-use assets in their own right.

[144] Likewise, digital tokens may be employed for the exchange of five-year vouchers for cloud computing or first-class plane tickets, which remain valid for use by any individual until a predetermined date.

[145] If a taxpayer purchases an interest in the Mona Lisa but never views it, this would likely be deemed as non-personal use. On the other hand, if a taxpayer acquires an interest in a painting and displays it in their own living room, the paining would generally be considered mainly for personal use or enjoyment. However, variations can arise. For example, a painting might be securely wrapped and stored in the taxpayer’s garage or at a friend’s house who holds the remaining interest in the artwork. In such cases, determining a reliable basis for demonstrating personal use or enjoyment becomes more challenging.

[146] The challenge of determining whether an asset is used for a speculative purpose is highlighted in Kjærsgaard and Arfwidsson, n 77. In Denmark, capital gains and losses from the sale of personal property acquired for a speculative purpose are taxable, and the speculative purpose need not be the sole or even the primary purpose of acquiring an asset. Drawing on Danish case law and administrative practices, the authors assert that a speculative purpose in the context of crypto assets would be determined by facts

the loss-offsetting rule against capital gains. The inability to offset capital losses from collectables against taxable capital gains from personal-use assets has been questioned from a theoretical standpoint. Extending the loss-offsetting rule for collectables would impact revenue collection, and ensuring a fair and consistent practice in distinguishing between ordinary CGT assets and collectables is important.

On the other hand, the ambiguity surrounding the determination of personal use or enjoyment may be exploited to classify a crypto asset as a collectable. As mentioned, the exemption applies to collectables acquired for $500 or less, subject to the market value also being no more than $500 to prevent circumvention.[147] In addition, an anti-fragmentation rule deems multiple articles sold separately for tax purposes as a single asset when they are typically sold as a set.[148] However, these measures may not effectively target potentially collectable crypto assets, as they are often traded (or can be designed to be traded) at low values despite the significant growth of the crypto industry. Crypto assets are generally divisible and can be sold in any size of bunch, although the collectable value may be derived from a particular collection in rare circumstances.

The definition of "collectable" has not been extensively litigated thus far, but this is expected to change if non-wasting intangible assets can be held mainly for personal use or enjoyment and subsequently classified as collectables. The interpretation of "artwork" is particularly troublesome, as the legislative definition does not clarify whether it refers to the digital data or the printed or digital photo produced from it.[149] Similarly, the uncertainty extends to digital cats (crypto kitties) in a blockchain-based pastime, CryptoKitties, where the traded asset is essentially the unique DNA of the crypto kitty, capable of being visualised as a cartoon cat on various software platforms. This mechanism can be seen as one kind of generative art, which is a more general category of art created by algorithm from specific "seed" data that can be recorded in non-fungible tokens.

The interpretative uncertainty surrounding digital artworks and crypto kitties creates ambiguity as to whether they should be classified as collectables or personal-use assets. Judicial interpretation will play a crucial role in determining their status.[150] If collectable crypto assets are personal-use assets, this would result in a significant tax exemption for a substantial portion of the collectable crypto asset market, contradicting the tax policy's intention to exempt only consumption from tax calculations, given the $10,000 acquisition threshold.

VI. Conclusion

In 2021, the federal court dismissed an interlocutory case concerning capital gains tax issues arising from the Ethereum hard fork but left unresolved the characterisation of pre-fork ether coins as personal-use assets and whether they are exempt from taxation.[151] The concept of personal-use assets aims to

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and circumstances of the relevant case with regard to the following: "whether the price of the specific coin has been volatile and/or increasing on average; whether the specific coin has limited practical applications; whether the specific coin has no or limited personal attachment tied to it; whether the specific coin can be easily bought and sold; and whether the coin and realized gains and losses from the sale of the coin has been subject to extensive media coverage" (626). The Danish tax authorities however maintain a rebuttable presumption that the acquisition of a crypto asset such as Bitcoin and Ether is for speculative purposes (626, fn 60).

[147] *Income Tax Assessment Act 1997* (Cth) s 118-10(2).

[148] *Income Tax Assessment Act 1997* (Cth) s 108-25.

[149] See *Income Tax Assessment Act 1997* (Cth) s 995-1(1) (definition of "artwork").

[150] The ATO viewed that non-fungible tokens representing graphics or art(work) in the non-fungible token game were not collectables for the private ruling issued on 1 October 2020 (authorisation no 105169415099). However, this ruling was made on the basis that non-fungible tokens were not used or kept mainly for personal use or enjoyment. The taxpayer collected them without an intention to play games and indicated that some might be gifted the taxpayer's relative in the future.

[151] In *ASZ21 v Federal Commissioner of Taxation* [2021] FCA 1304 (distinguished in *YTL Power Investments Ltd v Federal Commissioner of Taxation* [2023] FCA 258, [35] on the basis that *ASZ21 v Federal Commissioner of Taxation* involved no assessment issued to the taxpayer), the Commissioner made an interlocutory application to seek summary dismissal in response to the taxpayer's application for declaratory relief. The grounds for the application were that "(a) the applicant has no reasonable prospect of successfully obtaining the declaratory relief sought; and/or (b) the proceeding is an abuse of the process of the Court" ([2]). One of the issues raised in the case was whether the Ether coins purchased before the fork were personal-use assets, thereby exempting from tax the capital gains from post-fork coins disposed of as a gas fee for deploying a non-fungible token and in

exclude assets mistakenly treated as taxable against tax policy, but their legislative definition may inadvertently cover assets that neither depreciate nor are consumed.[152] Capital gains from personal-use assets are subject to taxation if acquired for more than $10,000, a threshold set for administrative convenience, omitting small-value transactions. If personal-use assets are characterised as collectables, capital gains become taxable if their acquisition cost exceeds $500 or if their market value is over $500. Like investment assets, capital losses from taxable collectables can be used to offset capital gains from other taxable collectables. However, the characterisation of a collectable is not based on its ordinary meaning but depends on a legislatively specified list of assets deemed to possess both investment and personal-use attributes.

Several recommendations arise from examining the tax policy behind personal-use assets and collectables. First, the characterisation of crypto assets should be based on the nature and use of the asset traded in crypto transactions. If a crypto asset simply serves as a receipt for transferring another asset, costs and proceeds should be properly attributed to the transferred asset, preventing double counting. Second, cryptocurrencies that resemble foreign currencies, used for speculation or as a commodity for exchange, should be rarely classified as personal-use assets. Third, crypto assets that represent non-wasting intangible assets, as discussed in Scenario 2 in Part V, should not be considered personal-use assets as mischaracterising them as personal-use assets poses a significant threat to government revenue, given the rapid growth of the crypto industry.

Distinguishing between investment assets, which follow general CGT rules, and personal-use assets or collectables, subject to special CGT rules, is crucial due to the significantly different tax outcomes, including tax exemption of small-value transactions. Mischaracterising crypto assets as collectables, especially when they represent non-wasting assets or personal collections, could exempt a substantial market segment from taxation, contradicting policy goals and revenue objectives.

These recommendations aim to achieve a more accurate identification of consumption based on tax policy principles, while minimising potential revenue losses. However, interpreting and classifying new and emerging types of crypto assets within the existing taxation framework present challenges. Further analysis is necessary to navigate the evolving landscape of crypto transactions and establish a robust and equitable income tax system.

part for Australian dollars. The Commissioner conceded that the substantive matters needed to be dealt under Pt IVC of the *Taxation Administration Act 1953* (Cth), instead of declaratory relief that the taxpayer had sought. The dismissal by the court was not followed by any proceedings under Pt IVC to address the substantive issues, including the personal-use asset classification. The judicial characterisation of personal-use assets (and collectables) remains uncertain.

[152] At the inception of the CGT provisions, the government forecasted a revenue yield of $25 million in the fifth year of operation from appreciated personal-use assets. However, the actual revenue yield from individual taxpayers alone amounted to $174 million. This information is referenced in Delany, n 37.