

The inclusion of virtual currencies in the calculation of income tax

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ABSTRACT

Keywords: Virtual currencies, Bitcoin, gross income, income tax, regulation, tax administration, legal tender, money, method of payment

This study is aimed at the application of South African legislation to virtual currencies, such as Bitcoin. Due to the increased popularity of virtual currencies, its future taxation could be determined in the light of existing law. This mini-dissertation studied the nature and characteristics of virtual currencies as well as its advantages and disadvantages in order to determine what problems states are facing concerning the regulation of it. More specifically, this study identified the main characteristics that contribute towards the struggle to legislate virtual currencies in general.

Despite attempts by countries such as China and Japan to treat virtual currencies as legal tender, to date, they are not accepted as legal tender under the South African banking law. However, this does not mean that virtual currencies cannot be deemed to be money or a valid method of payment in South Africa.

In 2014, the South African National Treasury stated that the merchant who accepts virtual currencies, does so at own risk. However, the National Treasury did not expound on the income tax consequences in these circumstances. Therefore, this study applied the elements of "gross income" under the *Income Tax Act* 52 of 1968 and the supplementary case law, to various virtual currency transactions. The purpose was to determine whether virtual currencies could be included in a taxpayer's gross income. The study of the elements above and the application thereof to virtual currencies led to a positive conclusion: virtual currencies can be included in a taxpayer's "gross income".

In light of the possible inclusion of virtual currencies, it should be kept in mind that the mere inference of inclusion is not sufficient. As a result, tax administration laws were reviewed to determine whether the inclusion of virtual currencies can be ensured and to decide on the consequences of non-compliance. Alternative legislation, such as legislation from the banking and financial sector, within the South African as well as the United States context were also revised in order to contribute to ensuring the inclusion

of virtual currencies. Despite the study of alternative legislation, this study mainly approached virtual currencies from a tax law perspective.

This study closed with suggested solutions to the problems identified above and throughout the study.

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LIST OF ABBREVIATIONS

ANCP	Administrative non-compliance penalties
Berkeley Tech LJ	Berkeley Technology Law Journal
BSA	Bank Secrecy Act (Title 31 of the United States Code, sections 5311, <i>etcetera</i>)
CCVCs	Convertible centralised virtual currencies
CDVCs	Convertible decentralised virtual currencies
Ch	Chapter
CIJL	Chicago Journal of International Law
CILSA	Comparative and International Law Journal of South Africa
CIR	Commissioner for Inland Revenue
CommLaw Conspectus	Journal of Communication Law and Technology Policy
CSARS	Commissioner of the South African Revenue Services
CVCs	Convertible virtual currencies
ECTA	Electronic Communications and Transactions Act 25 of 2002
EFT	Electronic funds transfer
E-money	Electronic money
EV	Elsevier Journal of Banking and Finance
FACTA	Foreign Account Tax Compliance Act (Title 26 of the United States Code, sections 1471-1474, 6038D)
FATF	Financial Action Task Force

FICA	Financial Intelligence Centre Act 38 of 2001
FinCEN	Financial Crimes Enforcement Network
GAO	Government Accountability Office
Harv JL & T	Harvard Journal for Law and Technology
IBERJ	International Business and Economic Research Journal
ICTL	Information and Communication Technology Law
IJGLS	Indiana Journal for Global Legal Studies
ILJ	Indiana Law Journal
IMF	International Monetary Fund
IPR	Internet Policy Review
ITA	Income Tax Act 58 of 1962
La L Review	Louisiana Law Review
LCLR	Layola Consumer Law Review
NBER	National Bureau of Economic Research
NCVC	Non-convertible virtual currencies
NWJTI	North Western Journal of Technology and Intellectual Property
PER	Potchefstroom Electronic Law Journal
SA Merc LJ	South African Mercantile Law Journal
SARB	South African Reserve Bank
SARBA	South African Reserve Bank Act 90 of 1989

SARS	South African Revenue Service
SBI	Sekretaris van Binnelandse Inkomste
SIR	Secretary for Inland Revenue
Stell LR	Stellenbosch Law Review
TAA	Tax Administration Act 28 of 2011
TOSEBLJ	The Ohio State Entrepreneurial Business Law Journal
TSAR	Tydskrif vir die Suid-Afrikaanse Reg
Trinity CL Rev	Trinity College Law Review
USP	Understatement penalties
US	United States
USA	United States of America
VLR	Villanova Law Review
VCs	Virtual currencies
Wake Forest L Rev	Wake Forest Law Review
Wash LR	Washington Law Review

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Chapter 1 Context and methodology

1.1 Problem statement

The use of virtual currencies (hereafter: VCs) to purchase goods or services and perform other activities has become increasingly popular in South Africa.¹ It stands to reason that a significant part of the South African population does not utilise VCs due to obstacles impeding access to these currencies. Nevertheless, VCs cannot be left unregulated for those persons who do use it. Typically, these are the more affluent individuals and business enterprises. In 2014, the South African National Treasury released a User Alert, particularly on the monitoring of VCs, in which the South African Reserve Bank (SARB), the South African Revenue Service (SARS) and others warned the public about the risks of VCs.²

The National Treasury (2014) stated that there are no specific laws or regulations available in South Africa governing the use of VCs, therefore, it remains the merchants' choice whether they would accept VCs or not.³ The National Treasury also asserted that the "relevant authority will continue to monitor and assess the use of [VCs]" and that this authority will provide further guidance or regulations "should the need arise".⁴ However, three years later (2017), the use of VCs has increased and businesses in South Africa have been built on such currencies,⁵ yet, to date, no explicit legislation or regulation has been prepared and presented for VCs.⁶

Before examining the problems related to VCs, the nature of these currencies should be determined first. VCs can be defined as a unit of account that can be created, stored

¹ Other activities include investment and "mining". In addition, there are over 200 merchants in South Africa that accept Bitcoin; National Treasury 2014 <http://www.treasury.gov.za>; Visser 2016 <https://www.luno.com/blog/en/post/south-africa-pay-with-bitcoin>.

² These risks include: "no investor protection and no recourse"; "operational risks" of virtual platforms; and misuse. Also see the SARB's Position Paper on Virtual Currencies; SARB 2014 <http://www.resbank.co.za> 10; National Treasury 2014 <http://www.treasury.gov.za>; *Electronic Communications and Transactions Act* 25 of 2002.

³ It remains the merchant's responsibility to do research before accepting VCs; National Treasury 2014 <http://www.treasury.gov.za>.

⁴ National Treasury 2014 <http://www.treasury.gov.za>.

⁵ Regarding Bitcoin, businesses such as Bitcoin exchanges have purchased "rigs" (the computer software needed to "mine" bitcoins) and appointed "miners" to exploit them. Some of these businesses also provide users with "wallets" in which they can hold their bitcoins.

⁶ The SARB merely issued a Position Paper on VCs; SARB 2014 <http://www.resbank.co.za>.

and transacted digitally and electronically.⁷ Such currencies are issued by private developers (not central banks or government authorities) and take the form of digital representations of value.⁸ The nature of VCs and subsequent problems that arise from it is illustrated best through a practical example. The most popular form of VCs is Bitcoin.⁹ The first notable characteristics of Bitcoin are its decentralised nature and anonymity.¹⁰ In other words, there is no central bank, government, management or borders and the users employ it as a trade instrument instead of national currency since there is no "paper trail".¹¹ Due to these characteristics, VCs have become effective vehicles for money laundering, the financing of terrorism and tax evasion. In order to curb the last mentioned, it is crucial that the question be answered whether VCs can be included in a taxpayer's gross income and how the inclusion of VCs will be ensured.

As was mentioned previously, the National Treasury gave the assurance of further guidance or regulations. However, it is a difficult task to regulate decentralised VCs for tax purposes due to its nature and characteristics. Subsequently, this raises the question about the "relevant authority" that has to issue guidance and regulations. This responsibility cannot rest on a single authority, for instance SARS, but has to include all relevant authorities, such as the SARB, the Financial Intelligence Centre and others.¹²

The Treasury's statement that the onus rest on the merchants to accept VCs or not, raises further questions. The problems that demand the SARB's attention, while on the other hand, certain issues must be dealt with by SARS. The problems faced by the SARB are merely ancillary to this study since these problems and/or their solutions may contribute to the main issues from a tax perspective. Regarding SARB, the problem is that VCs do not resort under the definition of "legal tender" as in the *South African*

⁷ National Treasury 2014 <http://www.treasury.gov.za>; He *et al* *IMF Virtual Currencies and Beyond* 7.

⁸ He *et al* *IMF Virtual Currencies and Beyond* 7.

⁹ For a visual explanation on the working of Bitcoin see CuriousInventor 2014 <https://youtu.be/I9j0k30eQs> and WeUseCoins 2014 <https://youtu.br/Gc2en3nHxA4>; Naidoo 2017 *MoneyWeb* 8; *Bitcoin* (uppercase) refers to the system and the currency as a whole, while *bitcoins* (lowercase) refer to individual coins; De Martino *Bitcoin Guidebook* xii; Other forms of virtual money include Ethereum, Ripple, Litecoin, Dash, Neo, Stellar and Dogecoin; the present study, however, focused mainly on Bitcoin; O'Connell 2016 <https://www.cryptocoinsnews.com>.

¹⁰ Which will be discussed more thoroughly in Chapter 2.

¹¹ DeMartino *Bitcoin Guidebook* 3-4; Voorhees 2015 <https://bitcoinmagazine.com>.

¹² SARB is the only authority that has issued a position paper on VCs; SARB 2014 <http://www.resbank.co.za>; In other words, to date, no action has been taken by SARS in respect of VCs.

Reserve Bank Act (SARBA).¹³ The mentioned definition only includes notes, coins and gold.¹⁴ However, this does not imply that VCs will not qualify as "money" from a South African banking and tax law perspective, or that transactions including VCs will be considered void.¹⁵ Also, if the transaction is considered void from a banking law perspective, this question exists as to whether it will also be void from a tax law perspective. Nonetheless, the National Treasury made it clear that there is no specific legislation or regulation governing VCs, but it did not specify whether existing legislation could be interpreted, adapted, and applied to VCs.¹⁶

Regarding applied legislation: If a merchant accepts VCs, the question is whether or not VCs can be included in that role-player's "gross income" as stipulated by the *Income Tax Act* (ITA).¹⁷ However, even if the merchant accepted VCs and SARS included these currencies in the taxpayer's "gross income", a further question arises: How would SARS become aware of such income? Not all taxpayers are law-abiding citizens who duly include these currencies in their annual tax return. The subsequent problem for SARS would be how to regulate VCs to avoid non-disclosure of income and tax evasion, in light of the mentioned (cf. the National Treasury) lack of specific legislation or regulation for VCs and whether existing legislation can be adapted to include VCs.

In light of the discussion above, the role-players involved should be taken into account, seeing that their tax consequences may differ as well as the legislation regulating each of them. Within the Bitcoin economy, the following role-players can be identified: "miners", Bitcoin exchanges, users and Bitcoin itself. The mining of bitcoins entails the following:

*The process of confirming Bitcoin transactions in groups called blocks by solving complex mathematical computations and then sending the transactions to the rest of the network. For doing this, miners are rewarded with small amounts of Bitcoin, which is how new bitcoins are made. Miners also receive small fees attached to transactions, which is what they have to subsist of when all 21 million bitcoins are mined, estimated to occur around 2140.*¹⁸

¹³ Section 17 of Act 90 of 1989; National Treasury 2014 <http://www.treasury.gov.za>.

¹⁴ Section 17 of SARBA.

¹⁵ In other words, VCs may constitute a method of payment.

¹⁶ See Chapter 4.

¹⁷ Section 1 of Act 58 of 1962.

¹⁸ Own emphasis; De Martino *Bitcoin Guidebook* xvii.

Therefore, mining may also have income tax consequences in the hands of the miner.¹⁹ Bitcoin exchanges, on the other hand, provide an online or mobile Bitcoin wallet to users as well as a market place to buy and sell bitcoins, and may also incur income tax consequences.²⁰ Due to the nature of Bitcoin exchange platforms, there are queries about its legislative regulation. These centre around avoiding money laundering, financing terrorism, or tax evasion.²¹ The user is a person who holds a Bitcoin wallet and trades or holds bitcoins. The form of taxation in respect of bitcoins held by the user will be determined with reference to the intention of the user. Finally, Bitcoin as such entails an entity on the Internet over which no state has exclusive jurisdiction.²² Bitcoin itself cannot be subject to South African tax legislation or national legislation that attempt to regulate it. Within itself, the Bitcoin economy has its own rules which may contrast with that of national legislation or regulation.

The present study, therefore, aimed at concluding that VCs can be included in the calculation of "gross income" for income tax purposes. The objectives were to explore the legal nature and classification of VCs, its tax consequences and regulatory challenges in order to determine whether VCs can be included in the calculation of "gross income". A further aim of this study was to determine how VCs will be included in the calculation of "gross income" if aim above had a positive conclusion. The objective was to find the answers to regulate and ensure inclusion by studying tax law and other fields of law such as banking and financial sector legislation. Another aim was to investigate whether there is a need for explicit legislation targeting VCs. The objective in this regard was to study existing legislation and determine whether it is sufficient to include and regulate VCs for tax law purposes.

1.2 Research questions

The primary research question to launch the present study was:

¹⁹ However, deduction may be allowed for the mining "rig", also known as the computer software used to mine bitcoins. The miner may also mine with the intention to hold bitcoins as an investment.

²⁰ Bitcoin date unknown <https://bitcoin.org>; De Martino *Bitcoin Guidebook* 4; there are different types of wallets – cold, hot, local, web and paper; See: De Martino *Bitcoin Guidebook* xiii, xvi-xviii, xx for the definitions of the abovementioned wallets.

²¹ For instance the *Prevention of Organised Crime Act* 121 of 1998 and the *Financial Intelligence Centre Act* 38 of 2002; See chapter 4.

²² See chapter 4.

What is the current legal position on the inclusion of virtual currencies when calculating income tax?

To answer this question, the following secondary research questions were formulated:

- Why do VCs not fall within the definition of "legal tender" in terms of section 17 of the SARBA?
- To what extent is VCs covered by the definition of "money"?
- Will a transaction where VCs are used as method of payment be declared void?
- To what extent does the receipt of VCs meet the requirements of the definition of "gross income" as in section 1 of the ITA?
- Which regulatory challenges are involved when VCs are included in the definition of "gross income"?
- How does the legal nature of VCs effect its regulation?
- How can current legislation be used to overcome the regulatory challenges that SARS faces in respect of VCs?

1.3 Research method and case study

The primary research methodology of the present study was a literature review of the relevant legislation, case law, textbooks and applicable electronic resources such as law journals. These sources were consulted to establish the South African position about VCs and to ascertain how existing legislation and case law can apply to VCs and help protect its users.²³ These sources were also applied to determine whether VCs can be included within the definition of "gross income" as in section 1 of the ITA.

Considering the regulatory challenges, a brief comparison was drawn between South Africa and the United States as the latter provides similar regulatory solutions to the South African law. Throughout the study, no single case study was used, rather several

²³ From the point of view of SARB and SARS.

case studies or examples were used in applying the principles, to help explicate the findings.

1.4 Framework of the study

The present chapter (ch 1) introduced the issues surrounding VCs within the South African context. The chapter highlighted VCs' lack of legal status in South Africa and questioned the legality and validity of transactions involving VCs. This chapter also identified the role-players within the VC economy and possible income tax consequences related to the specific activities or transactions involving these currencies.

Chapter 2 presents and discusses the definitions of "legal tender" and "money" as defined in legislation and outlined by scholars in the field of study. This is followed by a discussion of VCs' nature to answer the question whether VCs are legal tender, money, or an allowable method of payment, and motivate the findings. This identifies regulatory challenges due to the nature of VCs, to be discussed in chapter 4.

Chapter 3 focuses on the definition of "gross income", more specifically its three basic elements: an amount in cash or otherwise; received by or accrued to the taxpayer; and excluding receipts of capital nature. These elements are discussed in light of relevant case law, SARS interpretation notes, and electronic sources, after which they are applied to the context of VCs. The chapter concludes by answering the question whether VCs can be included in a taxpayer's "gross income".

Chapter 4 examines the regulatory challenges identified in the previous chapter. The aim is to define and discuss these challenges. The focus falls on the regulation of VCs by Bitcoin itself as well as by the South African and United States authorities, to reach conclusions on whether existing legislation is sufficient to regulate VCs.

Chapter 5 concludes by summarising the findings of the present study. The aim is to answer the general research question: What is the current South African legal position on the inclusion of VCs when calculating income tax? The findings to the secondary questions are discussed and this chapter provides the researcher's perspective, confirmed by supporting provisions and recommendations on the matter under investigation.

Chapter 2 Virtual currencies

2.1 Introduction

The notion of virtual currencies (VCs) is not unfamiliar to the present time, especially since that these currencies are, to an extent, disconnected from the value of the goods that it represents.²⁴ Historically, parties used to exchange desired goods such as vegetables for fruit.²⁵ Later on, people made payment through physical representations of value such as shells.²⁶ Finally, actual money was issued by banks. In the current era, parties are able to exchange VCs in the same way.²⁷ The rationale is that VCs, despite its diverse forms, also represent a value and can be used as payment in various contexts.²⁸ This chapter, therefore, explores the definition of "legal tender" and "money" as well as its application to VCs and thus, the validity of transactions with this new currency. However, first the nature of VCs should be established below.

2.2 Definition and operation of VCs

In its User Alert for 2014, the National Treasury defined "VCs" as a unit of account that is created and stored electronically and digitally.²⁹ The International Monetary Fund (IMF) also noted that VCs can be obtained and transacted electronically where the parties to the transaction have agreed to use this currency.³⁰ VCs are, however, more complex than a mere digital representation of "money's" value. This new currency is issued by private developers (Bitcoin) and the unit of account (bitcoins) by the holder is determined by the developers.³¹ The private developer (Bitcoin) also determines the number of units of an account that can be held and whether these units can be sold in fractions.³² In this regard, the number of bitcoins available is limited to 21 million; it can

²⁴ Nieman 2015 *PER* 1981.

²⁵ Nieman 2015 *PER* 1981.

²⁶ Nieman 2015 *PER* 1981.

²⁷ Nieman 2015 *PER* 1981.

²⁸ Nieman 2015 *PER* 1981.

²⁹ National Treasury 2014 www.treasury.gov.za 1.

³⁰ He *et al IMF VCs and Beyond* 7; Also see: Plassaras 2014 *CJIL* 377-407.

³¹ Bitcoins are held by users in their Bitcoin wallets; He *et al IMF VCs and Beyond* 7; see chapter 1.1.

³² He *et al IMF VCs and Beyond* 7.

also be transacted as a single bitcoin, in fractions (such as 0,05th of a bitcoin) or in multiples.³³

The diagram depicted in Figure 2-1 below and the subsequent discussion provides guidelines to understand the working of VCs.³⁴

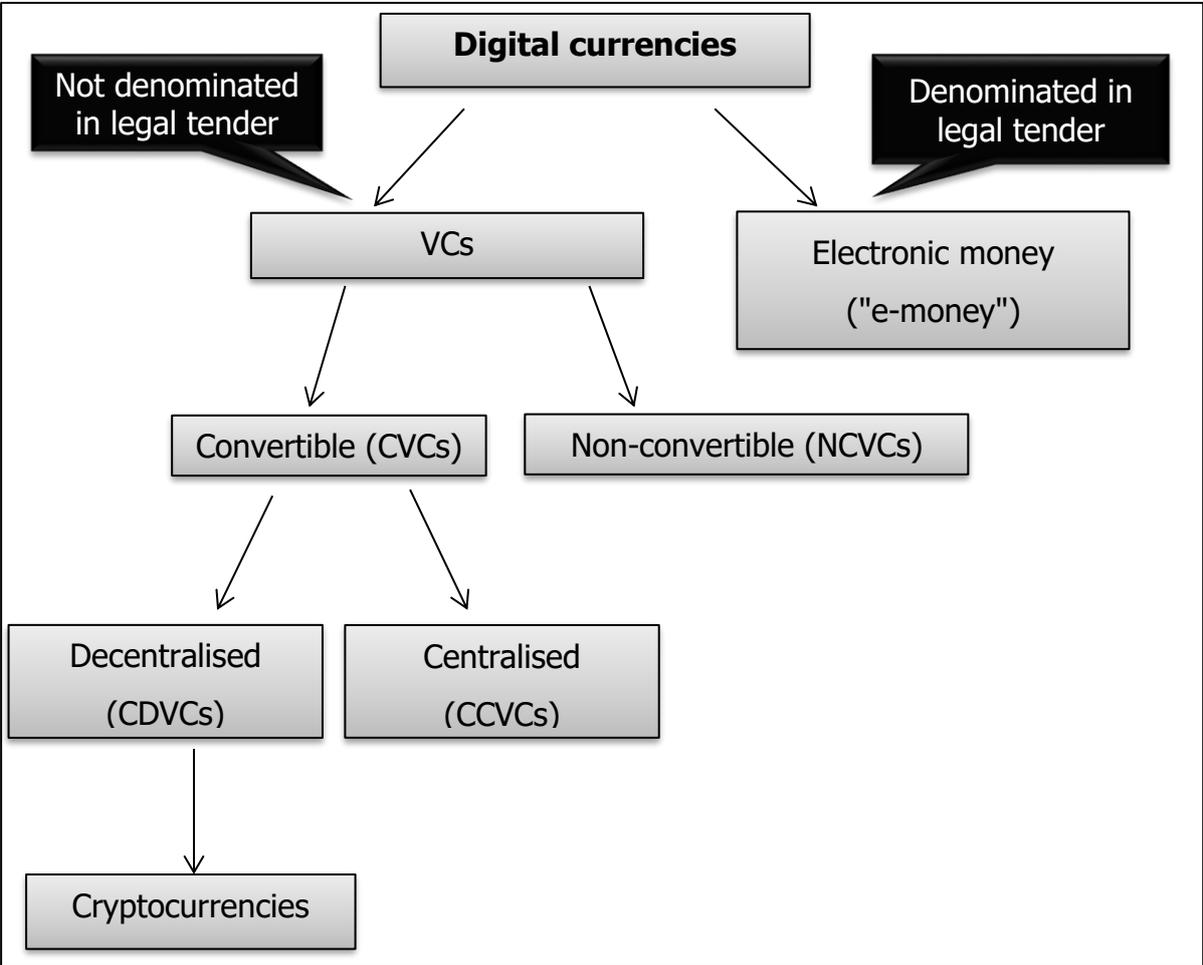


Figure 2-1: Classification of VCs.

A digital currency can be defined as follows:

[A] digital representation of either virtual currency (non-fiat) or e-money (fiat) and thus is often used interchangeably with the term virtual currency.³⁵

In light of this definition and inferred from the diagram above, it is evident that VCs resort under the category of digital currency along with electronic money (i.e. "e-money").³⁶ VCs can, therefore, be defined as:

³³ De Martino *Bitcoin Guidebook* 3.
³⁴ This diagram was adapted from Figure 1 in He *et al IMF VCs and Beyond* 7.
³⁵ FATF 2015 <http://www.fatf-gafi.org> 26.

... digital representation of value that can be digitally traded and function as (1) a medium exchange; and/or (2) a unit of account; and/or (3) store value, but does not have legal tender status ... in any jurisdiction.³⁷

On the other hand, e-money is a "digital payment mechanism" that is used for and denominated in fiat currency, which includes electronic fund transfers (EFTs).³⁸ Digital currencies can also be divided into those that cannot be denominated in legal tender (VCs) and those that can (e-money).³⁹

Within VCs itself, non-convertible (NCVCs) can be distinguished from convertible VCs (CVCs).⁴⁰ Regarding the convertibility of currency, the Financial Action Task Force (FATF)⁴¹ emphasised:

[T]he notion of "convertible currency" does not in any way imply an *ex officio* convertibility (e.g. in the case of gold standard), but rather *de facto* convertibility (e.g. because a market exists). Thus, a virtual currency is "convertible" only as long as some private participants make offers and others accept them, since the "convertibility" is not guaranteed at all by law.

NCVCs generally are centralised and cannot be exchanged for real currency as it operates in its own (virtual) milieu.⁴² This poses less risk to the public due to the closed nature of the virtual milieu in which it operates.⁴³ An example of a NCVC is a coin received in virtual games such as World of Warcraft.⁴⁴ Conversely, CVCs are either centralised or decentralised and can be exchanged for real currencies.⁴⁵

Convertible centralised VCs (CCVCs), on the one hand, requires a single administrator or authority that issues the currency, determines the rules regulating the currency and has the authority to remove the currency from circulation.⁴⁶ On the other hand,

³⁶ In other words, both "e-money" and virtual currency are digital representations of money; He *et al IMF VCs and Beyond* 7.

³⁷ FATF 2015 <http://www.fatf-gafi.org> 26; SARB 2014 <http://www.resbank.co.za> 2.

³⁸ He *et al IMF VCs and Beyond* 7; FATF 2015 <http://www.fatf-gafi.org> 2: "e-money" is a "digital representation of fiat currency used to electronically transfer value denominated in fiat currency"; Also see SARB 2009 <https://www.resbank.co.za/RegulationAndSupervision> 3.

³⁹ He *et al IMF VCs and Beyond* 8; see figure 1.

⁴⁰ He *et al IMF VCs and Beyond* 8.

⁴¹ FATF 2015 <http://www.fatf-gafi.org> 27.

⁴² He *et al IMF VCs and Beyond* 8; FATF 2015 <http://www.fatf-gafi.org> 27; "Non-convertible ... virtual currency is intended to be specific to a particular virtual domain or world ... and under the rules governing its use, cannot be exchanged for fiat currency"; SARB 2014 <http://www.resbank.co.za> 2.

⁴³ SARB 2014 <http://www.resbank.co.za> 3.

⁴⁴ FATF 2015 <http://www.fatf-gafi.org> 27; SARB 2014 <http://www.resbank.co.za> 2.

⁴⁵ FATF 2015 <http://www.fatf-gafi.org> 27; SARB 2014 <http://www.resbank.co.za> 2.

⁴⁶ FATF 2015 <http://www.fatf-gafi.org> 27.

convertible decentralised VCs (CDVCs) have no administrating authority and are "distributed, open-source, math-based peer-to-peer VCs".⁴⁷ Therefore, the creation of the currency, the verification of transactions and cross-border transfer of funds are performed and controlled by the users and not by a central bank or authority.⁴⁸ Furthermore, CDVCs are also known as "cryptocurrencies", which include Bitcoin, Litecoin and Ripple.⁴⁹

2.2.1 Cryptocurrencies

In 2016, there were over 600 cryptocurrencies in existence.⁵⁰ Such currencies are also known as crypto-assets or crypto-money and can be described as:

... math-based ... protected by cryptography – i.e., it incorporates principles of cryptography to implement a distributed, decentralised, secure information economy.⁵¹

From the definition above, it is evident that cryptocurrencies are derived from cryptography. Cryptography is a mechanism that uses the public and private keys to encode the rules of a cryptocurrency system securely through mathematical equations and on a peer-to-peer basis.⁵² A cryptocurrency, therefore, depends on a public and private key in order to transfer its value between parties.⁵³ It should be clear from the description above that cryptocurrencies are not based on the traditional money and banking systems, nor is it backed by a country's central bank or by gold reserves.⁵⁴

Additionally, Maxwell⁵⁵ explains the working of cryptocurrency through an analogy to the stones of the Yap people in the Pacific Islands. In the 1900s, the Yap used large, unmovable stone coin disks to buy larger goods. Since these discs could not be moved, ownership was merely transferred and the knowledge of ownership was public nature. Thus, it was difficult to commit fraud, seeing that no person could spend another

⁴⁷ FATF 2015 <http://www.fatf-gafi.org> 27; SARB 2014 <http://www.resbank.co.za> 2.

⁴⁸ SARB 2014 <http://www.resbank.co.za> 3.

⁴⁹ FATF 2015 <http://www.fatf-gafi.org> 27.

⁵⁰ Creamer's Media 2016 www.engineeringnews.co.za; FATF 2015 <http://www.fatf-gafi.org> 27.

⁵¹ Blockchain Technologies date unknown www.blockchaintechologies.com; FATF 2015 <http://www.fatf-gafi.org> 27; De Martino *Bitcoin Guidebook* vii: "Any digital currency that uses cryptography to secure its system or users' identities and account holdings."

⁵² Also known as "mining" in the Bitcoin context; Narayanan *et al Bitcoin and Cryptocurrency Technologies* 1; FATF 2015 <http://www.fatf-gafi.org> 27-28.

⁵³ FATF 2015 <http://www.fatf-gafi.org> 27; De Martino xiv, 4.

⁵⁴ Creamer's Media 2016 www.engineeringnews.co.za.

⁵⁵ Maxwell 2014 www.cryptocurrencymadesimple.com; also see: De Martino *Bitcoin Guidebook* 4-7.

individual's disc, the same disc could not be spent twice, and the currency could not be faked.⁵⁶ As the case is with the large Yap stones, bitcoins cannot be moved around as it stay fixed on the "blockchain", namely a public ledger that keeps track of every transaction and account that the users hold.⁵⁷ Anyone can confirm ownership of a bitcoin on the "blockchain". Furthermore, like the large Yap stones, it is difficult to commit fraud with VCs, seeing that no one can spend another's bitcoin and the same unit cannot be spent twice. Furthermore, the currency cannot be faked since cryptography is needed to solve a complex mathematical equation in order to create a bitcoin.⁵⁸

2.3 Advantages and disadvantages of virtual and crypto-currencies

The previous paragraph mentioned certain advantages of VCs. Further advantages and disadvantages are discussed below.

2.3.1 Advantages of cryptocurrencies

Regarding Bitcoin in particular, a transaction cannot be reversed and the risk involved for each party to the agreement is minor.⁵⁹ Most cryptocurrencies are considered "borderless, fast, cheap and easy".⁶⁰ In other words, cryptocurrency makes payment more efficient and keep transaction costs relatively low.⁶¹ The borderless nature and affordability of VCs can also promote financial inclusion. This is significant at a regional level (Africa),⁶² seeing that it can facilitate the transfer or "sending" of money across

⁵⁶ A new stone had to be carved to accomplish this. One of the advantages of digital assets in general is that it cannot be duplicated; Maxwell 2014 www.cryptocurrency-madesimple.com; Also see: De Martino *Bitcoin Guidebook* 4-7; De Villiers and Sher 2015 *PER* 60.

⁵⁷ De Martino *Bitcoin Guidebook* xiii.

⁵⁸ De Martino *Bitcoin Guidebook* 17.

⁵⁹ De Villiers and Sher 2015 *PER* 60: The view of De Villiers and Sher is that the irreversibility of Bitcoin substantially mitigates the possibility of fraud, is not completely true. Although the feature of irreversibility is attractive to "law-abiding" users, it does not prevent them from misrepresenting their identity or using VCs surreptitiously.

⁶⁰ De Villiers and Sher 2015 *PER* 60; SARB 2014 <http://www.resbank.co.za> 5.

⁶¹ FATF 2015 <http://www.fatf-gafi.org> 31, De Villiers and Sher 2015 *PER* 60; This is evident in cases where global transactions take place and exchange fees are avoided, or where cryptocurrencies can facilitate already-existing online payment systems such as PayPal and PayFast as well as online stores such as takealot.com. However, by avoiding exchange fees, users could possibly circumvent the Exchange Control Regulations of 1961; SARB 2014 <http://www.resbank.co.za> 10-11; PayFast 2015 <https://www.payfast.co.za/2015/06/05/10>; see GN R445 in GG 35430 of 8 June 2013 for the amended Exchange Control Regulations of 1961.

⁶² See: Oji *Promoting Financial Inclusion* 5-7.

borders at none to low cost. A final advantage that could be highlighted of cryptocurrencies, more specifically Bitcoin, is the limited number of units in circulation, whereby inflation is controlled.⁶³

2.3.2 Disadvantages of cryptocurrencies

The disadvantages include the facilitation of money laundering and tax evasion due to the decentralised and anonymous nature of these cryptocurrencies.⁶⁴ Such currencies are also used as a method of payment for the Dark Web in order to trade in illegal sales such as military equipment.⁶⁵ Scant protection is offered to consumers as compensation for loss should the cryptocurrency fail or its value fluctuate.⁶⁶

The SARB identified several risks to consumers:⁶⁷ (a) loss and theft due to a breach of security; (b) a user error or a technological failure of the wallet; (c) fraud or unauthorised use; (d) processing error in the transaction; (e) absence of insurance to users;⁶⁸ and (f) no obligations on wallet operators to make certain disclosures, such as regarding fees and charges. In addition, cryptocurrencies also create a risk of financial instability through the connection between these currencies and the real economy.⁶⁹ Finally, it must be mentioned that there is growing uncertainty about the legal and regulatory framework governing VCs.⁷⁰

After outlining the basic definition, classification and principles regarding VCs, the following correlating concepts are examined below: "legal tender" and "money".

⁶³ This is arguably one of the most attractive characteristics of cryptocurrencies for investment purposes. However, the advantageous nature of this characteristic is debatable in light of the volatility of Bitcoin in particular. In addition, notably this is not a closed list of advantages; De Villiers and Sher 2015 *PER* 60; FATF 2015 <http://www.fatf-gafi.org> 31.

⁶⁴ De Villiers and Sher 2015 *PER* 59; FATF 2015 <http://www.fatf-gafi.org> 3, 31; SARB 2014 <http://www.resbank.co.za> 5, 7-9.

⁶⁵ De Villiers and Sher 2015 *PER* 60.

⁶⁶ This protection entails the safety and efficiency of the payment systems and payment service providers who contract with users to render services, and provide price stability; SARB 2014 <http://www.resbank.co.za> 6-7, 9; the possible applicability of the *Electronic Communications and Transactions Act* 25 of 2002 is cause for further study.

⁶⁷ SARB 2014 <http://www.resbank.co.za> 10.

⁶⁸ See: Abramowicz 2015 *Wake Forest L Rev* 671-709 for a comprehensive discussion on crypto-insurance.

⁶⁹ SARB 2014 <http://www.resbank.co.za> 12.

⁷⁰ SARB 2014 <http://www.resbank.co.za> 6.

2.4 "Legal tender"

2.4.1 Definition

VCs do not have legal tender status in South Africa or in any other jurisdiction.⁷¹ Section 17(1) of the SARBA stipulates that notes issued by the SARB are deemed to be "legal tender",⁷² while section 17(2) provides that gold coins and other coins will be regarded as a "legal tender".⁷³ In other words, the only recognised "legal tender" in South Africa entails notes, coins and gold coins.⁷⁴ However, the question arises whether other methods of payment could qualify as "legal tender".

The question above can be illustrated by referring to a real-life scenario.⁷⁵ In 2013, Standard Bank refused to accept cheques for the settlement of accounts on behalf of the municipality of the City of Johannesburg (City).⁷⁶ Debtors to the City were still allowed to pay with cash, credit or debit cards, or electronic transfer (EFT).⁷⁷ In response to this decision, the members of the public argued that they are tendering a cheque, namely a legal form of payment, which cannot be refused by the City.⁷⁸ The City's revenue spokesperson, Kgamanyane Stan Maphologela, responded that although cheques are a legal tender in South Africa, any prospective recipient has a right to decline it.⁷⁹ The latter part of Maphologela's statement has been supported by legal scholars,⁸⁰ whereas the former part was refuted. In the former part, Makakaba emphasises that "a valid cheque represents money" but "it is trite law that a cheque is

⁷¹ VCs enjoyed legal tender status in China for a brief period in 2017; FATF 2014 <http://www.fatf-gafi.org> 26; National Treasury 2014 www.treasury.gov.za 2.

⁷² As well as outstanding notes of other banks. In this case, an amount equal to that specified on the note will be deemed a legal tender. SARB should also have "assumed liability in terms of section 15(3)(c) of the *Currency and Banking Act* 31 of 1920 or in terms of any agreement entered into with another bank before or after the commencement" of the SARBA; s 17(1) of SARBA.

⁷³ Section 17(2)(a) and (b) of SARBA; "... undefaced and unmutilated coin which is lawfully in circulation in the Republic and of current mass ..."

⁷⁴ It is important to note that not all gold coins are deemed to be a legal tender. A further question would be whether the virtual currency can be considered as a "legal tender" due to its similarities with gold coins, or rather a commodity due to its similarity with gold.

⁷⁵ Cox 2013 www.iol.ac.za.

⁷⁶ Cox 2013 www.iol.ac.za.

⁷⁷ Cox 2013 www.iol.ac.za.

⁷⁸ Cox 2013 www.iol.ac.za.

⁷⁹ Maphologela interpreted legal tender incorrectly, seeing that his interpretation is not in line with section 17 of SARBA; Cox 2013 www.iol.ac.za.

⁸⁰ Subramanien 2014 *Obiter* 389.

neither money nor a legal tender".⁸¹ Therefore, the difference between a legal tender, money, and a legal method of payment should be noted.⁸²

However, VCs cannot be considered "legal tender", even though it is an acceptable method of payment. In its Position Paper on VCs, the SARB stated that it is the only authority allowed to issue legal tender in South Africa, and that such a tender can be offered legally as payment in South Africa, which obliges a creditor to accept it.⁸³ The National Treasury affirmed that any potential receiver of VCs may refuse to accept payment by cryptocurrencies and will thus, not be in breach of law, seeing that these currencies are not regarded as a legal tender.⁸⁴ Therefore, parties may use VCs as a method of payment provided that they agreed upon it.

This raises a further question, namely whether the virtual currency can be viewed as a legal tender due to its similarity to gold coins, or a commodity based on its similarity to gold.

2.4.2 *Gold coins*

It is important to note that not all gold coins are considered as a legal tender – only Krugerrands and the Natura and Protea range.⁸⁵ These coins are purchased for its inherent value based on the substance from which it is produced, calculated according to its spot price in US dollars.⁸⁶ However, gold coins can serve as both legal tender and commodity.

⁸¹ Makakaba 2012 *Obiter* 627; Subramanien 2014 *Obiter* 389.

⁸² Also see: Du Toit 2014 *TSAR*; Schulze 2004 *SA Merc LJ*.

⁸³ It should be noted that even though cryptocurrencies are not recognised as legal tenders, it can be exchanged for legal tenders and can be used to acquire real-world services and goods if the receiver agrees to it beforehand; SARB 2014 <http://www.resbank.co.za> 4-5; National Treasury 2014 www.treasury.gov.za 2.

⁸⁴ National Treasury 2014 www.treasury.gov.za 2; SARB 2014 <http://www.resbank.co.za> 5.

⁸⁵ JSE 2014 <https://www.jse.co.za/trade/equity-market/krugerrands>; FNB date unknown <http://www.fnb.co.za>; SARB date unknown <http://www.resbank.co.za/MonetaryPolicy>.

⁸⁶ SARB date unknown <http://www.resbank.co.za/MonetaryPolicy>; Jones 2007 *Personal Finance Letter* 4.

2.4.2.1 Gold coins as a legal tender

When considering gold coins, Krugerrands can be used as a legal tender in terms of section 17(2)(a) of the SARBA.⁸⁷ Oelofse,⁸⁸ however, critiques the notion that the Krugerrand is a legal tender as the nominal value is not expressed in terms of coinage units, thereby lacking a fundamental attribute of money. Disagreeing with Oelofse, Pretorius⁸⁹ relies on section 17(2)(a) in order to submit that a Krugerrand should be regarded as a legal tender even if it does not have a nominal value expressed in coinage units. If applied to VCs, Pretorius's arguments still suffice. Similar to the Krugerrand, VCs do not have a nominal value stated on it, seeing that it is an intangible currency. Nevertheless, VCs remain a similar "size" and can be spent in fractions, while this is not the case with the Krugerrand.⁹⁰ In addition, the value of VCs as well as those of Krugerrands does not remain constant.⁹¹

Furthermore, Pretorius⁹² poses the question whether, despite the content of section 17(2)(a), a person may refuse to accept Krugerrands as payment. A practical consideration in favour of the refusal is the situation of merchants. They do not all have access to the following resources: a scale to weigh such a coin; means to determine the value of the coin; being educated on the authenticity of the coin. Regarding VCs, merchants may also refuse to accept these currencies without being in breach of the law,⁹³ since the exact practical considerations mentioned above for Krugerrands, govern VCs. In other words, all merchants do not have a wallet to hold VCs, or have access to means that can determine the value of these cryptocurrencies, nor are they educated about the authenticity and use of VCs.

⁸⁷ When Krugerrands were first minted and prior to the establishment of SARBA, section 12(1)(a) of the *South African Mint and Coinage Act 78 of 1964* identified "any Republican gold coin" (including the Krugerrand) as a "legal tender"; Pretorius 2004 *SA Merc LJ* 466.

⁸⁸ As per Pretorius 2004 *SA Merc LJ* 467.

⁸⁹ Pretorius 2004 *SA Merc LJ* 468.

⁹⁰ However, Krugerrands can be spent in terms of existing coin fractions, for example, the quarter-ounce Krugerrand.

⁹¹ Both depend on factors such as supply and demand; JSE 2014 <https://www.jse.co.za/trade/equity-market/krugerrands>.

⁹² This can also apply in the absence of an agreement about the nominal value of the Krugerrand; Pretorius 2004 *SA Merc LJ* 468.

⁹³ Chapter 2.3.1; National Treasury 2014 www.treasury.gov.za 2.

2.4.2.2 Gold coins as a commodity⁹⁴

When referring to gold coins, it is important to understand the two categories: *commodity* coins, namely, those with rarity value (so-called "collectable coins" such as Mandela R5 coins); and *bullion* coins with inherent value due to the material of which it is made (which includes Krugerrands).⁹⁵ The discussion in this chapter focuses on the bullion category. The Krugerrand is classified as a bullion coin since new coins are minted annually and there is no significant difference between a Krugerrand minted in 1980 and in 2012.⁹⁶ Conversely, for a cryptocurrency such as Bitcoin only a limited number are available and only a certain amount can be "mined" in a specific period. Therefore, bitcoins could possibly be recognised as intangible currency with rarity value. However, to a certain extent, it also has an inherent value due to its digital nature.⁹⁷ Investing in bullion and/or VCs has numerous advantages.⁹⁸ However, for the purpose of the present discussion, only the possible tax consequences of these cryptocurrencies are of importance.

⁹⁴ Also see: Baur and McDermott 2009 *EV Journal on Banking and Finance* 1886-1888; Bouri *et al* 2016 *EV Finance Research Letters* 193, 197; Botha *et al* *Financial Planning Handbook* 462; JSE 2014 <https://www.jse.co.za/trade/equity-market/krugerrands>; and Dyhrberg 2016 *EV Financial Research Letters* 142 for information concerning the history and investment features of gold.

⁹⁵ Bullion coins, as mentioned in chapter 2.4.1, derive its value from the intrinsic value of the metal of which it is produced, where coins with rarity value derive its value from the limited amount of particular coins available; Jones 2007 *Personal Financial Letter* 4.

⁹⁶ Jones 2007 *Personal Financial Letter* 4.

⁹⁷ In addition, the JSE suggests that although Krugerrands are afforded legal tender status, they are not intended to be used as a currency. However, the converse is true for cryptocurrencies such as Bitcoins – it is intended to be used as a currency but does not have legal tender status; JSE 2014 <https://www.jse.co.za/trade/equity-market/krugerrands>; De Filippi disagrees: "As a digital cryptocurrency, bitcoin has no intrinsic value, per se." However, De Filippi provides no reason for this claim; De Filippi 2014 *IPR* 2.

⁹⁸ One of the key gains when investing in gold bullion is that the investor holds a physical or tangible and portable investment, of which the value does not necessarily depend on the performance of a gold mine. VCs, however, are intangible and not physically portable, unless carrying a mobile phone around with a mobile wallet qualifies it as being "portable". Similar to gold, the value of VCs does not depend on future-earnings or debt – as with gold market stock. Gold is also readily marketable. For VCs, the theory about to the law of one price could also apply as in the case of gold. Furthermore, VCs may have an advantage over gold, as VCs such as Bitcoin, is continually open to trade; See: Botha *et al* *Financial Planning Handbook* 462; Jones 2004 *SA Merc LJ* 4; JSE 2014 <https://www.jse.co.za/trade/equity-market/krugerrands>; Brümmer and Rademeyer "Ontleding en waardering" 288-296; Baur and McDermott 2009 *EV Journal on Banking and Finance* 1888; Jones 2007 *Personal Financial Letter* 4-5; FNB date unknown <http://www.fnb.co.za>; and Dyhrberg 2016 *EV Financial Research Letter* 140; Bouri *et al* 2016 *EV Finance Research Letters* 197; Also see Naidu *The Law of One Price on Bitcoin* 21 for the law of one price.

Where the Krugerrand is held as a commodity and an individual alienates this currency, after the alienation the one who made the disposal is liable for capital gain tax.⁹⁹ If the Krugerrand is deemed a "legal tender", there is the possibility of income tax consequences should a person be remunerated in Krugerrands for services rendered.¹⁰⁰ It is submitted that the same tax-liability consequences should follow a similar legal route for VCs.¹⁰¹

Therefore, both Krugerrands and VCs can be considered as a legal tender or as a commodity. Although VCs cannot be viewed as a "legal tender", it could be dealt with as "money" or a valid method of payment.

2.5 "Money"

It should be noted, as indicated by Schulze and Pretorius,¹⁰² that although a legal tender can be considered as money, the latter is not necessarily a legal tender. Before "money" in the simplest sense of the word (coins and banknotes), parties bartered with tangible objects.¹⁰³ Schulze¹⁰⁴ points out that the concept of money is currently undergoing changes to include more modern variations of such a medium.

There is no definition of "money" in South African legislation and, as a result, the researcher consulted literature to find a suitable definition of this concept.¹⁰⁵ Mann¹⁰⁶ suggests that:

[I]n law, the quality of money is to be attributed to all chattels which, issued by the authority of law and denominated by the authority of law and denominated with regard to a unit of account, are meant to serve as a universal means of exchange in the state of issue.

⁹⁹ In terms of Schedule Eighth to the ITA.

¹⁰⁰ This also depends on the individual's intention; See chapter 3.

¹⁰¹ See chapter 3.

¹⁰² Pretorius 2004 *SA Merc LJ* 468; Schulze 2004 *SA Merc LJ* 51.

¹⁰³ One of earliest objects was cowrie – the egg-shaped shells of molluscs originating from the shallower stretches of the Pacific and Indian oceans. Cowries were found to be "ideally suited to serve as a currency" since it bore religious and ornamental qualities. It was also sturdy, could be counted and cleaned easily. In addition, cowries were nearly impossible to counterfeit or imitate. Thereafter, several other objects were used as money until pre-coinage metallic money was used and later, coins and banknotes as currently known to the general public; Schulze 2004 *SA Merc LJ* 50.

¹⁰⁴ Schulze 2004 *SA Merc LJ* 50.

¹⁰⁵ This is not defined by the SARB either; Du Toit 2014 *TSAR* 806.

¹⁰⁶ Mann *Legal Aspects of Money* as per Du Toit 2014 *TSAR* 806; Also see: Yermack 2013 *NBER* 2, 9-16.

The deficiency with Mann's definition appears to be its reference to "chattels". In law, "chattels" are known as tangible and movable personal property.¹⁰⁷ Due to the nature of such property, most modern variations of money would not satisfy Mann's definition. Years later, Proctor¹⁰⁸ suggested a corrective as the essential characteristics of money:

- (a) it must be expressed by reference to a name and denominated by reference to a unit of account which, in each case, is prescribed by the law of the state concerned;
- (b) the currency and unit so prescribed must be intended to serve as a generally accepted measure of value and medium of exchange within the state concerned; and
- (c) the legal framework for currency must include a central bank or monetary authority responsible for the issue of the currency, and including the appropriate institutional provisions for its management through the conduct of monetary policy and the oversight of payment systems.

Regarding (a) above, based on both definitions of Mann and Proctor, it is evident that individual states have monetary sovereignty. According to the IMF, monetary sovereignty includes the following exclusive rights afforded to states: to issue currency; determine and change the value of that currency; and to regulate its use.¹⁰⁹ These exclusive rights are also explicated in section 14(1) and 15(1) of the SARBA. Considering (b) above, virtual currency is not a "generally accepted measure of value" by the National Treasury, nor is it an accepted "medium of exchange in the state concerned".¹¹⁰ Concerning (c), VCs do not carry the status of central bank. Bitcoin does have a creator, Satoshi Nakamoto, which implies that Bitcoin as such has rules.¹¹¹

To conclude: Based on Mann's definition and Proctor's correctives, VCs do not amount to "money" in the classic sense. However, regarding more current variations of money, Schulze¹¹² posits:

Perhaps it is safest not to try and provide an all-encompassing definition of money, but rather to leave the definition of money to be worked out, as the varying needs of the new and modern applications appear to require.

In this light, the basic characteristics that modern money variations require in order to be considered legally as "money" can be outlined as follows:¹¹³

¹⁰⁷ Merriam-Webster date unknown <https://www.merriam-webster.com>.

¹⁰⁸ Proctor *Mann on the Legal Aspects of Money* 41; Du Toit 2009 *TSAR* 4; Also see: Yermack 2013 *NBER* 2; 9-16.

¹⁰⁹ Gianviti 2014 <https://www.imf.org> 2.

¹¹⁰ National Treasury 2014 www.treasury.gov.za 1-2.

¹¹¹ De Martino *Bitcoin Guidebook* xxii, 23.

¹¹² Schulze 2004 *SA Merc LJ* 50.

- It must be commonly accepted as a medium of exchange, and not considered as goods, wares or merchandise.
- It should not be linked to the credit of the transferor. Put differently, it should be given and accepted as final payment of a debt.
- It should pass freely by mere delivery.
- It should be self-contained, requiring no collection, clearing or settlement and leaving no record.
- The transferee should be able to take it free of the claims of prior owners or holders.¹¹⁴

When considering the characteristics above, VCs possibly fail to meet the basic traits of money.¹¹⁵ The first characteristic cited above implies that the variation of modern money in question must be accepted commonly as a means of exchange. However, it does not state by whom this common acceptance must take place. From the definitions above, it can be inferred that the central bank or authority should recognise VCs as a means of exchange. However, the public users on the Internet have already accepted VCs as such, for example, bitcoins can be used to purchase items on the platform takealot.com.¹¹⁶ In addition, VCs can also be provided and accepted as a final debt between parties who have agreed to settle their transaction through these cryptocurrencies.

On the other hand, it was pointed out above that VCs are not considered as legal tenders in South Africa. Therefore, no creditor can legally demand payment in VCs.¹¹⁷ The basic characteristics imply that modern variations functioning as money should also be transferred through delivery. Thus, it can be accepted that delivery takes place once a bitcoin has been "mined" and is available in a user's Wallet.¹¹⁸ VCs can also be considered independent and complete units in its own right. The finally-mentioned characteristic requires that this modern variation of money should be transferred free from the claims of previous owners. Due to the nature of VCs, these currencies can be transferred without claims attached to it.

¹¹³ Schulze 2004 *SA Merc LJ* 50-51.

¹¹⁴ Schulze 2004 *SA Merc LJ* 51.

¹¹⁵ I.e. excluding the second half presented by the first bullet.

¹¹⁶ PayFast 2015 <https://www.payfast.co.za/2015/06/05/10>.

¹¹⁷ National Treasury 2014 www.treasury.gov.za 1-2.

¹¹⁸ Defining the moment of delivery is a topic for further research.

To summarise, the legislature presents no legally-accepted definition of "money". Therefore, it is possible that virtual currency as a modern variation of money can be accepted as such, even if it does not imply a legal tender.

2.6 Conclusion

In conclusion, DCVCs or cryptocurrencies are not considered as "legal tenders" under South African law. Due to its decentralised nature, cryptocurrencies may not be able to reach the status of such a tender. However, these currencies are accepted as a valid method of payment, should the parties agreed to it prior to the transaction.¹¹⁹ If merchants choose to accept payment by VC, there is a possibility that the receipt of this currency will be included in their income tax. The possible inclusion of VCs within the calculation of a taxpayer's income tax will be explored in the following chapter (ch 3).

In addition, due to the decentralised and anonymous nature of VCs, it is also evident that certain individuals may exploit these cryptocurrencies to avoid and evade taxes. These regulatory challenges will be defined and discussed in chapter 4.

¹¹⁹ Although parties can agree on payment through cryptocurrencies prior to the transaction, it is unclear whether South African legislation, such as the *Electronic Communications and Transactions Act* 25 of 2002, provide remedies to aggrieved parties should there be arbitrary consequences.

Chapter 3 Income tax consequences

3.1 Introduction

The National Treasury's User Alert (2014) established that it is the merchant's choice to accept virtual currencies (VCs) or decline it. Therefore, if a merchant accepts VCs, this raises the question on how these currencies reflect the various elements of the definition for "gross income" according to the *Income Tax Act* (ITA).¹²⁰ Since VCs are not regulated by SARS, individuals may not feel compelled to include these currencies in their tax returns, and/or it can even lead to tax evasion as there is no paper trail. The means of regulation for VCs will be discussed in the following chapter (ch 4).

3.2 Definition of "gross income"

The definition of "gross income" can be found in section 1 of the ITA and the interpretation of its elements is provided in case law and SARS Interpretation Notes.¹²¹ The respective elements describing gross income are: an amount in cash or otherwise; received by or accrued to the resident; and excluding receipts or accruals of capital nature.¹²² These elements must, therefore, be reflected by VCs.

3.3 Distinct VC transactions

VCs, as is the case with other variations of property, are either considered as capital or income when it is disposed of. Regarding Bitcoin in particular, there are three distinct transactions throughout the Bitcoin-lifecycle which may have possible tax consequences.¹²³ The first transaction concerns the acquisition of bitcoins through mining.¹²⁴ The second entails receipt of bitcoins in exchange for goods or services; in

¹²⁰ Section 1 of Act 58 of 1962.

¹²¹ The definition of "gross income" in terms of s 1: "'Gross income', in relation to any year or period of assessment, means- (i) in the case of any resident, the total amount in cash or otherwise, received by or accrued to or in favour of such resident; or (ii) in case of any person other than a resident, the total amount in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of capital nature."

¹²² Section 1 of the ITA; Olivier and Van den Berg *Praktiese Boedelbeplanning* 65; Croome *et al Tax Law: An Introduction* 65.

¹²³ Parsons 2014 *Accounting perspectives in SA* 19; Parsons "What is Bitcoin?" 8-9.

¹²⁴ This transaction will possibly draw income tax consequences; Parsons 2014 *Accounting perspectives in SA* 19.

other words, acquiring bitcoins based on an underlying transaction or agreement.¹²⁵ The third transaction concerns the exchange of bitcoins for legal tender; in other words, the disposal of bitcoins for South African rand.¹²⁶ Each of these transactions has different tax consequences; they will be included either in the taxpayer's gross income, or will be taxed as a capital gain.¹²⁷

3.4 Total amount in cash or otherwise

The "total amount in cash or otherwise" does not refer solely to money,¹²⁸ but also to the "value of any form of property earned by the taxpayer".¹²⁹ This property can take the form of either corporeal or incorporeal goods, provided that it holds money value.¹³⁰ The court attempted to define "money value" in *CIR v Delfos* 1933 AD 242 (*Delfos*), and held that if an object has "no value in money or cannot be turned into money", it cannot serve as income.¹³¹ However, in the preceding case of *Lategan v CIR* 1926 CPD 203 (*Lategan*), the court maintained that the property should have an "ascertainable money value".¹³² This term generally refers to the market value of the property as

¹²⁵ For example, an employment contract. Such a transaction will also have income tax consequences. This includes services delivered by Bitcoin exchanges; Parsons 2014 *Accounting perspectives in SA* 19.

¹²⁶ This transaction will possibly have capital gains tax consequences in terms of section 26A and Schedule 8 to the ITA; Parsons 2014 *Accounting perspectives in SA* 19.

¹²⁷ In terms of section 26A of the ITA and Schedule 8 to the ITA; Parsons 2014 *Accounting perspectives in SA* 19.

¹²⁸ Money in the simplest sense – cold, hard cash.

¹²⁹ Stiglingh *et al Silke* 2017 16; *Lategan v CIR* 1926 CPD 203 209; Croome *et al Tax Law: An Introduction* 66.

¹³⁰ Stiglingh *et al Silke* 2017 16; *Lategan v CIR* 1926 CPD 203 209; *CIR v People's Stores (Pty) Ltd (Walvisbay)* 1990 2 SA 353 (A); *CSARS v Brummeria (Pty) Ltd* 2007 6 SA 602 (SCA) para 15; Croome *et al Tax Law: An Introduction* 66.

¹³¹ Stiglingh *et al Silke* 2017 16; Croome *et al Tax Law: An Introduction* 66; *Delfos* 1933 AD 242 246-249, 251; In *Delfos*, the taxpayer was a director of a company who did not receive his full salary from 1923 to 1929. In 1930 the company paid him the outstanding amount which was due to him in the respective years. In some of his returns the taxpayer included the whole amount even if he did not receive it, and in other years he only included what he received. The outstanding amount that was owed to him was included by the Commissioner in his gross income in 1930. The question before the court was whether the outstanding amount falls within the year of assessment (1930) or whether it should be reverted to the unpaid years – see subsequent paragraph.

¹³² *Lategan* 209; confirmed by *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301 318, 319; Spiro 1973 *CILSA* 200; In *Lategan*, "The taxpayer sold wine in one year of assessment, but payment was only due in the following year of assessment." Furthermore, "The Commissioner claimed that the whole purchase price should be included in the appellant's gross income for the year ending 30th June, 1920. The appellant contended that the instalments payable after June, 1920, should be excluded, and the first question submitted for our decision is whether the instalments payable after June, 1920, should be included in or excluded from the appellant's gross income for the year ending 30th June, 1920"; *Lategan* 207; Jansen van Rensburg 2008 *Stell LR* 38; Croome *et al Tax Law: An Introduction* 66.

assessed on the date of receipt or its accrual – which will be included in the taxpayer's gross income.¹³³ The court in *CSARS v Brummeria Renaissance (Pty) Ltd* 2007 6 SA 602 (SCA) (*Brummeria*) disagreed with the principle laid down in *Delfos* and held that the test to ascertain whether property has money value is objective and not subjective.¹³⁴ The respondents (*Brummeria*) relied on *Stander v CIR* 1997 3 SA 617 (C) (*Stander*) to further their argument that the receipt and right to use an interest-free loan could not be converted into money value.¹³⁵

In *Brummeria*, the respondents were granted an interest-free loan as *quid pro quo* for a "lebensreg" (life right) of the units which the respondents were developing with the loan capital.¹³⁶ The Commissioner sought to have the interest-free loan included in the respondent's assessment. This was done on the grounds that the right to receive and use loan capital without having to repay it with interest, has an ascertainable money value and the fact that such value was received by the respondents.¹³⁷ The primary question was, therefore, whether a receipt or accrual in the form of goods that does not constitute money has money value.¹³⁸ The court referred to *Cactus Investments (Pty) Ltd v CIR* 1999 1 SA 315 (SCA)¹³⁹ and held that gross income:

... includes ... not only income actually received, but also *rights of a non-capital nature* which accrued during the relevant year and [*rights that*] are capable of being valued in money ... The judgment in the *People's Stores* case tells us that no more is required for an accrual than that *the person concerned has become entitled to the right in question*.¹⁴⁰

¹³³ More specifically, "market value" is described as the "price that could be obtained between a willing buyer and seller in an open market"; Stiglingh *et al Silke* 2017 16; *Lace Proprietary Mines Ltd v CIR* 1938 AD 267 268, 274, 280-281.

¹³⁴ The court's interpretation of the principle laid down in *Delfos* indicated that the court (in *Delfos*) applied a subjective test rather than an objective one; *Brummeria* paras 14-15; Stiglingh *et al Silke* 2017 17. Also see: Jansen van Rensburg 2008 *Stell LR* 34-50 for a discussion on whether *Brummeria* contributes to the understanding of "amount"; Croome *et al Tax Law: An Introduction* 66.

¹³⁵ *Brummeria* para 13; In *Stander*, "the taxpayer received an overseas trip as a prize and the Commissioner sought to include the value of the prize in his taxable income. The prize was awarded by Delta Motor Corporation (Pty) Ltd, which was not Stander's employer. Friedman JP found that no property accrued to the taxpayer before he went on the overseas trip by virtue of provisions of the General Law Amendment Act"; as per Jansen van Rensburg 2008 *Stell LR* 38.

¹³⁶ *Brummeria* para 3.

¹³⁷ *Brummeria* paras 5, 9.

¹³⁸ *Brummeria* para 15.

¹³⁹ In this case, the court further referred to an explanation in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990 2 SA 353 (A).

¹⁴⁰ Own emphasis; *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990 2 SA 353 (A); *Brummeria* para 11.

As a result, the court emphasised that the question whether goods (that does not constitute money) can be turned into money is only one test to ascertain whether the accrual or receipt of such goods has money value.¹⁴¹ Therefore, the court maintained that the right to use loan capital interest-free is valuable and can be assessed in monetary value, and, therefore, included the interest-free loan in the respondent's gross income.¹⁴²

From the discussion in chapter 2 above, it is evident that VCs are not legal tender or money in *strictu sensu* in terms of South African law. However, the case law above has confirmed that "amount" does not necessarily include money in *strictu sensu*, but also corporeal or incorporeal goods that contain money value. VCs are classified as incorporeal goods and can possibly amount to the element of "total amount in cash or otherwise". By applying the objective test, as suggested in *Brummeria*, VCs can be considered to have money value since the receipt or accrual of VCs as alternative to money is valuable and has money value.¹⁴³ The money value, which is determined by market value of VCs can be ascertained easily.¹⁴⁴ The Bitcoin website allows persons to calculate the value of a bitcoin at the given moment as well as the value in the past.¹⁴⁵

3.5 Received by or accrued to

3.5.1 General

The total amount in cash or otherwise should be "received by or accrued to" the taxpayer.¹⁴⁶ In the paragraph above, it was established that VCs fall within the

¹⁴¹ *Brummeria* para 15.

¹⁴² *Brummeria* para 9; Jansen van Rensburg has the following opinion: "The SCA judgement creates a possibility that, in the future, it could be contended that any *benefit*, irrespective whether or not it is *property*, could constitute an *amount*. What such a 'benefit' may entail (apart from the fact that it must have objective economic value) is not explained in the judgement, leading to considerable uncertainty."; Jansen van Rensburg 2008 *Stell LR* 50.

¹⁴³ Chapter 2 identified the advantages of cryptocurrencies (VCs). One advantage is that the transactions are less costly and borderless. In other words, there are low transaction costs even for cross-border transactions. If the values of VCs are high, an advantage can be having high value in monetary terms when compared to the transaction costs levied by banks.

¹⁴⁴ In other words, VCs has ascertainable money value.

¹⁴⁵ See: Bitcoin 2017 <https://price.bitcoin.com/>; See Berger *Bitcoin exchange transactions* 4, 26-30 for the consideration of VCs as barter transactions. Berger concluded that Bitcoin transactions do not amount to barter transactions.

¹⁴⁶ Section 1 of the ITA; It should be emphasised that either one or the other should have taken place. In other words, where the total amount has neither been received by, nor accrued to a person, the amount cannot be included in the calculation of "gross income"; Stiglingh *et al Silke* 2017 18; Spiro

parameters of the definition the "total amount in cash or otherwise". Therefore, VCs must be received by or accrued to taxpayers, to be included in their gross income. The inclusion of VCs to fulfil the latter element is problematic since there is no case law or legislation to this effect.¹⁴⁷ Seeing that the words "received by" and "accrued to" are not defined in the ITA, it can be determined by referring to case law.¹⁴⁸

Before distinguishing "received by" from "accrued to", the word "or" between the two concepts should be taken note of.¹⁴⁹ According to Spiro, two inferences can be drawn from the word "or" in this case.¹⁵⁰ Firstly, the insertion of this word does not give the Commissioner of SARS the discretion whether the amount was received or accrued.¹⁵¹ Secondly this insertion proscribes the possibility of double taxation.¹⁵² The Legislature would have used "and", which should have permitted the Commissioner to exercise discretion and/or allowed the double taxation of an amount.¹⁵³

3.5.2 "Received by"

3.5.2.1 Legal receipts

It should first be noted that the physical control over an asset or money is not a prerequisite for it to be a receipt.¹⁵⁴ Since VCs cannot be controlled physically due to its incorporeal nature, it does not mean that a taxpayer cannot receive these currencies.

submitted that "received by or accrued to" implies "that whatever is first in time is a part of gross income"; Spiro 1973 *CILSA* 203; Olivier and Van den Berg *Praktiese Boedelbeplanning* 65; Croome *et al Tax Law: An Introduction* 67.

¹⁴⁷ Stiglingh *et al Silke* 2017 18; In addition, there is no method to establish that such a receipt or accrual took place unless the taxpayer declares the income in his/her tax return; See: chapter 4.3.1; Also see: *SIR v Silverglen Investments (Pty) Ltd* 1969 1 SA 365 (C).

¹⁴⁸ Stiglingh *et al Silke* 2017 18; Olivier and Van den Berg *Praktiese Boedelbeplanning* 65; Croome *et al Tax Law: An Introduction* 66; Berger *Bitcoin exchange transactions* 2; Chawira *Taxation of illegal schemes* 10.

¹⁴⁹ As per definition of "gross income" in section 1 of the ITA.

¹⁵⁰ Spiro 1973 *CILSA* 203.

¹⁵¹ Spiro is of the opinion that the Legislature would have afforded the Commissioner such discretion if he wanted to; Spiro 1973 *CILSA* 203.

¹⁵² Spiro 1973 *CILSA* 203; Confirmed in *Delfos* 263; in other words, where the Commissioner has "... already taxed on receipts, he has no right to tax on the accrual of the receipt in a subsequent year, and vice versa".

¹⁵³ Spiro 1973 *CILSA* 203.

¹⁵⁴ *CIR v Genn & Co (Pty) Ltd* 1955 3 SA 293 (A); Stiglingh *et al Silke* 2017 18; Spiro 1973 *CILSA* 201; Chawira *Taxation of illegal schemes* 12; Muller 2007 *Obiter* 167; Jansen van Rensburg 2008 *Stell LR* 37.

Furthermore, according to Spiro, the simplest explanation of the words "received by" is that which "comes into a person's pocket".¹⁵⁵ *Geldenhuis v CIR* 1947 3 SA 256 (C) (*Geldenhuis*) provides a more extensive explanation of this statement. The court held that "received by" described the total amount or the value of the benefit received by the taxpayer "on his or her own behalf and for his or her benefit".¹⁵⁶ In other words, the taxpayer becomes entitled to the amount or the money value of the property that was received.¹⁵⁷ This entitlement arises from an underlying obligation (a contract or a delict) and the intention of the taxpayer plays no part in such cases.¹⁵⁸ This is also known as the objective approach.¹⁵⁹

The underlying obligation, for example, would be a contract concluded between the parties where a person receives VC as consideration for services rendered.¹⁶⁰ Should the individuals have rendered the service, they will be entitled to the VCs (as per contract). When applying the principles above to VCs, should individuals receive VCs for services rendered, they do it on their behalf and for their own benefit. On the other hand, where agents receive a VC on behalf of clients, the agents did not do it in the manner above.¹⁶¹ The one entitled to the VC is the person who received it and will be liable for income tax, whereas the agent will not be. The agents will be liable for income tax on their commission or fees charged in the course of their agency. Should a court have to decide whether the VC was received by the taxpayer, it will follow an objective approach by examining the underlying obligation and determine whether the taxpayer was entitled to the VC.

¹⁵⁵ Spiro 1973 *CILSA* 200.

¹⁵⁶ *Geldenhuis* 266; Stiglingh *et al Silke* 2017 18; Croome *et al Tax Law: An Introduction* 67; Muller 2007 *Obiter* 170; Jansen van Rensburg 2008 *Stell LR* 37.

¹⁵⁷ Stiglingh *et al Silke* 2017 18; Chirwa *Taxation of illegal schemes* 11; pages 11- 14 focuses on the meaning of "received by" in respect of legal receipts, and more specifically, the objective approach followed by the court to determine whether the taxpayer has in facts received an amount or property with an ascertainable money value.

¹⁵⁸ Stiglingh *et al Silke* 2017 18; Muller 2007 *Obiter* 170.

¹⁵⁹ Stiglingh *et al Silke* 2017 18; Croome *et al Tax Law: An Introduction* 68; Muller 2007 *Obiter* 170; "The taxpayer's entitlement to the proceeds was the deciding factor" in cases involving legal receipts; the entitlement (or "objective") approach was also followed by the courts in *Brookes Lemos Ltd v CIR* 1947 2 SA 976 (A); *Greases (SA) Ltd v CIR* 1951 3 SA 518 (A); *CIR v Witwatersrand Association Racing Clubs* 1955 3 SA 293 (A); *SIR v Smant* 1973 1 SA 754 (AD); *CSARS v Cape Consumers (Pty) Ltd* 1999 4 SA 1213 (C).

¹⁶⁰ A mere moral obligation will not suffice; obligation must be contractual or delictual – *CIR v Witwatersrand Association Racing Clubs* 1955 3 SA 293 (A).

¹⁶¹ *Genn* 301; Also see: *Brookes Lemos Ltd v CIR* 1947 2 SA 976 (A) 983; Muller 2007 *Obiter* 174; Jansen van Rensburg 2008 *Stell LR* 37.

The courts follow the objective approach for legal receipts. However, for illegal receipts, there has been confusion as to whether the objective or subjective approach should be followed since there was no consistent application of either.¹⁶²

3.5.2.2 Illegal receipts or income

Currently there are more frequent usages of VCs to fund terrorism and evade tax liability. This raises the question whether VCs acquired through illegal activities or for illegal activities will be "received by" the taxpayer.¹⁶³ In *CIR v Delagoa Bay Cigarette Co* 1918 TPD 391 (*Delagoa Bay*), the court held that the legality regarding the source of the income is immaterial.¹⁶⁴ For example, should individuals be remunerated in VCs for stealing a car, they would receive amount on their own behalf and for their own benefit even if the agreement is *contra bonos mores* and the contract unenforceable.

¹⁶² Croome *et al Tax Law: An Introduction* 70; Stiglingh *et al Silke* 2017 18-19; In *COT v G* 1981 4 SA 167 (ZA) (*COT v G*), the court made reference to the intention of the taxpayer, however, the court made its judgement based on the objective approach. The approach of the court was objective since the court referred to the intention of the taxpayer, but the intention of this party was not conclusive. The court held that the taxpayer did not receive the amount since he had no right and underlying entitlement to it (Mutual intention).

Conversely, in 1992 and 1996, *ITC 1545* 1992 54 SATC 464 (*ITC 1545*) and *ITC 1624* 1996 59 SATC 373 (*ITC 1624*), the court based its judgement on the subjective approach. In *ITC 1545*, the taxpayer knowingly entered into contracts which were *contra bonos mores*. Transactions that took place was deemed to be void and, therefore, amounts could not have accrued to the taxpayers since they were not entitled to payment. In addition, the court held that "an amount received by a taxpayer for his own benefit in pursuance of a void transaction, should constitute an amount 'received' within the ordinary literal meaning of that word". Consequently, the illegal income was included in the taxpayer's gross income (unilateral intention). In *ITC 1624*, the taxpayer fraudulently overcharged customers. The court held that the taxpayer "received" the money from overcharging clients and, therefore, intended it to be part of his business income. Thus, it should be included in the taxpayer's gross income. The court held that the taxpayer's "intention was fraudulent and designed to profit from ill-gotten gains" and that the taxpayer did in fact benefit from it (unilateral intention).

However, in 2005, the court in *ITC 1792* 67 SATC 236 (*ITC 1792*) followed the objective approach again. In *ITC 1792*, the taxpayer partook in questionable share transactions and was later convicted of fraud but returned all the profits made and interests. The court disregarded the taxpayer's intention to benefit from the scheme and concluded that he did not receive the profits on or for his own behalf, since it did not belong to the taxpayer. In other words, the court followed the entitlement approach as in the case with legal receipts; as per Stiglingh *et al Silke* 2017 19; Muller 2007 *Obiter* 173-174; Chawira *Taxation of illegal schemes* 15-18.

¹⁶³ "By way of illegal activities" means, for example, theft, and "for illegal activities" implies bribes, payment for executing an illegal, criminal conduct.

¹⁶⁴ *Delagoa Bay* 394; Stiglingh *et al Silke* 2017 18; Muller 2007 *Obiter* 174; "... it is immaterial for income tax purposes whether or not the business carried on by the taxpayer is in fact illegal or legal". In other words, it does not matter whether the source is legal or illegal.

When the courts follow the subjective approach, they study the intention of the taxpayer rather than the underlying obligation. The confusion about whether the objective or subjective approach should be followed was laid to rest in *MP Finance Group CC (in liquidation) v CSARS* 2007 69 SATC 141 (*MP Finance*).¹⁶⁵ In *MP Finance*,¹⁶⁶ the taxpayer operated an illegal pyramid scheme and received deposits from people while lacking the necessary statutory authorisation. These deposits were not kept in a trust as the capital of the investors, but rather was used to pay interest to other investors. Subsequently, the Commissioner included these deposits in the calculation of the gross income of the taxpayer since the latter had received it and utilised it for his own benefit. In this particular case, the taxpayer argued that he did not receive the money as it refunded the investors. The court in *MP Finance* followed a subjective approach.¹⁶⁷ Therefore, the current legal position is:

[A]n amount will be regarded as having been received by a taxpayer for purpose of income tax if he or she *intended* to receive it for his or her own benefit.¹⁶⁸

Due to the nature and function of VCs, it may seem impossible that it could be stolen.¹⁶⁹ However, in the case of Bitcoin, there is a possibility where the holder did not protect his private key. Since it is still possible that VCs could be stolen, the above-mentioned case law can find applicability in cases involving these currencies. Seeing that *MP Finance* is the prevailing position, the perpetrator should have intended to receive the VC for his or her own benefit.¹⁷⁰

As mentioned above, the relationship between "received by" and "accrued to" lies in the preposition "or". In addition, if money or property with money value has already been

¹⁶⁵ See: footnote 162; Stiglingh *et al Silke* 2017 19-20; Croome *et al Tax Law: An Introduction* 70; Chawira *Taxation of illegal schemes* 19-20.

¹⁶⁶ *MP Finance* paras 1-12.

¹⁶⁷ The court held that: "Illegal proceeds were intended to be received by the taxpayer for its own benefit, in view of the fact that it intended to personally benefit from the deposits"; as per Stiglingh *et al Silke* 2017 19; Croome *et al Tax Law: An Introduction* 70; Also see: Interpretation Note 80 of 2014 for the tax treatment of stolen money.

¹⁶⁸ Own emphasis; Stiglingh *et al Silke* 2017 19; Also see: Croome *et al Tax Law: An Introduction* 70.

¹⁶⁹ See: Tu and Meredith 2015 *Wash LR* 299-300 for a discussion as to how VCs can be stolen.

¹⁷⁰ Stiglingh *et al Silke* 2017 20.

included as a "receipt" in one year, it cannot be included in the taxpayer's income as an "accrual" in subsequent years.¹⁷¹

3.5.3 "Accrued to"

In light of case law, there has been uncertainty whether "accrued to" implies that the taxpayer should be entitled to the amount, or whether the amount should be due and payable to be included in this individual's gross income.¹⁷²

In *Lategan*, the court held that taxpayers have to be entitled to an amount in order for it to have accrued to them.¹⁷³ The court held that the amount accrues to taxpayers in the year of assessment in which they became entitled to the amount and not in the year of assessment in which it becomes due and payable.¹⁷⁴ However, in *Delfos*, there was a dissensus about whether the amount accrues to the taxpayer in the year of assessment in which it becomes due and payable, or in the year of assessment in which the taxpayer is entitled to this payment.¹⁷⁵ Two of the Appeal Judges supported the *Lategan* judgement by rendering the accrual in the year of assessment in which the taxpayer becomes entitled to it.¹⁷⁶ The other two Appeal Judges, however, opposed and rendered an accrual to have taken place in the year of assessment in which it becomes due and payable.¹⁷⁷ As a result of *Lategan* and *Delfos*, uncertainty arose whether "accrued to" means "entitled to", or whether it implies "due and payable". The uncertainty was rectified by the Appellate Division in *People's Stores*,¹⁷⁸ where all the Appeal Judges held that:

¹⁷¹ Spiro 1973 *CILSA* 203; "[R]eceived by or accrued to" means "that whatever is first in time is a part of gross income".

¹⁷² Stiglingh *et al Silke* 2017 20.

¹⁷³ *Lategan* 210; Stiglingh *et al Silke* 2017 20; Olivier and Van den Berg *Praktiese Boedelbeplanning* 65; Croome *et al Tax Law: An Introduction* 70-71.

¹⁷⁴ *Lategan* 210; Stiglingh *et al Silke* 2017 20; Olivier and Van den Berg *Praktiese Boedelbeplanning* 65; Croome *et al Tax Law: An Introduction* 70-71.

¹⁷⁵ *Delfos* 251, 255, 260, 262; Stiglingh *et al Silke* 2017 20; Olivier and Van den Berg *Praktiese Boedelbeplanning* 65; Croome *et al Tax Law: An Introduction* 71; Also see: *Hersov's Estate v CIR* 1957 1 SA 471 (A).

¹⁷⁶ Wessels CJ and Curlewis JA; *Delfos* 251, 255; Stiglingh *et al Silke* 2017 20; Croome *et al Tax Law: An Introduction* 71.

¹⁷⁷ Stratford JA and De Villiers JA; *Delfos* 260, 262; Stiglingh *et al Silke* 2017 20; Croome *et al Tax Law: An Introduction* 71.

¹⁷⁸ Jansen van Rensburg 2008 *Stell LR* 37; In *People's Stores*, the taxpayer carried "on business as a subsidiary in the Edgars group of companies ... it sells its wares to customers for cash or credit". Most of the credit sales were "made under its so-called six-months-to-pay revolving scheme". This

[T]he outstanding instalments accrued to the taxpayer in the view of the fact, that it was *entitled thereto*, although the amounts would only be due and payable in the following year of assessment.¹⁷⁹

Therefore, the *People's Stores* followed the *Lategan* judgement.¹⁸⁰

Furthermore, it should be emphasised that the taxpayer must be entitled to the amount unconditionally.¹⁸¹ In other words, where an accrual claim is conditional on the occurrence of certain future events, an amount would not have accrued to the taxpayer in terms of the definition of "gross income".¹⁸²

In addition, *Stiglingh et al* noted that, regarding "accrual", the taxpayer's subjective intention is irrelevant, as well as the physical receipt of the amount and whether the entitlement can be enforced.¹⁸³ In other words, the objective approach of entitlement is followed in such a case.¹⁸⁴ Therefore, the underlying obligation of the agreement has to be studied together with the law of contract or delict, to determine whether a taxpayer is entitled to an amount.¹⁸⁵ Under the law of contract, parties only become entitled to remuneration for performance once they have completed their duties in terms of the contract.¹⁸⁶

The following case study will explain: Dave, a South African resident, has concluded an employment contract where his employer remunerates him in bitcoins at the end of every month which he has worked. In such a case, Dave only becomes entitled to the

scheme entails: "... (amounts) charged to a customer's account are payable in six equal monthly instalments. At or soon after every month end, a statement of account is rendered to each customer. The instalment reflected on the statement as payable, has to be paid before the next statement date. In other words, a purchase made in January would be reflected on the statement rendered at or soon after the end of that month. One-sixth of the purchase price would be reflected on the statement as payable. It would have to be paid before the date of the next statement rendered at or soon after the end of February." The taxpayer sold goods in this manner to the amount of R1,3 million and at the end of 1983, the amount of R341 281 was still outstanding. The Commissioner included the latter amount in the taxpayer's taxable income; *People's Stores* 360-361; Also see: Spiro 1973 *CILSA* 202-203 for commentary prior to *People's Stores*.

¹⁷⁹ Own emphasis; *Stiglingh et al Silke* 2017 20, 21.

¹⁸⁰ *Stiglingh et al Silke* 2017 21; Olivier and Van den Berg *Praktiese Boedelbeplanning* 66; Croome *et al Tax Law: An Introduction* 71; *People's Stores* also disagreed with Spiro's commentary prior to *People's Stores*; see: Spiro 1973 *CILSA* 202-203.

¹⁸¹ *Ochberg v CIR* 1933 CPD 203; *Mooi v CIR* 1972 AD 215; Croome *et al Tax Law: An Introduction* 71.

¹⁸² *Ochberg v CIR* 1933 CPD 203; *Mooi v CIR* 1972 AD 215; *Stiglingh et al Silke* 2017 21; Croome *et al Tax Law: An Introduction* 71.

¹⁸³ *Stiglingh et al Silke* 2017 21.

¹⁸⁴ *Stiglingh et al Silke* 2017 21.

¹⁸⁵ *Stiglingh et al Silke* 2017 21.

¹⁸⁶ *Cactus Investments (Pty) Ltd v CIR* 1999 SCA; *Stiglingh et al Silke* 2017 21.

bitcoins (they accrue to him) at the end of every month. However, it is also possible that the bitcoins may accrue to him at the beginning of the month for the anticipated services rendered for the following month. Therefore, the receipt may be conditional if Dave's agreement of employment states that he will have to return the bitcoins if he does not render services as agreed. In the latter case, the amount does not accrue to Dave unless the specific condition is fulfilled.

3.6 Not a receipt or accrual of capital nature

3.6.1 General

The court has confirmed that all receipts and/or accruals are either of capital or revenue nature;¹⁸⁷ however, the definition of "gross income" excludes receipts or accruals consisting of capital.¹⁸⁸ Although capital receipts or accruals are not included in a taxpayer's "gross income", a portion will still be subject to capital gains tax and included in the calculation of taxable income and consequently, income tax.¹⁸⁹ If the Commissioner is of the opinion that the receipt or accrual can function as revenue, the onus rests on the taxpayer to prove that the receipt or accrual entails income.¹⁹⁰ However, each case will be decided on its own merits whilst considering the surrounding circumstances.¹⁹¹

The ITA also provides no definition for "capital", nor a test that distinguishes capital from income.¹⁹² Moreover, case law does not provide for a single definition of or test for "capital" either.¹⁹³

¹⁸⁷ *Pyott v CIR* 1945 13 SATC 121 126; Clegg noted that "there is no halfway house"; Clegg *Income Tax in South Africa* 5.1; *Pyott v CIR* 1945 13 SATC 121 126; Olivier 2012 *De Jure* 172; Stiglingh *et al Silke* 2017 30; However, it is possible that a single receipt or accrual may be apportioned between income and capital; *Tuck v CIR* 1988 50 SATC 98 111; See: Emslie 1988 *De Rebus* 590-592.

¹⁸⁸ Stiglingh *et al Silke* 2017 29; Croome *et al Tax Law: An Introduction* 82: "However, this does not mean that all receipts/accruals are excluded from constituting gross income...".

¹⁸⁹ In terms of section 26A and Schedule 8 to the ITA; Stiglingh *et al Silke* 2017 29; Olivier 2012 *De Jure* 172; Croome *et al Tax Law: An Introduction* 82: "...because capital gains are taxed at a lower effective rate".

¹⁹⁰ Clegg *Income Tax in South Africa* 5.1.

¹⁹¹ Clegg *Income Tax in South Africa* 5.1.

¹⁹² Stiglingh *et al Silke* 2017 30; Olivier 2012 *De Jure* 172; Williams 2010 *Without Prejudice* 50; Hannington 2011 *Tax Breaks* 6.

¹⁹³ Stiglingh *et al Silke* 2017 30; Williams 2010 *Without Prejudice* 50; Hannington 2011 *Tax Breaks* 6.

3.6.2 Obvious classification

Although there is no single test to determine whether a receipt or accrual entails capital or revenue, certain transactions are ostensibly capital, and other transactions clearly involve income.¹⁹⁴ On the one hand, interest, rentals and royalties, as well as remuneration for services rendered and profits, are generally considered as receipts or accruals in terms of income.¹⁹⁵ On the other hand, a lump sum inheritance, gifts, lottery, or betting wins as well as the proceeds on the sale of assets are generally viewed as receipts and accruals as capital, and will not be included in the taxpayer's gross income.¹⁹⁶ All the receipts and accruals mentioned above are possible in respect of VCs as well. VCs can also be gifted and bequeathed to others, and be used to pay rent or interest. The possibilities of transactions for which VCs can be used seem endless.

However, the distinction between income and capital is not always obvious. As a result, tests were formulated in case law to assist with the classification. These tests are applied to certain VC transactions in chapter 3.6.5.

3.6.3 Fruit-and-tree test

The first assessment that helps clear up the above-mentioned distinction is the fruit-and-tree test formulated in *Visser v CIR* 1937 SATC 271.¹⁹⁷ In terms of this test, Judge Maritz declared:

*"Income" is what "capital" produces, or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in the matters of income tax, but its application is very often a matter of great difficulty, for what is principal or tree in the hands of the one man may be interest or fruit in the hands of another. Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller they are a trade asset. A farm owned by a farmer is a capital asset; in the hands of a land-jobber it becomes stock-in-trade.*¹⁹⁸

In other words, the capital can be considered the tree and income the fruit that the tree bears.¹⁹⁹ Therefore, where the receipt or accrual amounts to the fruit of an income-

¹⁹⁴ Stiglingh *et al Silke* 2017 30; Clegg *Income Tax in South Africa* 5.1; Croome *et al Tax Law: An Introduction* 84.

¹⁹⁵ Stiglingh *et al Silke* 2017 30; Croome *et al Tax Law: An Introduction* 84.

¹⁹⁶ Stiglingh *et al Silke* 2017 30; Croome *et al Tax Law: An Introduction* 84.

¹⁹⁷ Stiglingh *et al Silke* 2017 30; Croome *et al Tax Law: An Introduction* 83; Olivier 2012 *De Jure* 173.

¹⁹⁸ Own emphasis; *Visser v CIR* 1937 SATC 271 276.

¹⁹⁹ Stiglingh *et al Silke* 2017 30; Croome *et al Tax Law: An Introduction* 83.

earning asset, it will be considered as income.²⁰⁰ Where the receipt or accrual amounts to the income received due to the disposal of an income-earning asset, it will be viewed as capital.²⁰¹

This test is not always conclusive and, in certain cases, it cannot determine successfully whether a receipt or accrual entails capital or income.²⁰² Therefore, the courts also developed the tests based on the intention of the taxpayer. These tests were studied in the minority and majority judgement of *CIR v Pick 'n Pay Employee Share Purchase Trust* 1992 4 SA 39 (A) (*Pick n Pay*).²⁰³

3.6.4 Intention of the taxpayer

3.6.4.1 General

The court generally examines the intention of the taxpayer when disposing of an asset, to determine whether the proceeds can be considered income or capital.²⁰⁴ In other words, a subjective test is applied.²⁰⁵ Emslie²⁰⁶ noted in this regard:

It is trite law that it is the intention of the taxpayer which determines whether the proceeds of the sale of an asset are of a capital or of a revenue nature.

The court will examine the taxpayer's intention at the acquisition of an asset, the duration of holding and/or disposal of an asset.²⁰⁷ This will help the court determine

²⁰⁰ Olivier 2012 *De Jure* 173; Emslie 1988 *De Rebus* 529; Emslie noted that the disposal of an asset that is held as an income-producing machine, or "as a source of future profits", will be of capital nature. Where an asset that is "held with the speculative intention" to be used in the scheme of profit-making, is disposed of, the proceeds will be of income nature. Also see: Mudimeli 2005 *Codicillus* 79.

²⁰¹ However, the application of the aforementioned test can become difficult in certain instances. Bitcoin exchanges hold bitcoins as income-earning assets, while an investor will hold this currency as investments (capital asset); Olivier 2012 *De Jure* 173-174; Stiglingh *et al Silke* 2017 30; Croome *et al Tax Law: An Introduction* 83; See: *BP Southern Africa (Pty) Ltd v CSARS* 69 SATC 79.

²⁰² Croome *et al Tax Law: An Introduction* 83.

²⁰³ Joubert 2009 *Obiter* 381-391; *Pick 'n Pay* 42, 46, 54-55, 57-58.

²⁰⁴ Clegg *Income Tax in South Africa* 5.2-5.3; Clegg notes that certain factors may help determine the intention of the taxpayer. These factors include the: "nature of the taxpayer; holding period; financing method; treatment of the asset prior to realisation; reason for realisation; circumstances around the acquisition or disposal; continuity of activities; and subsequent treatment of proceeds"; Croome *et al Tax Law: An Introduction* 86.

²⁰⁵ Croome *et al Tax Law: An Introduction* 86.

²⁰⁶ Emslie 1988 *De Rebus* 529; *Elandsheuwel Farming (Edms) Bpk v SBI* 1978 1 SA 101 (A) 118; Mudimeli 2005 *Codicillus* 79: This principle is "trite and requires no supportive citation of authority".

²⁰⁷ Croome *et al Tax Law: An Introduction* 86.

whether the proceeds will entail capital or revenue.²⁰⁸ However, there is no single, infallible test to clarify such a distinction.²⁰⁹

3.6.4.2 Profit-making scheme

With regards to the scheme of profit-making, the court in *Overseas Trust Corporation Ltd v CIR* 1926 AD 444 (*Overseas Trust Corp*) held that:

Where an asset is realised at a profit as a mere change of investment there is no difference in character between the amount of enhancement and the balance of the proceeds. But where the profit is, in the words of an eminent Scotch Judge (see *Californian Copper Syndicate v Inland Revenue* (41 Sc.L.R p 694)) "*a gain made by an operation of business in carrying out a scheme of profit making,*" then it is revenue derived from capital productively employed, and must be *income*.²¹⁰

The scheme of profit-making was further laid down in *Elandsheuwel Farming (Edms) Bpk v SBI* 1978 1 SA 101 (A) (*Elandsheuwel*).²¹¹ The question before the court was whether the proceeds from the sale of a particular asset "amounted to a realisation of a capital asset", or whether the proceeds was "in course of carrying on a business or in pursuance of a profit-making scheme".²¹² The court noted that a single transaction generally amounts to the realisation of a capital asset.²¹³ The scheme of profit-making, however, entails:

[T]he acquisition of an asset for the *purpose of reselling it at a profit*. This profit is then the result of the productive turnover of the capital represented by the asset and consequently falls into the category of income.²¹⁴

²⁰⁸ Williams 2010 *Without Prejudice* 50; *CIR v Stott* 3 SATC 253. Also see: Urquhart 1979 *Acta Juridica* 229-320; Clegg *Income Tax in South Africa* 5.2.

²⁰⁹ Williams 2010 *Without Prejudice* 50; Williams notes that the "question whether a receipt or accrual is of capital nature is a question of law". This statement was confirmed by Clegg; Clegg *Income Tax in South Africa* 5.2.

²¹⁰ Own emphasis; *Ocean Trust Corp* 453. Also see: *CSARS v Volkswagen of South Africa (Pty) Ltd* 2001 2 All SA 111 (A).

²¹¹ *Elandsheuwel* 101; Also see: Van Wyk 1977 *De Rebus Procutatoriis* 769-773; Mudimeli 2005 *Codicillus* 79.

²¹² *Elandsheuwel* 101; Croome et al *Tax Law: An Introduction* 87; Also see: Van Wyk 1977 *De Rebus Procutatoriis* 769-773; Mudimeli 2005 *Codicillus* 79.

²¹³ *Elandsheuwel* 118; Mudimeli 2005 *Codicillus* 79; The taxpayer may, however, have mixed or alternative intentions; See: *ITC 1522* 1992 54 SATC 185 and *CIR v Nedbank* 1986 3 SA 591 (A). The court may also ascribe the taxpayer's intention to being either dominant or secondary; Croome *et al Tax Law: An Introduction* 88; See: *Bernato Holdings (Pty) Ltd v CIR* 1978 2 SA 440 (A) and *CIR v Nassbaum* 1996 58 SATC 283.

²¹⁴ Own emphasis; *Elandsheuwel* 101; Mudimeli 2005 *Codicillus* 79: "A profit-making scheme involves the acquisition of an asset for the purpose of reselling it at a profit. This profit is then the result of the productive turnover of capital represented by the asset and consequently falls into the category

Therefore, *Elandsheuwel* confirms what the court held in *Ocean Trust Corp*. Moreover, an asset which is sold with the scheme of profit-making, amounts to the taxpayer's trading stock or floating capital.²¹⁵ However, where the taxpayer purchases the asset with the intention of retaining rather than selling it for a profit, the asset will amount to fixed capital.²¹⁶

The leading precedent on the profit-making scheme is the *Pick 'n Pay* case.²¹⁷ Although *Pick 'n Pay* deals with a trust that was formed to provide the employees of this business enterprise with shares, the minority and majority judgement provides an extensive discussion about the scheme of profit-making test.²¹⁸ The trust purchased shares from *Pick 'n Pay* and then sold it to the employees. However, the trust had no intention of making a profit on the on-selling of the shares.²¹⁹ Nevertheless, the trust in certain instances did make a profit and the question before the court was whether that profit was of capital nature.²²⁰ The majority judgement held that the profits could be considered as capital, whereas the minority judgement held that it was not.²²¹ The majority applied a subjective test by focusing on the objectives of the taxpayer to conduct a business, while the minority applied the objective test to ascertain the nature of the amount.²²²

The latter considered the facts of the case and whether the profits were received in the ordinary course of business.²²³ However, after applying the subjective test, the majority (former) judgement came to the conclusion that the "trustees were not carrying on a business with the contemplation of making profits".²²⁴ Therefore, the majority

of income (revenue). In effect, the asset constituted the taxpayer's stock in trade or floating capital ... In contrast to [the above], the sale of an asset that was acquired with the view of holding it either in a non-productive state or in order to derive income from the productive use thereof, and was in fact so held, constitutes the realisation of a fixed capital asset and the proceeds an accrual of capital nature".

²¹⁵ *Elandsheuwel* 101; see subsequent sub-chapter.

²¹⁶ *Elandsheuwel* 101; see subsequent sub-chapter.

²¹⁷ Janse van Rensburg 2008 *Stell LR* 37.

²¹⁸ *Pick 'n Pay* 42, 53, 58.

²¹⁹ *Pick 'n Pay* 42; Olivier 2012 *De Jure* 173.

²²⁰ *Pick 'n Pay* 53; Olivier 2012 *De Jure* 173.

²²¹ *Pick 'n Pay* 42; Olivier 2012 *De Jure* 173.

²²² *Pick 'n Pay* 58; Olivier 2012 *De Jure* 173.

²²³ *Pick 'n Pay* 46, 54, 57; Olivier 2012 *De Jure* 173.

²²⁴ *Pick 'n Pay* 60; Joubert 2009 *Obiter* 385.

judgement held that the profits were of capital nature.²²⁵ In other words, where the business is not conducting its operations with a scheme of profit-making, the receipts or accruals received for such operations will be considered capital.²²⁶ The minority judgement also considered the scheme of profit-making test, but focussed on the fixed-and-floating capital test, which is explained below.²²⁷

3.6.4.3 Fixed against floating capital

Similar to the scheme of profit-making, the fixed and the floating capital is also premised on the intention of the taxpayer.²²⁸ Fixed capital can be viewed as a fixed asset held as an investment, while floating capital constitutes trading stock and is sold with the intention of gaining a profit from its sale.²²⁹ In *CIR v George Forest Timber Co Ltd* 1924 1 SATC 20 (*George Forest Timber*), the court held that:

Capital ... may either be fixed or floating. I take the substantial difference to be that *floating capital is consumed or disappears in the very process of production, while fixed capital does not*; though it produces fresh wealth, it remains intact. The distinction is relative, for even fixed capital ... gradually wears away and needs to be renewed ... Ordinary merchandise in the hands of a trader would be floating capital. Its use involves its disappearance; and the money obtained for it is received as part of the ordinary revenue of the business.²³⁰

Consequently, floating capital is regarded as income, while fixed capital is considered capital.²³¹ In light of the discussion above and the facts of *Pick 'n Pay*, the minority judgement concluded that the share obtained by the trust should be regarded as floating capital.²³²

²²⁵ *Pick 'n Pay* 60; Joubert 2009 *Obiter* 385.

²²⁶ *Pick 'n Pay* 60; Joubert 2009 *Obiter* 385.

²²⁷ *Pick 'n Pay* 47-48; Joubert 2009 *Obiter* 386.

²²⁸ Croome *et al Tax Law: An Introduction* 85.

²²⁹ *Pick 'n Pay* 48; Croome *et al Tax Law: An Introduction* 85.

²³⁰ Own emphasis; *George Forest Timber* 23-24; Oliver 2012 *De Jure* 174. Also see: *Pick 'n Pay* 48; *CSARS v Volkswagen of SA (Pty) Ltd* para 8; *SIR v Crane* 1977 4 SA 761 (T) 196-198; *Ammonia Soda Company Ltd v Chamberlain* [1918] 1 LR ChD 266 286-287; *CIR v Allied Building Society* 1964 4 SA 1 (AD) 13; *Stone v SIR* 1974 3 SA 584 (AD) 595.

²³¹ Olivier 2012 *De Jure* 174.

²³² *Pick 'n Pay* 48; See: Joubert 2009 *Obiter* 387 for critique against the minority judgement.

3.6.5 Applying the tests to VCs

The above-mentioned tests to distinguish income from capital can also be applied to VCs. It is suggested that VCs could be taxed similar to bullion coins due to their resemblances;²³³ however, the focus is on the various transactions in bitcoins.

The first transaction in the Bitcoin-lifecycle with possible tax consequences is best explained through the following case study: Peter, a South African resident, owns highly-advanced computers and verifies Bitcoin transactions for a living (mining).²³⁴ As *quid pro quo* for verifying his transactions, Peter is rewarded with bitcoins.²³⁵ Since Peter receives bitcoins in exchange for verifying a transaction, such compensation can be seen as remuneration for services rendered and, therefore, of income nature. However, Parsons²³⁶ notes that in order to acquire bitcoins, a miner must download and install certain software and use a suitable computer with the appropriate hardware. According to Parsons,²³⁷ such actions can imply a scheme of profit-making. Parsons possibly implied that miners wish to gain financially from rendering the service of

²³³ In chapter 2, the similarities were drawn between VCs and as Krugerrands. It was indicated that Krugerrands are subject to the same tests as the intention of the taxpayer to determine its nature. See: *CIR v Nel* 1997 59 SATC 349, where the Commissioner sought to tax the proceeds of the Krugerrands, but the taxpayer objected. The court held that the taxpayer's actions supported his intentions and that he merely exchanged one capital asset for another in an emergency situation. Therefore, the proceeds were of capital nature. This position was confirmed by *ITC 1543* 1992 54 SATC 446.

SAICA emphasised that the taxpayer bears the onus to prove that he had the intention to retain the coins. Thus, circumstances that force a taxpayer to dispose of Krugerrands will not affect such intention, provided that the taxpayer adduces evidence to such effect and his actions are reconcilable with his intention. In *ITC 1355* 1981 44 SATC 132 and *ITC 1379* 1983 45 SATC 263 the court found in favour of the taxpayers because they provided sufficient evidence that their intentions had not changed.

However, in *ITC 1525* 1991 54 SATC 209 and *ITC 1526* 1991 54 SATC 216, the taxpayers failed to discharge the onus laid on them. In the former, the taxpayer did not draw sufficient evidence of his intention to hold the coins permanently and his proceeds were considered to be of income nature. The taxpayer in the latter case did provide evidence about his intention to hold the Krugerrands permanently. However, in difficult times, he would dispose of some Krugerrands. Despite the evidence by the taxpayer, the court held that he invested his money in Krugerrands to prevent the decline of his money's value until such time as the taxpayer wished to use it. Should the cases above be applied to VCs, it is clear that the taxpayer must prove he had the intention to hold his VCs permanently and his actions must support his intention; Stiglingh *et al Silke* 2017 40-41; Parsons 2014 *Accounting perspectives in SA* 20; SAICA 1999 <https://www.saica.co.za/>.

²³⁴ The highly-advanced computers are known as "rigs" and the specific action is termed "mining".

²³⁵ Parsons 2014 *Accounting perspectives in SA* 19.

²³⁶ Parsons 2014 *Accounting perspectives in SA* 19.

²³⁷ Parsons 2014 *Accounting perspectives in SA* 19.

verifying transactions and that such remuneration is not in *strictu sensu* a salary or commission. Parsons²³⁸ adds that:

There is also a *lottery element to how Bitcoins are awarded to miners*, that may bring an element of fortune. However, in *Morrison v CIR* the court held that a professional gambler's winnings were not capital of nature because they formed a part of his or her business. It is therefore likely that the elements of conducting a business required for successful Bitcoin mining would outweigh any considerations of luck, and the resultant income would be *revenue in nature*.

Furthermore, the retaining of bitcoins as a capital asset, or its disposal for profit, also remains a possibility after the miner received the bitcoins as compensation. Should miners decide to dispose of the bitcoin later, their intentions will be scrutinised to determine the nature of the proceeds.

The second transaction entails the receipt of bitcoins in exchange for goods or services; in other words, acquiring bitcoins based on an underlying transaction or agreement.²³⁹ This transaction can be described through the following case study: Dave, a South African resident who works for a respected law firm, does not receive his salary, bonus or thirteenth cheque in South African rands, but rather in bitcoins. In cases where bitcoins are received in exchanged for goods and services, Parsons²⁴⁰ is of the opinion that the nature of the underlying transaction would determine the nature of the receipt. In Dave's case, the underlying transaction is based on a contract of employment. Thus, remuneration received in terms of such a contract will be included in a taxpayer's "gross income" according to paragraph (c) of section 1 of the ITA. Therefore, the nature of the underlying transaction in Dave's case determines that his remuneration will be considered as income rather than capital. However, should Dave dispose of the bitcoins, his intention will be examined to determine whether the proceeds will entail income or capital.

The third transaction concerns the exchange of bitcoins for legal tender; in other words, the disposal of bitcoins for South African rands.²⁴¹ Where bitcoins are disposed of for legal tender, the scheme of profit-making and the floating or fixed capital tests

²³⁸ Own emphasis; Parsons 2014 *Accounting perspectives in SA* 19.

²³⁹ Parsons 2014 *Accounting perspectives in SA* 19.

²⁴⁰ Parsons 2014 *Accounting perspectives in SA* 19.

²⁴¹ Parsons 2014 *Accounting perspectives in SA* 19.

becomes relevant. The application of these tests is explained best through imaginary examples.

The first example is of BitTrader, a South African resident company that works as a Bitcoin trader and frequently buys bitcoins when the market is declining, and resells when the market is at a high. From the example, it can be inferred that BitTrader does not intend to hold the bitcoins as a permanent investment, but rather intends to make a profit on its sale whenever the market recovers. In other words, BitTrader manages a profit-making scheme. If BitTrader buys bitcoins for itself in order to sell it to the public, the fixed-and-floating capital test can be used to determine whether the proceeds of such a sale entail income or capital. According to the mentioned test, BitTrader's bitcoins will constitute floating rather than fixed capital since BitTrader frequently resells the bitcoins when the market is high. Therefore, the receipts or accruals received from the disposal of bitcoins will be included in BitTrader's gross income since the receipts will be of income nature.

The second example is the opposite of the first. Mary, a South African resident and a manager at her local bank, acquires bitcoins and intends to hold them as long-term investments. Her expectations are that the proceeds of the bitcoin's sale in 20 years will contribute significantly to her retirement savings. In such an instance, it is evident that Mary has no scheme of profit-making as she does not frequently buy and sell bitcoins for profit. A similar result will be evident when the floating-and-fixed capital test is applied. Should Mary experience difficult times and decides to sell her bitcoins, it will not be viewed as floating capital since she intends to hold onto her bitcoins as a permanent investment. Therefore, should Mary decide to realise her investment after 20 years, she would be liable for capital gains tax since her receipts will be of capital nature.²⁴²

3.7 Conclusion

In the previous chapter it was concluded that a VC transaction is a valid method of payment provided that the parties to the transaction agreed to it. From the discussion of the definition of "gross income" and its elements, it is evident that VC can form a

²⁴² In terms of section 26A and Schedule 8 to the ITA.

part of a taxpayer's gross income. VCs qualify as a "total amount in cash or otherwise", seeing that this currency has an ascertainable money value. It can also be "received by" a taxpayer, where it can be determined objectively from an underlying obligation that the taxpayer is entitled to it. Where the VC is received in terms of an illegal arrangement, it will be determined subjectively whether the taxpayer intended to receive it for his/her own benefit. In the alternative, VCs can also "accrue to" the taxpayer when he/she becomes entitled to it, provided that it has not already been included as a receipt.

From the discussion above, it is evident that the tests to determine whether a VC can be considered as capital or income, can be applied to VCs and have a successful outcome. Therefore, such a currency can be included in a taxpayer's "gross income".²⁴³ However, the question remains whether SARS can compel taxpayers to include their VC transactions in their tax returns under existing legislation and what the consequences of omission will entail. This issue will be investigated in the following chapter (ch 4).

²⁴³ See: Bal 2013 *European Taxation* 351-356 and Bal 2015 *Handbook for Digital Currency* 267-282 for an international perspective on the taxation of VCs.

Chapter 4 Regulatory challenges

4.1 Introduction

The previous chapter (ch 3) concluded that it is possible for virtual currencies (VCs) to be included in a taxpayer's "gross income" where all the elements of the definition in terms of section 1 of the ITA are present. Since it is possible for VCs to be taxed, the question arises on how VCs can be regulated to ensure taxpayers include their income in the form of VCs in their tax returns.²⁴⁴ This question is difficult to answer because of the decentralised and anonymous nature of VCs. Due to this nature, it is difficult for authorities such as SARS to regulate inclusion.²⁴⁵ The rationale behind the inclusion of VCs is understood best when considering the consequences of non-regulation. Where VCs are not regulated, the possibility of money laundering and tax evasion arise – which can have a larger detrimental impact on the local and global economy.²⁴⁶

Following the question on how VCs can be regulated, a further question arises on whether these currencies can be regulated under existing legislation or whether legislation is necessary that specifically focus on VCs. This chapter discusses the existing legislation and its sufficiency.²⁴⁷ The discussion is divided into three sections: general regulation; tax specific regulation; and financial-sector-specific legislation. This chapter also focuses on Bitcoin as the most researched and discussed VC, seeing that this currency is the most popular VC. The South African perspective will be compared with that of the United States, which shows significant commonality to the South African perspective on regulation.²⁴⁸

²⁴⁴ It should also be determined whether authorities such as the SARB and SARS can regulate the use of VCs under the South African jurisdiction.

²⁴⁵ Bal 2015 *Handbook of Digital Currency* 272: "People who have "virtual income" do not pay tax on that income for two reasons: They are not aware that such income is taxable and they deliberately avoid paying tax knowing that this noncompliance is unlikely to be detected and punished."; Tu and Meredith 2015 *Wash LR* 297-298.

²⁴⁶ See: Tu and Meredith 2015 *Wash LR* 297.

²⁴⁷ *Financial Intelligence Centre Act* 38 of 2001; ITA; *Tax Administration Act* 28 of 2011.

²⁴⁸ Also see: Kaplanov 2012 *LCLR* 172-173 for Kaplanov's case against the regulation of Bitcoin.

4.2 General regulation

Due to its decentralised nature, Bitcoin "cannot be effectively regulated" by states as "there is no Bitcoin company to raid, subpoena or shut down".²⁴⁹ Therefore, regulation by other bodies must be considered, whether on the Internet, or states who regulate the use of VCs. The most problematic aspect of VCs and state regulation is that states cannot exercise control over the Internet as this economy has no geographical borders.²⁵⁰ Despite the lack of geographical borders and state jurisdiction, there still is clear means to exercise control over VCs.²⁵¹ Within general regulation, there are three different categories, namely: self-regulation; regulation of market participants and prohibition.²⁵²

4.2.1 Self-regulation

Self-regulation entails that social norms and market mechanisms regulate the relationships between the users of VCs.²⁵³ However, Doguet²⁵⁴ and Reyes²⁵⁵ submits social norms are no longer sufficient because where the Internet used to be a minute ecosystem with limited species, it currently is an extensive ecosystem with far more extensive species.²⁵⁶ Market mechanisms, on the other hand, provide for VCs to have its own "rules".²⁵⁷ Market mechanisms should be thought of as the rules similar to those of board games such as Monopoly and Cluedo. As board games, both types have different

²⁴⁹ Twomey 2013 *Trinity CL Rev* 75; Tu and Meredith 2015 *Wash LR* 296-297; Also see: Bal 2015 *Handbook of Digital Currency* 272.

²⁵⁰ Referring to the Bitcoin economy in particular. In addition, Bitcoin users and miners remain anonymous. It remains a complex task to enforce taxation or anti-money laundering laws against anonymous users and miners; Twomey 2013 *Trinity CL Rev* 75; Tu and Meredith 2015 *Wash LR* 297; Doguet 2013 *La L Review* 1142-1143: "[T]he United States does not exercise preeminent control over the medium through which Bitcoins travel: the Internet itself. Because the latter is able to cut through invisible geographic boundaries, it erodes the traditional jurisdictional notions upon which laws and their enforcement are founded."; Also see: De Filippi 2014 *IPR* 10.

²⁵¹ Doguet notes that although "there may be no way to exercise perfect control over it", it does not mean that "effective control is out of the question"; Doguet 2013 *La L Review* 1143; Tu and Meredith 2015 *Wash LR* 297.

²⁵² Doguet 2013 *La L Review* 1143; Also see: Tu and Meredith 2015 *Wash LR* 300-313.

²⁵³ Doguet 2013 *La L Review* 1144, 1146-1147; There are also shortcomings within self-regulation. Doguet notes that Bitcoin's own inability to mitigate small-scale criminal activities is due to the large Bitcoin community. He adds that Bitcoin provides no means to punish those who use it with criminal intent and the community itself cannot punish wrongdoers. Therefore, state action is required; confirmed by Gruber 2014 *Quinnipiac Law Review* 187 and De Filippi 2014 *IPR* 9-10.

²⁵⁴ Doguet 2013 *La L Review* 1144.

²⁵⁵ Reyes 2016 *VLR* 194, 213, 219-221.

²⁵⁶ Also see: Guadamuz and Marsden 2015 *First Monday* 21.

²⁵⁷ Doguet 2013 *La L Review* 1144.

internal sets of rules which players have to follow.²⁵⁸ One such rule within the Bitcoin context, is that transactions are irreversible.²⁵⁹ The mentioned rule was established to protect honest buyers.²⁶⁰ However, social norms and market mechanisms provide no advantage to South African authorities regarding the inclusion of VCs in a taxpayer's tax return. The reason is that these authorities only regulate and protect users in the milieu in which the VCs function.

4.2.2 *Regulating market participants*

This above-mentioned regulation concerns market participants such as investors and traders.²⁶¹ These participants are already subject to existing regulations, whether in the United States or South Africa.²⁶² This form of regulation also holds the most advantage for South African authorities to ensuring inclusion of VCs in the taxpayer's tax return. This is because residents, and certain non-residents, can be regulated within the South African jurisdiction under this country's law. A more extensive discussion will follow in subsequent subheadings on the regulation of market participants within the USA and the South African context.²⁶³

²⁵⁸ In other words, there is more than one form of VCs, each with its own rules.

²⁵⁹ Bitcoin notes that the irreversibility of transactions places a responsibility on users to "take care to do business with people and organisations that [they] know and trust, or who have an established reputation"; Bitcoin date unknown <https://bitcoin.org/en/you-need-to-know>; Doguet 2013 *La L Review* 1144.

²⁶⁰ Doguet 2013 *La L Review* 1144-1145; Bitcoin date unknown <https://bitcoin.org/en/you-need-to-know>; However, Bitcoin is not designed to distinguish honest from fraudulent traders. As a response, reputation systems have developed naturally; See: Gruber 2014 *Quinnipiac Law Review* 185-186 and Doguet 2013 *La L Review* 1144-1145 for a discussion on reputation systems. Doguet uses the Bitcoin Police as an example of a reputation system. The Bitcoin Police was a "community-run organisation" that was tasked "to identify and prevent scammers in the Bitcoin economy." However, the Bitcoin Police is no longer an active (see: bitcoinpolice.org; the Twitter account still exists but it is not active). Nevertheless, these mechanisms are effective only within small communities where information is obtained easily; as the Bitcoin community grows, information is more difficult to come by. Significantly, social media and general forums are also used to complain about the economy or traders. Furthermore, Doguet suggests that autonomous agents should be employed to prevent criminal activities; See: Doguet 2013 *La L Review* 1144-1145 for a discussion on autonomous agents as well as Franco *Understanding Bitcoin* 187-188.

²⁶¹ Doguet 2013 *La L Review* 1147; Turpin 2014 *IJGLS* 351-352.

²⁶² See: Chapter 4.3.3; *Financial Intelligence Centre Act* 38 of 2001; ITA; *Tax Administration Act* 28 of 2011; Doguet 2013 *La L Review* 1147; Turpin 2014 *IJGLS* 351-352; De Filippi 2014 *IPR* 9-10; Tu and Meredith 2015 *Wash LR* 304-313.

²⁶³ See: chapters 4.3 and 4.4.

4.2.3 Complete prohibition

According to Doguet,²⁶⁴ it will only be necessary to ban Bitcoin when "technology's harm greatly outweighs the societal benefits".²⁶⁵ Such a decision will also be made when legislatures find that Bitcoin is used wholly for illegal purposes.²⁶⁶ Furthermore, the prohibition of the use of Bitcoin can be considered as follows:

... "economically insufficient means of regulation" for three primary reasons. First, they eliminate any potential benefit conferred by banned technology. Second, they tend to stymie any future innovation that could have resulted from the technology's continued use. Finally, they entail high costs with respect to enforcement.²⁶⁷

Despite the above-mentioned reasons why the prohibition of VC would be "economically insufficient", prohibiting regulations will only halt its use by law-abiding citizens. Criminals will not be deterred since they are already partaking in illegal activities.²⁶⁸ Therefore, prohibition will be disadvantageous to South African authorities.

In the paragraphs above, it was identified that the regulation of market participants would be the most advantageous to South African authorities when ensuring the inclusion of VCs in income tax. The subsequent paragraphs will discuss this regulation within the South African and US contexts and focus on the respective authorities.²⁶⁹

²⁶⁴ Doguet 2013 *La L Review* 1149. Also see: Gruber 2014 *Quinnipiac Law Review* 193; Kaplanov 2012 *LCLR* 167-169 and Guadamuz and Marsden 2015 *First Monday* 21-22 confirm this statement.

²⁶⁵ Several countries have already banned the use of VCs in general or Bitcoin in particular. Countries that have banned Bitcoin include: Vietnam, Iceland, Bangladesh, Ecuador; Madeira 2017 <http://bitcoinist.com/bitcoin-still-illegal-six-countries/>.

²⁶⁶ In September 2017, China banned Bitcoin. While the reasons are not known yet, it is suspected that the cryptocurrency threatens the local banks and economy; Mourdoukoutas 2017 <https://www.forbes.com/sites/panosmourdoukoutas>; In addition, it is unlikely that the USA will ban the use of Bitcoin as it will drastically affect the US dollar. Also, "[s]ome scholars have suggested that lawmakers might respond with hostility to successful digital currencies because they could undermine the government's seignorage income and decrease the value of the nation's currency (if individuals preferred the digital currency to the national one)"; Doguet 2013 *La L Review* 1150

²⁶⁷ Doguet 2013 *La L Review* 1151.

²⁶⁸ Doguet 2013 *La L Review* 1151; Kaplanov 2012 *LCLR* 169-171.

²⁶⁹ Within the South African context, the discussion will focus on regulation market participants by SARS and the Financial Intelligence Centre. The market-participation regulation within the US context will focus on the functioning of the US Treasury (more specifically the Financial Crimes Enforcement Network) and the Internal Revenue Service; See: chapters 4.3 and 4.4.

4.3 Tax specific regulation

The first step to ensure the inclusion of VCs in a tax return, therefore, also in the calculation of a taxpayer's "gross income", is to study existing tax legislation and ascertain whether the principle can be applied to VCs.

4.3.1 South African perspective: tax returns

Income tax liability for the taxable income received by or accrued to taxpayers, is imposed on natural persons and companies in terms of section 5(1)(c) and (d) of the ITA. Taxpayers' taxable income is determined in the income tax return they are required to submit annually in terms of section 66(13) of the ITA and section 25 of the *Tax Administration Act (TAA)*.²⁷⁰ In terms of section 210 of the TAA, omitting to declare income, can lead to a penalty in terms of chapter 15 or 16 of the TAA; while section 235 of the TAA provides that a false entry in a return is a criminal offence.²⁷¹ However, South Africa does not have specific taxation laws for VCs. As a result, the existing legislation and precedent must be interpreted to include VCs.²⁷²

As mentioned above, omitting to declare one's income can lead to penalties under the TAA. These penalties can be divided into three categories: general fixed amount;²⁷³ specific percentage-based;²⁷⁴ and understatement (USP).²⁷⁵ The first two categories are known as administrative non-compliance penalties (ANCP).²⁷⁶ General fixed amount penalties are laid on when a taxpayer does not submit a return on time or fails to submit entirely,²⁷⁷ whereas specific percentage-based penalties are imposed where a taxpayer fails to pay tax for a return(s) not submitted.²⁷⁸ The amount of the penalty

²⁷⁰ 28 of 2011; Croome *et al Tax Law: An Introduction* 16-17, 454-455, 457.

²⁷¹ Section 210 of the TAA; Venter *Factors influencing tax evasion* 10; Stiglingh *et al Silke 2017* 1151; s 235(1) provides that the consequences of tax evasion is either a fine, or imprisonment not exceeding five years.

²⁷² See chapter 3.

²⁷³ Section 211 of the TAA.

²⁷⁴ Section 213 of the TAA.

²⁷⁵ Surtees and Ross 2014 *SARS Professional* 24; Arendse 2013 *TaxTalk* 32.

²⁷⁶ Surtees and Ross 2014 *SARS Professional* 24; Arendse 2013 *TaxTalk* 32.

²⁷⁷ Surtees and Ross 2014 *SARS Professional* 24; Arendse 2013 *TaxTalk* 33; Stiglingh *et al Silke 2017* 1151.

²⁷⁸ Surtees and Ross 2014 *SARS Professional* 24; Arendse 2013 *TaxTalk* 34.

imposed is determined by the table found in section 211 of the TAA,²⁷⁹ while the latter is determined by referring to the relevant tax legislation.²⁸⁰ It should be noted that general fixed amount penalties may not be imposed where specific percentage-based or an understatement penalty has already come into effect.²⁸¹ However, SARS may remit imposed penalties in terms of section 216 to 218 of the TAA. Penalties can only be remitted in the following circumstances provided that the requirements are met: failure to register;²⁸² nominal or first incidence of non-compliance;²⁸³ and in exceptional circumstances.²⁸⁴

The third category of penalties, the understatement penalties (USP) are imposed on a taxpayer "who makes an error, deliberately or otherwise, in submitting a return".²⁸⁵ More specifically, section 221 defines an "understatement" as:

- [A]ny prejudice to SARS or the *fiscus* in respect of a tax period as a result of –
- (a) a default in rendering a return;
 - (b) an *omission* from a return;
 - (c) an *incorrect statement* in a return;
 - (d) if no return is required, the failure to pay the correct amount of 'tax'; or
 - (e) an impermissible avoidance arrangement.²⁸⁶

However, where an USP has already been imposed, an administrative non-compliance penalty (ANCP) will not be imposed for the same return.²⁸⁷ Therefore, simply put, a USP will be determined as follows:

²⁷⁹ Section 211(2) of the TAA; Surtees and Ross 2014 *SARS Professional* 24: "The penalty will increase by the same amount for every month that the return is overdue up to a maximum amount of 35 months. Interestingly, if SARS is not in possession of the address of the offender the penalty period extends to 47 months"; Arendse 2013 *TaxTalk* 34.

²⁸⁰ For example, Schedule 4 to the ITA. See Surtees and Ross 2014 *SARS Professional* 24; Arendse 2013 *TaxTalk* 34, for more examples.

²⁸¹ Stiglingh *et al Silke* 2017 1151; s 210(2) of the TAA.

²⁸² Section 216 of the TAA; penalty will be remitted in whole or part if the person voluntarily approached SARS and filed subsequent returns under the TAA; Hall 2014 *Tax Breaks* 3.

²⁸³ Section 217 of TAA; SARS may remit a penalty or a portion of it up to the amount of R2 000 if SARS is satisfied that there were reasonable grounds for non-compliance and that it was remedied; Surtees and Ross 2014 *SARS Professional* 24; Hall 2014 *Tax Breaks* 3.

²⁸⁴ Section 218 of the TAA; Taxpayer must submit a "remittance request" in order for SARS to consider remitting a penalty or a portion of it. SARS will only consider remittance where the taxpayer was unable to comply with the Act due to a natural or human-made disaster; civil disturbance or disruption in services; serious illness or accident; serious emotional or mental distress; etc.; s 218(2)(a)-(g) of the TAA.

²⁸⁵ Surtees and Ross 2014 *SARS Professional* 25.

²⁸⁶ "Tax" is also defined in s 221 of the TAA; Stiglingh *et al Silke* 2017 1154-1155.

²⁸⁷ Section 210(2)(b) of the TAA.

... applying the highest applicable understatement penalty percentage in accordance with the table [in section 223] ... to each shortfall in relation to each understatement in a return.²⁸⁸

Subsequently, section 223 of the TAA provides a percentage table to calculate the USP. The table affords a "formal decision-making matrix" that SARS applies "in determining the extent of the penalty".²⁸⁹ In making its decision, SARS considers the following behaviour: "substantial understatement"; "reasonable care not taken"; "no reasonable grounds for tax position not taken"; "gross negligence"; and "intentional tax evasion".²⁹⁰

It is submitted that the principles and penalties above can also be applied to VCs. However, the application of all the principles above may be problematic when considering Bitcoin. Although existing legislation and case law can be interpreted to include Bitcoin in a taxpayer's income, such an individual may still plead ignorance since there are no explicit legislation covering Bitcoin, and there is a lack of action by SARS.²⁹¹ Should SARS interpret existing legislation and case law compelling taxpayers need to include income in the form of Bitcoin, then the above-mentioned penalties will be applicable unequivocally. From a statement by the National Treasury (2014), it is evident that SARS will most likely not interpret existing legislation and case law in this manner. However, the statement does provide that, despite privation of recourse, the acceptance of VCs by merchants are their choice.

4.3.2 South African perspective: Tax evasion

Due to the decentralised and anonymous nature of VCs, tax evasion is a concern to all revenue services. Tax evasion means taxpayers *breach* tax legislation with the intention to lower their tax burden.²⁹² In this regard, taxpayers evade tax by not declaring their

²⁸⁸ Stiglingh *et al Silke 2017* 1155; Surtees and Ross 2014 *SARS Professional* 25; S 222(2): "The understatement penalty is the amount resulting from applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to the shortfall determined under subsection (3) and (4)"; s 223(1)-(3) provides how such a "shortfall" is calculated.

²⁸⁹ Surtees and Ross 2014 *SARS Professional* 25.

²⁹⁰ See table in s 223 of the TAA. Also see: Mazansky 2016 *Business Tax & Company Law Quarterly* 1-4.

²⁹¹ Also see: Bal 2015 *Handbook of Digital Currency* 272.

²⁹² Venter *Factors influencing tax evasion* 10; Croome *et al Tax Law: An Introduction* 22-23, 487; Olivier and Van den Berg *Praktiese Boedelbeplanning* 69: "Dié begrip het op 'n oneerlike optrede betrekking. Dit verwys na gekookte state, verswyging van inligting en skelmagtige optrede wat alles op bedrog neerkom."; Stiglingh *et al Silke 2017* 797: Tax evasion is "usually characterised by fraud and deceit" such as tampering with returns, books and accounts, concluding disguised transactions, deliberate non-disclosure of income or overstatement of expenditure.

income, whether partially or in full, or by manufacturing false expenditure.²⁹³ Section 235(1) of the TAA defines tax evasion as follows:

A person who with the *intent to evade tax* or to assist another person to evade tax or to obtain an undue refund under a tax Act –
(a) makes or causes or allows to be made *any false statement or entry in a return* or other document, or signs a statement, return or other document so submitted without reasonable grounds for believing the same to be true;
... is guilty of an offence and, upon conviction, is subject to a fine or to imprisonment for a period not exceeding five years.²⁹⁴

It is submitted that the section above makes it possible for a taxpayer to commit tax evasion involving Bitcoin. Where tax payers have the intent to evade tax and make a false entry in their tax return on their bitcoins, they can be found guilty of tax evasion.²⁹⁵ In addition, tax evasion is criminalised by section 104(1)(d) of the ITA, which provides that a person who has the intention to evade tax and does so through fraud is guilty of tax evasion. Bitcoin can be used fraudulently since persons can conceal their income in bitcoins from SARS.²⁹⁶

Tax avoidance, on the other hand, is not illegal. These are instances where taxpayers *use shortcomings* within tax legislation with the intent to lower their tax burden.²⁹⁷ However, the distinction between tax evasion and avoidance is not without problems: in the past, certain courts did not emphasise the distinction between the two, but rather combined them;²⁹⁸ taxpayers may also be convinced *bona fide* that they are lawfully

²⁹³ Venter *Factors influencing tax evasion* 10; Stiglingh *et al Silke 2017* 797: "[T]ax evasion' connotes inherently unlawful methods, such as incorrect income statements in income tax returns ... and sham or disguised transactions."

²⁹⁴ Own emphasis.

²⁹⁵ However, the question exists on whether a n omission to include VCs amounts to a "false statement"; see: Section 104(1)(d) of the ITA.

²⁹⁶ Also see: Bal 2015 *Handbook of Digital Currency* 272 for how VCs are used as tax havens to evade taxes.

²⁹⁷ Venter *Factors influencing tax evasion* 11; Croome *et al Tax Law: An Introduction* 22-23, 487; Olivier and Van den Berg *Praktiese Boedelbeplanning* 69: "Dié begrip verwys na die toedrag van sake waar 'n belastingpligtige op 'n regmatige en earlike wyse sy sake so beplan dat hy nie meer belasting betaal as wat nodig is nie."; Stiglingh *et al Silke 2017* 797: "Tax avoidance' connotes stratagems which are *prima facie* lawful, that is to say, which are lawful unless proscribed by the Act." There are no formal definitions within South African tax legislation for tax evasion or tax avoidance.

²⁹⁸ Stiglingh *et al Silke 2017* 808; *CSARS v NWK Ltd* 2011 2 SA 67 (SCA): the court combined the two in its description of tax evasion.

avoiding tax, but the court may rule differently later;²⁹⁹ and the distinction is not always clear cut.³⁰⁰

The South African approach (as expounded above) is to a certain extent reconcilable with that of the USA. This confirms that South African legislation in this regard has the same standard as certain highly-rated First-world countries.

4.3.3 *United States: Internal Revenue Service*

In 2014, the Internal Revenue Service (IRS) released Notice 2014-21, which provided guidance on VCs.³⁰¹ However, US Government Accountability Office (GAO) already reviewed VCs and the IRS's approach to its taxation in a 2013 report.³⁰² In this report, the GAO noted that it is the IRS's responsibility to ensure compliance of taxpayers in all economic areas including VCs.³⁰³ One way in which the IRS meets this responsibility is by information reporting (IR).³⁰⁴ IR requires third parties and taxpayers to report certain transactions to the IRS.³⁰⁵ The IRS found that third-party reporting increases voluntary tax compliance, seeing that the taxpayers understand that the IRS is aware of their income due to IR.³⁰⁶

²⁹⁹ Stiglingh *et al Silke 2017* 803-804; Practice Note 5 (as per *Stiglingh et al*) issued by the Commissioner for Inland Revenue on 1 April 1987 in respect of s 105A of the ITA: Where taxpayers carry out a legitimate tax- avoidance scheme, complete their tax returns and answer questions by the Commissioner fully and honestly, they will have met their duties.

³⁰⁰ Stiglingh *et al* argues that the term "tax avoidance" is problematic since either the taxpayer's activities fall within tax legislation, or not; Stiglingh *et al Silke 2017* 803-804. Also see: *Smith v CIR* 1964 1 SA 324 (A); *C of IR v Challenge Corp Ltd* [1986] 2 NZLR 513 (PC) at 561-562; *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] 2 All ER 275 (HL) at 295 .

³⁰¹ However, in 2007 the IRS's Electronic Business and Emerging Issues policy group had already evaluated the position and potential of VC, whereas the IRS was of opinion that other issues deserve higher priority; US GAO 2013 www.gao.gov/assets/660/654620.pdf 15.; IRS 2014 <https://www.irs.gov/uac/newsroom/irs-virtual-currency-guidance>; McLeod 2014 *CommLaw Conspectus* 385.

³⁰² US GAO 2013 www.gao.gov/assets/660/654620.pdf 1; McLeod 2014 *CommLaw Conspectus* 385; Gruber 2014 *Quinnipiac Law Review* 195.

³⁰³ US GAO 2013 www.gao.gov/assets/660/654620.pdf 9; Also see: Tu and Meredith 2015 *Wash LR* 310.

³⁰⁴ US GAO 2013 www.gao.gov/assets/660/654620.pdf 9.

³⁰⁵ For example, third-party-settlement and barter transactions. However, Bitcoin transactions are not considered barter transactions according to Berger; Berger *Bitcoin exchange transactions* 38; US GAO 2013 www.gao.gov/assets/660/654620.pdf 9.

³⁰⁶ US GAO 2013 www.gao.gov/assets/660/654620.pdf 9; Also see: Bal 2015 *Handbook of Digital Currency* 272.

In addition, Gruber refers to the Foreign Account Tax Compliance Act (FACTA) disclosure requirements,³⁰⁷ which requires the following:

... that [an] individuals who holds any interest in a specified foreign financial asset shall attach to such a person's return ... [specified information] with respect to each asset if the aggregate value of such an asset exceeds \$50 000.³⁰⁸

However, the value of a bitcoin does not exceed \$50 000 yet. Furthermore, a "specified foreign financial asset" is defined as follows:³⁰⁹

... any *financial account* if maintained by a foreign financial institution, *any stock* or security issued by a person other than a United States person, *any financial instrument* or contract held for *investment* that has an issuer or counterparty which is other than a United States person, or any interest in a foreign entity.³¹⁰

In other words, where taxpayers hold a specified foreign financial asset, they must disclose it to the IRS in their tax return along with sufficient information in respect of the asset. Therefore, the IRS does not only encourage third-party reporting but also requires reporting by the taxpayers themselves.

Part of the problem, as McLeod³¹¹ notes, is that the IRS provides insufficient information on VCs.³¹² In its report, the GOA suggested that the IRS make information readily available and easily accessible.³¹³ This will lead to more cases of successful mitigation of tax-compliance risks such as tax evasion.³¹⁴ In 2014, the IRS released Notice 2014-21, which provided guidance on VCs.³¹⁵ Despite ignorant actions by taxpayers due to

³⁰⁷ Gruber 2014 *Quinnipiac Law Review* 200-201; Also see: Tsukerman 2015 *Berkeley Tech LJ* 1150-1152.

³⁰⁸ Title 26 of the United States Code, section 6038D; Gruber 2014 *Quinnipiac Law Review* 199.

³⁰⁹ As found in the above-mentioned section.

³¹⁰ Own emphasis; Gruber 2014 *Quinnipiac Law Review* 199-200; Gruber refers to title 26 of the Central Federal Code, section 1.6038D-3T, which outlines the type of assets that should be reported under section 6038D.

³¹¹ US GAO 2013 www.gao.gov/assets/660/654620.pdf 14; McLeod 2014 *CommLaw Conspectus* 386; Gruber 2014 *Quinnipiac Law Review* 195.

³¹² The same problem is faced within the South African context.

³¹³ Also see: Gatto and Broeker 2015 *TOSEBLJ* 448-450.

³¹⁴ US GAO 2013 www.gao.gov/assets/660/654620.pdf 16; McLeod 2014 *CommLaw Conspectus* 385; Gruber 2014 *Quinnipiac Law Review* 195.

³¹⁵ IRS 2014 <https://www.irs.gov/uac/newsroom/irs-virtual-currency-guidance>.

insufficient information prior to 2014, Bitcoin has also been used to terminate criminal operations.³¹⁶

In light of the crimes involving tax evasion and attempted tax evasion under US law,³¹⁷ a similar question arises as the one posed in chapter 4.2: Does the government have the authority to institute litigation against taxpayers in respect of their Bitcoin dealings? McLeod³¹⁸ notes that the answer to the question depends on the taxpayer's intention and actions. Regarding intention ("wilfulness"), the "failure to report [income] by itself does not constitute tax evasion".³¹⁹ However, concerning the actions of the taxpayer ("affirmative act"), the anonymous nature of Bitcoin can amount to a "concealment and therefore affirmative act".³²⁰

Further, the citizens and residents (individuals) of the USA or persons who conduct a trade in the USA are required by the Bank Secrecy Act (BSA) to keep records, file reports, or both, when they enter into a transaction or have "a relation for any person with a foreign financial agency".³²¹ These reports should be filed only when the foreign financial account exceeds the amount of \$10 000 during the previous year of assessment.³²² Omitting to file such a report can result in criminal and civil penalties.³²³

³¹⁶ See McLeod 2014 *CommLaw Conspectus* 386 for how Bitcoin was used to terminate criminal operations; Also see: Ball, Arthur and Gabbatt 2013 <https://www.theguardian.com/technology/2013>; Turpin 2014 *IJGLS* 357-359; Bal 2015 *Handbook of Digital Currency* 272.

³¹⁷ McLeod 2014 *CommLaw Conspectus* 398-399, "To be convicted of the crime of tax evasion, one must meet the required elements, which are 'willfulness; existence of a tax deficiency ... and an affirmative act constituting an evasion or attempted evasion of tax.' Attempt under this statute requires the 'intent to evade tax': and '[s]ome act done in furtherance of such intent.' The attempt need not be successful. The affirmative action requires that a taxpayer purposefully claims his income is lower than it truly is."

³¹⁸ Under US legislation; McLeod 2014 *CommLaw Conspectus* 399.

³¹⁹ McLeod 2014 *CommLaw Conspectus* 399; Also see: Tsukerman 2015 *Berkeley Tech LJ* 1150-1152 for a discussion on Bitcoin as a vehicle for tax evasion and Ly 2014 *Harv JL & T* 595-596.

³²⁰ McLeod 2014 *CommLaw Conspectus* 399.

³²¹ These reports are also known as Foreign Banks and Financial Accounts and must be filed by these persons when they have a fiscal interest, signature or authority in or over a bank, securities or any other financial account held in a foreign country; Gruber 2014 *Quinnipiac Law Review* 196-197; Title 31 of the United States Code, section 5315; Title 31 of the Central Federal Regulations, section 1010.350; Gatto and Broeker 2015 *TOSEBLJ* 430-431; Bryans 2014 *ILJ* 456; See: Ly 2014 *Harv JL & T* 596.

³²² See chapter 4.4.2; To date, Bitcoin's value does not exceed \$10 000.

³²³ Gruber 2014 *Quinnipiac Law Review* 197; Title 31 of the Central Federal Regulations, section 1010.306, section 5321 and 5322.

In addition, scholars argue that the wallet in which users hold their bitcoins is a foreign account and will, therefore, be subject to FACTA.³²⁴ Bitcoin wallets are generally provided by Bitcoin exchanges, who should register under FACTA as Foreign Financial Institutions (FFIs) with the IRS.³²⁵ Where Bitcoin exchanges are registered and operate from countries that have entered into agreements with the US Treasury, no compliance issues are bound to arise.³²⁶ However, registration does not provide exchanges access to US accounts without asking for something in return. Exchanges are required to provide information of account holders to the US government.³²⁷ However, McLeod³²⁸ identifies a loophole in the reporting requirements laid down in FACTA. The private key upon withdrawal from a Bitcoin wallet is not identified as a "record" that must be disclosed under FACTA; this only applies to "depository and custodial accounts".³²⁹ Since the private key of a Bitcoin wallet user is kept more secret than the PIN number to a person's bank account, the US government cannot require Bitcoin exchanges to provide the private key to them. Therefore, although highly improbable, the public key of a user should be followed to keep track of this person's transactions.

The USA perspective is similar to the South African one regarding regulations applied by the respective revenue services. The IRS and SARS both place the obligation on the taxpayers to include their income in their tax return or report their own income. Although tax legislation is implemented and, to a certain extent, already ensures the inclusion of VCs in tax returns, legislation that focuses on the financial sector may also be of assistance.

³²⁴ McLeod 2014 *CommLaw Conspectus* 399; Gruber 2014 *Quinnipiac Law Review* 200-201; Tsukerman 2015 *Berkeley Tech LJ* 1150-1152.

³²⁵ McLeod 2014 *CommLaw Conspectus* 399. Also see McLeod 2014 *CommLaw Conspectus* 400; Bitcoin traders operate worldwide and most countries from which they trade have entered into an agreement with the US Treasury. Since there are existing agreements, McLeod asks whether Bitcoin traders are Foreign Financial Institutions as provided for in FACTA. Under US legislation, such institutions are defined as "any financial institution which is a foreign entity" and provides for three criteria of which only one has to be met.

³²⁶ McLeod 2014 *CommLaw Conspectus* 400.

³²⁷ McLeod 2014 *CommLaw Conspectus* 400-401; Gruber 2014 *Quinnipiac Law Review* 201.

³²⁸ McLeod 2014 *CommLaw Conspectus* 401.

³²⁹ Therefore, "[i]f an American user elected to remove himself from an exchange he could do so knowing that the United States Treasury did not possess the access code to his Bitcoin wallet, despite the records they possess as a result of his transactions on the exchange"; McLeod 2014 *CommLaw Conspectus* 401.

4.4 Legislation focussing on the financial sector

The regulation of VCs should be a priority to the financial sector. The reason is that VCs can facilitate money laundering and, as a result, the purpose of legislation directed against money laundering, for example, the *Financial Centre Intelligence Act* (FICA),³³⁰ will be defeated. It is important to note that although there is a relationship between money laundering and tax evasion,³³¹ this chapter focuses on ways VCs can be regulated to ensure taxpayers include their VC income in their tax returns. However, it is possible that FICA may be of assistance as it regulates Bitcoin exchanges (traders) rather than users.

4.4.1 South Africa's Financial Intelligence Centre

The South African government attempts to curb money laundering and the financing of terrorism through the FICA and POCA.³³² The object of the former Act was to establish the Financial Intelligence Centre (FIC) whose main object is to help identify proceeds resulting from unlawful activities and to combat money laundering.³³³ To meet the said objective, FICA insists on the cooperation of institutions such as the SARB or SARS.³³⁴ The FIC attempts to combat money laundering through control measures that place a duty on "accountable institutions" to identify clients, keep records and deliver reports.³³⁵ In terms of Schedule 1 to FICA, "accountable institutions" include: attorneys, bankers, foreign exchanges, or accountants. Significantly, Bitcoin exchanges are not listed under

³³⁰ 38 of 2001.

³³¹ The specifics of this relationship are irrelevant to the present study. See: Storm 2013 *IBERJ* 1437-1450; *National Director of Public Prosecutions (NDPP) v Abrina 6822 Ltd and Others* 2011 1 SACR 419 (KZP). Money laundering within the VC context also known as "cyberlaundering" or "virtual laundering"; Stokes 2012 *ICTL* 223; "money laundering" is also defined in s 4 of POCA 121 of 1998. Also see: Kersop and Du Toit 2015 *PER* 1620-1621 for the three stages of money laundering.

Significantly, there are specific websites that facilitate money laundering through Bitcoin; for example, Bitcoin Fog. The latter is known as a "mixing service" and is used to mix a person's funds with those of others, to confuse the 'trail', which makes it impossible to determine the original source of the funds. It is possible that mixing services may launder money, as provided for in section 4(b)(i) of *POCA*; See: <http://bitcoinfog.info/>; Turpin 2014 *IJGLS* 356; Gruber 2014 *Quinnipiac Law Review* 176; More examples of mixing services are: Bitmixer (<https://bitmixer.io/>); CoinMixer (<https://coinmixer.se/en/>); Bitcoin Blender (<https://bitblender.io/>); *etcetera*; see: Singh 2015 *NWJTIP* 61-62.

³³² POCA to a lesser extent.

³³³ Similar to the US Financial Crimes Enforcement Network (FinCEN); see: Tu and Meredith 2015 *Wash LR* 306; S 3(1) of FICA.

³³⁴ Schedule 2 to the FICA.

³³⁵ Part 1-3 of Chapter 3 of the FICA.

schedule 1, yet the South Africa Bitcoin exchanges, Luno (previously known as BitX) and Ice^{3X}, are registered under FICA.³³⁶ However, the position of such exchanges as "accountable institutions" is unclear.

Furthermore, FICA outlines requirements termed "Know Your Clients".³³⁷ These requirements state that "accountable institutions" must establish and verify their customers' details when entering a business relationship or concluding a transaction.³³⁸ Although Bitcoin exchanges are not listed as "accountable institutions" under FICA, it requires a client's proof of identification and residence.³³⁹ However, it is understandable that legitimate exchanges prefer to register under FICA since it preserves the integrity of their services and the Bitcoin itself. From the US precedent, it is evident that false and insufficient reporting has dire consequences.³⁴⁰ Under FICA, "accountable institutions" can also be found guilty of offences and be penalised for similar reasons as in the USA, including the failure to identify clients and keep records.³⁴¹

It is submitted that FICA's reporting and record-keeping requirements may be of use to SARS in its attempt to combat tax evasion. If SARS can access the identities of exchanges' clients (wallet holders), it may find it possible to enquire into the nature of the bitcoins held by clients in their wallets – whether it entail income or capital – to determine whether there will be income tax liability.³⁴² Although few exchanges are registered under FICA, the regulation of those exchanges will already amount to a form of regulation to mitigate tax evasion.

³³⁶ Francois date unknown <https://www.bitcoinzar.co.za/>; De Villiers and Sher 2015 *Without Prejudice* 60; Nieman 2015 *PER* 1998.

³³⁷ Section 21-22 of FICA; FNB date unknown <https://www.fnb.co.za/downloads>; Also see: Tu and Meredith 2015 *Wash LR* 297.

³³⁸ Section 21 of FICA; They also have to keep record of their clients' identities for at least five years after the termination of the relationship. The records must be made readily available on the FIC's request. In in certain circumstances, accountable institutions must also report their clients' actions without being requested. These circumstances include when a client: makes a cash transaction above the prescribed limits; makes suspicious and unusual transactions; and wishes to covey cash or make an electronic transfer above the prescribed amount; s 22, 23 and 27-31 of FICA.

³³⁹ Francois date unknown <https://www.bitcoinzar.co.za/>.

³⁴⁰ See chapter 4.4.2.

³⁴¹ Section 46 and 47 of FICA; Also see s 48 – s 67 for other offences.

³⁴² However, its constitutionality should be examined in light of the right to privacy as in section 14 of the *Constitution of the Republic of South Africa* 108 of 1996.

Again, the South African approach can in some ways be reconciled with the USA perspective. This confirms that South African legislation in this respect is of the same standard as that of first-world countries.

4.4.2 US Treasury regulation³⁴³

The US Treasury attempts to deal with money laundering by regulating Bitcoin exchanges under the BSA.³⁴⁴ According to the BSA, certain domestic financial institutions and foreign financial agencies have to comply with reporting and record-keeping requirements.³⁴⁵ The rationale for these requirements is "to create a paper trail" where the relevant authorities can trace the laundered funds back to the illegal activity from which it derived.³⁴⁶

Furthermore, Bitcoin exchanges in the USA are characterised as "money transmission services".³⁴⁷ A "money transmitter" who delivers a "money transmission service" can be typified as follows:

[A]ccept[s] currency, funds or *other value that substitutes for currency* and transmit it to another location or person by any means ... [And] ... the inclusion of "value that substitutes for currency" is sure to foreclose any doubt whether Bitcoin exchanges are covered under revised regulations.³⁴⁸

³⁴³ The US Treasury's approach is similar to that of the Financial Intelligence Centre regarding FICA.

³⁴⁴ Gruber 2014 *Quinnipiac Law Review* 170-171; McLeod 2014 *CommLaw Conspectus* 402, 405; Tu and Meredith 2015 *Wash LR* 321-331; Bryans 2014 *ILJ* 456.

³⁴⁵ Gruber 2014 *Quinnipiac Law Review* 170-171; McLeod 2014 *CommLaw Conspectus* 402, 405; Tu and Meredith 2015 *Wash LR* 323-324; Gatto and Broeker 2015 *TOSEBLJ* 431; Bryans 2014 *ILJ* 456.

³⁴⁶ Gruber 2014 *Quinnipiac Law Review* 171; Tu and Meredith 2015 *Wash LR* 323-324.

³⁴⁷ Title 31 of the Code of Federal Regulations part 1010.100; Doguet 2013 *La L Review* 1147; Gruber 2014 *Quinnipiac Law Review* 142; McLeod 2014 *CommLaw Conspectus* 405; In the alternative, "money transmitters" have "money-transmission businesses"; However, a money-transmission service which is delivered by a "money-services business" is also included within the definition of "financial institutions". Title 18 of the United States Code, section 1960, provides that the following persons are subject to reporting requirements: "[A] person wherever located doing business, whether or not on a regular basis or as an organized or licenced business concern, wholly or in substantial part within the United States", who acts "as a dealer in foreign exchange, a check casher, a provider of prepaid access, or a money transmitter."; as per Gruber 2014 *Quinnipiac Law Review* 171-172; Also see: Gatto and Broeker 2015 *TOSEBLJ* 431.

³⁴⁸ Own emphasis; Doguet 2013 *La L Review* 1147; Tu and Meredith 2015 *Wash LR* 306; Gatto and Broeker 2015 *TOSEBLJ* 431: "The BSA Regulations' definition of money transmission services does not differentiate between real currencies and virtual currencies".

Under US legislation,³⁴⁹ money transmitters have to comply with certain regulations such as registration with the Financial Crimes Enforcement Network (with the Department of Treasury) (FinCEN) and its rules,³⁵⁰ as well as with the USA Patriot Act.³⁵¹

When considering the definition of a "money transmitter", a further question arises on which institutions or persons will fall within the scope of this definition. The FinCEN's regulations indicate that Bitcoin miners and users are not money transmitters, but exchangers or administrators.³⁵² Doguet³⁵³ and Gruber³⁵⁴ argue:

... the *inclusion of "value that substitutes for currency"* [in the definition of "money transmission services"] is sure to *foreclose any doubt* whether Bitcoin exchanges are covered under revised regulations.

However, according to the FinCEN's regulations, the BSA also applies to "brokers and dealers of e-currencies and e-precious metals" as well as centralised convertible VCs and decentralised convertible VCs.³⁵⁵ Both local and foreign money transmitters are also required to comply with the provisions of the BSA.³⁵⁶ Gruber³⁵⁷ further argues that Bitcoin users (e.g., business enterprises that accept Bitcoin) should be licenced and registered as a money-transmission business in order to act proactively and avoid possible litigation.³⁵⁸ It is suggested that users enquire at the FinCEN about to licencing

³⁴⁹ Title 31 of the Code of Federal Regulations part 1010.100.

³⁵⁰ In terms of title 31 of the United States Code 5311, the Bitcoin exchanges must compile "certain reports or records have a high degree of usefulness in criminal, tax and regulatory investigations". In terms of Title 31 of the Code of Federal Regulations 1022, they must also develop and implement effective anti-money laundering programs. As per the US PATRIOT Act and title 31 of the United States Code 5318, the Bitcoin exchanges are required to verify and maintain records of their customers; as per Doguet 2013 *La L Review* 1148; Tu and Meredith 2015 *Wash LR* 306; Gatto and Broeker 2015 *TOSEBLJ* 433; Bryans 2014 *ILJ* 456-459; Ly 2014 *Harv JL & T* 600.

³⁵¹ Twomey 2013 *Trinity CL Rev* 77; "Under the Patriot Act, Bitcoin exchanges would likely to be defined as either a 'financial institution' or a 'money transmitting business'." A financial institution is defined broadly to include "a currency exchange, which, if Bitcoin is defined as a currency; a Bitcoin exchange clearly is..."; See: Chapter 4.3 and 4.4.

³⁵² Gruber 2014 *Quinnipiac Law Review* 178; FinCEN 2013 <http://www.fincen.gov>; McLeod 2014 *CommLaw Conspectus* 404; Tu and Meredith 2015 *Wash LR* 329; Bryans 2014 *ILJ* 457; Turpin 2014 *IJGLS* 365; "... miners who sell their Bitcoins are defined as money service businesses ... and [is] subject to regulation as money transmitters."

³⁵³ Doguet 2013 *La L Review* 1147.

³⁵⁴ Own emphasis; Gruber 2014 *Quinnipiac Law Review* 173.

³⁵⁵ See chapter 2; Gruber 2014 *Quinnipiac Law Review* 178; FinCEN 2013 <http://www.fincen.gov>; Tu and Meredith 2015 *Wash LR* 329; See: Gatto and Broeker 2015 *TOSEBLJ* 433-437 for an extensive discussion on the persons and institutions required to comply with the BSA.

³⁵⁶ Gruber 2014 *Quinnipiac Law Review* 172.

³⁵⁷ Gruber 2014 *Quinnipiac Law Review* 173.

³⁵⁸ There are US precedents that serve as examples why certain Bitcoin users must comply continually. See: *United States v E-Gold, Ltd* 550 F Supp 2d 82 (DDC 2008) as per Gruber 2014 *Quinnipiac Law*

and registration if they are uncertain whether the relevant provisions of the BSA will apply to them.³⁵⁹

In summary, within the South African perspective, "money transmitters" – more specifically, Bitcoin exchanges - function similar to those under FICA.³⁶⁰ Therefore, these transmitters must comply with requirements for licencing and registration as well as with reporting requirements.

4.5 Conclusion

From the nature and increasing popularity of Bitcoin, it is evident that self-regulation by Bitcoin itself and the Bitcoin community, whether in the form of social norms or market participation, are not sufficient. From the rapid growth of technology in and around Bitcoin it is also evident that total prohibition of the use of VCs is not the solution. Both aforementioned forms of regulation impede South African authorities in ensuring the inclusion of VCs in a taxpayer's return.

Despite the attempts of governments worldwide to regulate VCs, the current solution in the South African context is to interpret and apply of existing legislation, or regulate market participants. Regarding taxation, the ITA and TAA already contain sufficient rules for a taxpayer's disclosure of income. Within the realm of financial sector legislation, FICA provides the sufficient regulation of "accountable institutions" and reporting requirements. As mentioned above, FICA can possibly be used to SARS's advantage to obtain the identities of account holders making it possible to enquire into their tax affairs. The National Treasury's User Alert (2014) noted that relevant authorities will address VCs with explicit legislation if necessary, but to date, no legislative attempts have emerged to regulate VCs.

*Review 173; Indictment, United States v Liberty Reserve SA, no 13-CR-368 (DLC) (S.D.N.Y 2013) 14 as per Gruber 2014 *Quinnipiac Law Review* 174-175; Gruber 2014 *Quinnipiac Law Review* 190; Gatto and Broeker 2015 *TOSEBLJ* 434.*

³⁵⁹ See: Gatto and Broeker 2015 *TOSEBLJ* 438-447 for the consequences of non-compliance with the BSA.

³⁶⁰ See: Govender 2017 *Without Prejudice* 24-26 for an extensive discussion on the application of certain legislation to Bitcoin within the South African finance context.

It is submitted that existing legislation does address VCs sufficiently. However, this does not mean certain definitions in law, such as "accountable institutions", should not be extended to include VCs explicitly.

Chapter 5 Conclusion and comments

The popularity of Bitcoin and similar virtual currencies (VCs) alike is growing daily in South Africa and around the globe.³⁶¹ Despite its volatility,³⁶² in future Bitcoin will remain a valuable representation of money with which people can enter into transactions. In South Africa, there are over 200 merchants who accept Bitcoin, including takealot.com and bidorbuy.³⁶³ In addition, more African countries, for example Zimbabwe, are also embracing Bitcoin and using it to overcome the restriction of local financial milieus.³⁶⁴ This proves that although an influential country such as China banned the use of this cryptocurrency, its use or value will not stagnate. The value of Bitcoin may have declined when the ban was announced in September 2017, however, it doubled in less than two months thereafter.³⁶⁵

In its User Alert, the South African National Treasury noted that the relevant authority will address VCs with guidance and regulation if necessary. The Treasury also affirmed that there is no explicit legislation covering VCs. However, it was submitted in chapter 4 that a mere extension or explicit inclusion of VCs in existing legislation and definitions will be a suitable point of departure.³⁶⁶

In light of chapter 2 it should be emphasised that VCs are not "legal tender" since it does not consist of notes and coins issued by the SARB. It seems improbable that VCs will attain legal tender status, seeing that the SARB may not gain control over these

³⁶¹ See: McKane 2017 <https://mybroadband.co.za/news/cryptocurrency>.

³⁶² See: 99Bitcoins 2017 <https://99bitcoins.com/price-chart-history/> for the history regarding the rise and fall of Bitcoin prices; Bitcoin date unknown <https://charts.bitcoin.com/chart/price> for a visual representation of the volatility of Bitcoin.

³⁶³ See Visser 2016 <https://www.luno.com/blog/en/post/south-africa-pay-with-bitcoin> for a list of merchants who accept Bitcoin.

³⁶⁴ Karombo 2017 <https://qz.com/1109470/bitcoin-highest-price-is-in-zimbabwe-due-to-a-forex-shortage/>: "Late on Monday (Oct. 23) Bitcoin prices traded around \$9,600 on the Golix exchange platform in Zimbabwe. But this is only because the country is experiencing payment challenges and acute liquidity challenges."

³⁶⁵ The ban was announced at the end of September 2017. When examining the charts at Bitcoin date unknown <https://charts.bitcoin.com/chart/price>, it is clear that the price of a bitcoin was roughly US\$ 3600, however, by the beginning of November it was roughly US\$ 7400.

³⁶⁶ See chapter 4.

currencies.³⁶⁷ However, this does not imply that the relevant authorities cannot regulate the use of VCs.³⁶⁸

Thus, the question arose whether VCs can be deemed money or a valid method of payment. The problem with the older definitions of money is that the definitions are not flexible enough in their interpretation to include modern forms such as digital currencies.³⁶⁹ Most of the definitions provide that the state's law must prescribe the name and unit of account attributed to its money. These definitions are problematic to VCs since monetary sovereignty is given to states and not private developers such as Satoshi Nakamoto (developer of Bitcoin). Schulze,³⁷⁰ in contrast to Mann and Proctor,³⁷¹ suggests that modern money should have certain basic characteristics in order to be considered as money. The reason is that an "all-encompassing definition" will not suffice due to the rapid technological innovation in money usage.³⁷² Therefore, it is suggested that VCs be deemed money or a valid method of payment by way of its popular use in an open market including merchants such as takealot.com, bidorbuy and many other South African as well as international traders. The result of this suggestion may contribute to a better understanding of the reasons for the inclusion of VCs in the calculation of income tax. The rationale behind this is that taxpayers may associate the unregulated nature and the lack of legal tender status with the notion that VC is not money in *strictu sensu* and consequently they do not have to include it in their income tax returns.

Even if VCs are not considered as legal tender or money, it should at the very least be recognised as an accepted or allowable method of payment. The National Treasury stated that merchants accept VCs at their own risk.³⁷³ In other words, it can be inferred that VC transactions are not void. Again, amongst average taxpayers, the unregulated nature and lack of legal tender status of VCs may create the impression that transactions involving VCs are void.

³⁶⁷ However, this does not mean that the SARB cannot use the principles of VCs and create its own form of VC. Whether people would make use of such a VC is doubtful as the VC might not be decentralised and anonymous; See chapter 2.4.1.

³⁶⁸ Chapter 4.

³⁶⁹ Proctor and Mann as per Schulze 2004 *SA Merc LJ* 50-51; chapter 2.5.

³⁷⁰ Schulze 2004 *SA Merc LJ* 50-51; chapter 2.5.

³⁷¹ Proctor and Mann as per Schulze 2004 *SA Merc LJ* 50-51.

³⁷² Schulze 2004 *SA Merc LJ* 50-51.

³⁷³ National Treasury 2014 <http://www.treasury.gov.za>.

Furthermore, due to the increasing popularity of VCs, it is recommended that authorities should attempt to provide regulations, or expand existing ones such as the *Electronic Communications and Transactions Act (ECTA)*,³⁷⁴ to assist merchants who have been prejudiced in VC transactions.³⁷⁵ The rationale for the use of ECTA lies within its objectives,³⁷⁶ which include:³⁷⁷

- promoting universal understanding and acceptance of and growth in electronic transactions;
- promoting legal certainty and confidence about electronic communications and transactions;
- ensuring electronic transactions conform to international standards;
- encouraging investment and innovation regarding electronic transactions;
- developing a safe and secure environment for consumers;
- encouraging businesses and the government to use electronic communications;
- promoting the development of electronic transaction services; and
- facilitating the stability of such transactions.

However, further study should be done to ascertain the exact applicability of ECTA to VC transactions.

Based on chapter 3, it should be noted that the acceptance of VCs remains the merchant's choice. Therefore, VCs should be included in a taxpayer's return as "gross income" if it is not of capital nature. If it entails capital,³⁷⁸ this will possibly lead to capital gains tax liability and the taxable capital gain will be included in the taxpayer's taxable income. However, further study will be necessary on the consequences that capital gains tax holds for VCs.

Although the ITA, TAA, or case law, does not refer explicitly to the inclusion of VCs, it does not mean that the mentioned legislative frameworks cannot be interpreted to include VCs as income in a person's "gross income". VCs can be interpreted to comply with the elements of "gross income". Such cryptocurrencies have an ascertainable money value and, therefore, amounts to a "total amount in cash or otherwise". Where the parties concluded a contract using VCs as payment, the amount in VCs can be "received by" the taxpayer. Alternatively, where a taxpayer is entitled to the amount in

³⁷⁴ 36 of 2005.

³⁷⁵ Rather than merely stating that they trade in VCs at their own risk, some form of protection should be afforded to merchants.

³⁷⁶ Section 2 of the ECTA.

³⁷⁷ Section 2(1)(c), (e), (h) – (k), (n) of ECTA.

³⁷⁸ For example, where VCs are held for investment purposes.

VCs, it "accrued to" this person. The tests to determine whether an amount entails capital or income, can also be applied to different transactions in VCs by the various role-players in the Bitcoin economy.³⁷⁹ If such payments are considered as income, it can be included in a person's "gross income". However, this raises the question on how SARS regulates the inclusion of VCs in a person's tax return. This question was addressed in chapter 4, as explained briefly below.

Chapter 4 discussed the provisions of tax legislation, such as the ITA and TAA, which provides for the inclusion of income in a person's tax return. Existing tax legislation covers the disclosure of income and the consequences of omission. The underlying rationale is preventing taxpayers from intentionally omitting to declare income and to help curb tax evasion. Therefore, it is proposed that the same consequences for omitting to declare income in a person's tax return, will apply to transactions that involve VCs. If such an omission amounts to tax evasion, the consequences of such evasion will realise. However, as noted in chapter 4, most taxpayers will plead ignorance for failing to include VCs in their tax return.³⁸⁰ It is thus suggested that SARS release further information about VCs on their website or an Interpretation Note focusing specifically on VCs within the realm of income tax. In this regard, SARS may experience a similar problem than the IRS prior to 2014:³⁸¹ insufficient information leads to tax evasion and it evokes other compliance risks. The release of sufficient and readily available information to taxpayers may increase the disclosure of income in their returns. However, naturally such information will only be respected by law-abiding citizens.

In addition, chapter 4 also discussed whether legislation in the financial sector, FICA, can help regulate VCs in order to include these cryptocurrencies in income tax returns. It was suggested that SARS utilises the reporting requirements that rest on "accountable institutions". However, as submitted in chapter 4, the definition of "accountable institutions" must first be extended to include Bitcoin exchanges. It was found that the FIC requires "accountable institutions" to disclose their clients' identities

³⁷⁹ See chapter 3.

³⁸⁰ The maxim *ignorantia juris non excusat* or "the ignorance of law is no excuse", also applies within the realm of tax law.

³⁸¹ IRS 2014 <https://www.irs.gov/uac/newsroom/irs-virtual-currency-guidance>.

and other basic information. Therefore, SARS may consider enquiring into account holders, or Bitcoin wallet holders. This evokes the constitutionality of such a suggestion in light of section 14 of the *Constitution of the Republic of South Africa*,³⁸² which deals with the right to privacy. Such constitutionality is a topic for further study.

The findings further show that existing legislation was deemed sufficient to regulate VCs, except that certain definitions such as "accountable institutions" should be extended to ensure the legislation is applied appropriately. From the findings it is also evident that the responsibility to regulate VCs and its use by the role-players in VC economies does not resort solely under a single South African authority. Each role-player has the responsibility to disclose individual VC transactions, in order to avoid the consequences of non-disclosure or of tax evasion. In this regard, it should be made clear to taxpayers that VCs possibly can form part of their "gross income". Again, as suggested above, it is recommended that SARS release its own perspective of VCs, whether on their website, or in the form of an Interpretation Note. This will prevent taxpayers from pleading ignorance as mitigating circumstance for non-disclosure of income.³⁸³

This information on SARS's website or in an Interpretation Note should analyse the definition of "gross income" and discuss the consequences of non-disclosure of income and/or tax evasion. Assuming that SARS decides to release an Interpretation Note, its content should reflect the aspects discussed in chapter 3 and 4 of the present study. The definition of "gross income" should be discussed by expounding the various elements in a reader-friendly manner or in layman's terms. The accompanying case law should be included to indicate how the basic principles on which "gross income" is based can be extended for application within the realm of VCs. Furthermore, the Interpretation Note should outline the consequences of non-disclosure of income in a tax return and of tax evasion, to emphasise its significance.

From this study as well as the rapid and continuous pace of technological growth around the world, it is evident that regulation to ensure the inclusion of VCs in the

³⁸² 108 of 1996.

³⁸³ The maxim *ignorantia juris non excusat* or "the ignorance of law is no excuse", also applies within the realm of tax law.

calculation of income tax is necessary. This vacuum, especially in the South African law, creates various opportunities. It was mentioned above that the responsibility to regulate VCs and the use thereof should not resort solely under a single South African authority. This vacuum creates an opportunity for different South African authorities to work together and create legislation that is VC-specific and legislation that approaches VCs from the different fields of law to the benefit of all South Africans making use of VCs. An attempt to fill this vacuum will not be without challenges. As mentioned above, the world currently experiences rapid and continuous innovation concerning technology, and the speed of innovation is a challenge in itself. The process of creating legislation, especially if various South African authorities are involved, may continue for a lengthy period. As a result, by the time the legislation is accepted by Parliament, technology may have changed. It is therefore suggested that if action is taken by South African authorities, it should be done swiftly.

In conclusion: In light of the present study's findings it is evident that no state can regulate VCs since its core characteristic is its decentralised nature. This makes VCs difficult to regulate as a whole. Nevertheless, the use of VCs and its inclusion in an income tax return can be regulated by SARS and other authorities. It should not only be regulated to generate taxes that help the government perform its duties towards citizens. The relevant regulating bodies will also indirectly promote technological innovation and financial inclusion within the South African and regional (African) context. In this regard, the South African regulation of cryptocurrencies such as Bitcoin will be on par with those in major First World countries.

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