

# ACCOUNTING AND TAX TREATMENT OF CRYPTOCURRENCIES: A SYSTEMATIC REVIEW

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## ABSTRACT

**Purpose:** *The primary aim of this study was to discuss the possible treatment of cryptocurrencies in the context of accounting and taxation.*

**Design/method/approach:** *The study followed a qualitative approach and used paper analysis to achieve the primary objective. The paper analysis included a systematic review of papers. The study focused on the paper analysis of existing data to refine a conceptual framework.*

**Findings:** *It was found that because of the volatility of cryptocurrencies, the existing measurement models which are the cost model and fair value model, do not cater to cryptocurrencies.*

**Practical implications:** *This study addressed the gap between financial information and regulations. These fintech advances do not merely challenge the monetary system but also the regulation system. Thus, the importance of acknowledging the application and the implication of technology on the current regulatory system is imperative and significant.*

**Originality/value:** *This study will serve as a basis for international accounting standard boards and tax authorities when modifying or developing standards and tax provisions that specifically address the treatment of cryptocurrency.*

**Keywords:** Crypto-assets, Virtual Currency, Blockchain, Accounting Treatment, and Tax Treatment.

## INTRODUCTION

In this modern digital age, for companies to stay competitive and follow market trends, they must change the traditional way of doing business, adapt to new trends, and adopt new digital business models (Ivana Martincevic, 2022). In recent years, disruptive technology has changed the way of doing business, the financial market systems, and the way people live daily (Alharbi and Sohaib, 2021, Chaveesuk et al., 2022). As a result of digital transformation, the financial markets introduced the concept of FinTech as a financial innovation (Kucharova et al., 2021). The products of FinTech feature some of the most technological emergence that challenges the business models and accounting practices. So far, these products are blockchain technology and cryptocurrencies (Ivana Martincevic, 2022, Ramassa and Leoni, 2022, Sharma et al., 2021). The first cryptocurrency, Bitcoin, was developed in the late 2000s by the alias programmer or group “*Satoshi Nakamoto*” (Sharma et al., 2021, Warmke, 2021).

Cryptocurrencies in the financial market operate and function without the hand of an intermediary (Kamps and Kleinberg, 2018, Tredinnick, 2019, Perkins, 2018). Since cryptocurrencies operate without the mediation of banks, it enables users to complete transactions anonymously without being blocked or questioned about their purchases and, there is no limit to how much they can transfer. In addition, transactions can be completed more quickly than in the traditional banking system (Warmke, 2021). Hence, there are risks associated with cryptocurrency transactions as they are completely digital and decentralized (Klopper and Brink, 2023). To minimize the degree of uncertainty for users, there must be a regulatory market to ensure a transparent global network for cryptographic transactions and data credibility. The primary focus area that requires attention is the accounting and tax treatment of cryptocurrencies. This is because cryptocurrencies are associated with risks such as money laundering, tax evasion, and potential investment scams (Cao, 2020, Kethineni et al., 2018), which require the regulatory body and the establishment and implementation of regulation policies to ensure transparency in the business transactions that involve cryptocurrencies (Ivana Martinčević, 2022).

Blockchain technology and cryptocurrency present a challenge to the traditional financial system and existing regulations (Sotiropoulou and Guégan, 2017). The International Financial Reporting Standards (IFRS) did not cater to cryptocurrency when they were developed. Currently, there is an absence of specific accounting standards that apply to cryptocurrencies (Luo and Yu, 2022). Consequently, this has opened room for flexibility when applying the existing standards resulting in uncertainty for users when preparing their annual financial statements (Klopper and Brink, 2023). As a result, the International Accounting Standard Board (IASB), in June 2019, issued guidance on how cryptocurrencies may be treated for accounting purposes (Tan and Zhang, 2021). The International Accounting Standards Board deduced the applicable standard that may be appropriate to be applied to cryptocurrencies if held for trading may be the International Accounting Standard (IAS) 2 Inventory. Otherwise, the International

Accounting Standard (IAS) 38 intangible assets may be applied (Klopper and Brink, 2023). However, this did not age well as many stakeholders (Mlambo, 2022, Procházka, 2018, Ramassa and Leoni, 2022) amongst others have challenged this conclusion made by IASB based on whether the proposed guidance provides and represents relevant and faithful information to the users resulting in them making better economic decisions (Klopper and Brink, 2023).

## LITERATURE REVIEW

### The Concept of Cryptocurrency and Blockchain

The digitalization of currency and the emerging financial market trends led to the introduction of the widely adopted digital currency called cryptocurrencies. The introduction of cryptocurrencies changed the financial market and regulation system around the world. There are numerous individual definitions of cryptocurrency, but they all contain the same fundamental characteristics that must be present when defining cryptocurrency. According to Kamps and Kleinberg (2018), cryptocurrency is a digital peer-to-peer medium of exchange that does not require third-party involvement. Mlambo (2022) defines cryptocurrency as a nonpaper medium of exchange that is decentralized by the government and does not have a physical commodity backup. In addition, Mukhopadhyay et al. (2016) define cryptocurrency as an anonymous virtual exchange system in which currency units are generated and distributed.

Cryptographic transactions are facilitated by blockchain technology. Cryptocurrency and blockchain have shaped the world of science and technology (Vujicic et al., 2018). The concept of decentralized money was seen more as a theoretical concept but in a few years, it became viable. According to Yaga et al. (2019), the concept of blockchain technology emerged between the years 1980 – 1990 and was developed by Leslie Lamport in 1989. Blockchain is a distributed digital ledger that records the transactions and digital events that have taken place and shared between participants (Yaga et al., 2019). It allows one community of users to record transactions in a shared ledger for that community. Once a cryptocurrency transaction is published in this network or information is entered, it cannot be changed (Segendorf, 2014). Only valid and verified transactions can be entered into a blockchain network (Gandal et al., 2018). This process is conducted by cryptocurrency miners. Blockchain is considered to function the same as a general ledger which records every cryptocurrency transaction and movement. Sometimes it is referred to as a distributed ledger technology. Cryptocurrency miners then use complex mathematical algorithms to verify and authenticate the cryptocurrency transactions and legitimate transactions are put together into blocks (Augot et al., 2017).

## **Comparing the classification of cryptocurrencies using the conceptual framework and IASB's recommended treatment**

### **Conceptual Framework**

Before cryptocurrency gained popularity back in 2017, the International Accounting Standards Board and other regulators across the world were lagging in providing guidance on the treatment of cryptocurrencies because of their lack of mainstream interest and market exposure as a whole (Anderson et al., 2022). To ensure that financial statements are presented in a high-quality reporting manner, accountants adopt and apply standards that are issued by standard-setting bodies (Weygandt et al., 2018). According to IASB's conceptual framework, *“the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity”* (IASB, 2018). In terms of IAS 8 (Accounting Policies, Changes in Accounting Errors and Estimates), the hierarchy of accounting transaction treatment depends on whether the transaction applies to a specific IFRS. If the transaction applies to a specific IFRS, then the transaction should be treated by applying the relevant IFRS (Moosa, 2019, Klopper and Brink, 2023).

In the absence of specific IFRS issued by the IASB to account for cryptocurrency, the conceptual framework serves as the main tool that assists the IASB in developing new standards and accounting policies to be applied to cryptocurrency. In examining whether cryptocurrency is an asset, one must first apply the definition of an asset and if the definition is not met, then a possible expense exists. Furthermore, the recognition criteria must be considered (Klopper and Brink, 2023, Lesley Stainbank, 2021).

In terms of the conceptual framework, an asset is a resource owned or controlled by the entity as a result of a past event. Resource is a right that has the potential to result in future economic benefits (IASB, 2018). Klopper and Brink (2023) articulate that in terms of cryptocurrencies, buying the digital currency unit for future disposal represents the possible future economic benefit. The decision to sell the digital currency unit shows that the entity has the power to control the resource. The buying of cryptocurrency is a past event. Thus, the definition requirements are met. Cryptocurrency is widely identified as an asset. When Moosa (2019), examined the adequacy of the conceptual framework to determine whether

cryptocurrency can be classified as an asset, the conclusion was that cryptocurrency meets the definition of an asset as defined.

## **Iasb's Proposed Classification of Cryptocurrencies**

### **Intangible assets**

In terms of IAS 38, an intangible asset is an identifiable asset that is non-monetary without physical substance. When defining intangible assets, there are characteristics as per IAS 38 that need to be met before an item is treated as an intangible asset. These characteristics are an asset that must be identifiable, must not have a monetary value, and lastly, must not have a physical substance (Damián Pastor, 2016). For cryptocurrency to be identifiable, it must either be, able to be separated from the entity and be sold or transferred separately or it must arise from contractual or other legal rights. Furthermore, within the intangible classification, it must be treated as either an indefinite or finite intangible asset (Foy, 2019). Cryptocurrency is used as an exchange for either fiat money or another cryptocurrency. Thus it can be sold or transferred (Mlambo, 2022). Thus, the first proviso of the definition is met.

The second proviso of the definition is that cryptocurrencies lack physical substance. According to Hartley (2019), the primary reason why cryptocurrency is considered an intangible asset is that it lacks physical form or substance. The exact reason why it was excluded from being considered cash. Mlambo (2022) adds that the fact that cryptocurrency is referred to as virtual currency appropriately proves that cryptocurrency lacks physical substance.

It is therefore appropriate to conclude that cryptocurrencies may be classified as an intangible asset even though cryptocurrencies may lack future economic benefit because of their volatility. Moosa (2019) highlights that the possible exclusion of cryptocurrency from IAS 38, is when it is held for sale on the day-to-day day running of the business.

### **Inventory**

Moosa (2019) acknowledges that when applying the inventory definition as contemplated in IAS2, the relevance that can be assessed against cryptocurrency is the "*held for sale in the day-to-day running of the business*" proviso of the definition. Mlambo (2022) further adds that the holder should consider what constitutes the "*ordinary course of the business*". Mining cryptocurrency and regular trading constitute an ordinary course of business (Mlambo, 2022). Contradictory, Tan and Zhang (2021) argue that companies that mine and resell cryptocurrencies are allowed to classify cryptocurrency as inventory; however, because of measurement criteria not being met, it is not appropriate to classify cryptocurrency as inventory. Luo and Yu (2022) acknowledge that the interpretations committee suggests that if IAS 2 is not available, then IAS 38 should be adopted. It may be appropriate to deduce that, despite measurement criteria not being met, if the holder is trading regularly and or mines cryptocurrency for resale, the IAS 2 classification is appropriate.

## **Comparing the measurement criteria of cryptocurrencies using the conceptual framework and IASB's recommended treatment**

According to Moosa (2019), cryptocurrency classified and recognized as an intangible asset should be, initially, measured at cost. Moosa (2019) further states, concerning the guidance provided, the cryptocurrency that has been separately acquired, their measurement

cost is determined to be the amount paid by the holder of cryptocurrency. Moreover, if the cryptocurrency was obtained by the form of exchange of non-monetary assets, the value to be put of cryptocurrency should be fair value. This may be considered appropriate; however, Tan and Zhang (2021) articulate that the Australian Accounting Standards Board believes neither the cost model nor the fair value model provides an appropriate measurement for cryptocurrency.

In terms of IAS 38, an intangible asset can be measured in two ways, one, and the cost model. Secondly, the fair value model. Mlambo (2022) highlights that these two measurement models do not cater to an asset that is subject to volatility. Thus, agreeing with the Australian Accounting Standards Board. Therefore, IAS 38 measurement criteria should be amended to cater to cryptocurrencies as they are subject to high volatility.

IAS 2 states inventory is measured at a lower cost or net realizable value. Cost provides historical information which is not relevant as cryptocurrencies are volatile. Again, Mlambo (2022) acknowledges that inventory measurement criteria do not cater to cryptocurrency and further suggests that an additional measurement model be introduced that will specifically account for cryptocurrency.

### **Income Tax Implications of Cryptocurrencies**

The prompt of the need to provide guidance is important because without guidance it makes it flexible for taxpayers to engage in tax evasion. The need to change regulations and laws is encouraged due to the growth and increase in cryptocurrency transactions (Ivana Martinčević, 2022). Witnessing this level of popularity of digital currency, legal questions relating to taxation, illegal transactions, and financial regulation arise (Beebeejaun and Dulloo, 2021). The rapid growth of cryptocurrencies in recent years has left many accountants and investors with uncertainty during tax season (Mordecai, 2019). This has resulted in some taxpayers being hit with large tax bills because of the misinterpretation and misconception of crypto-asset tax implications. In the context of tax collection, Bal (2013) articulates that cryptocurrency transactions are untraceable, and therefore, for tax compliance to be achieved, the identification of users and transactions is necessary. Beebeejaun and Dulloo (2021) further highlight that academics believe that because of cryptocurrency anonymity, they are not subject to tax.

Alsalmi et al. (2023) state that some tax authorities already have issued guidance on the tax treatment of digital currencies which are currently taxable in countries like Canada, Germany, Italy, the United States, and the United Kingdom, amongst others. Ivana Martinčević (2022) highlights that in some countries like China, Bangladesh, Vietnam, Russia, etc., the possession of cryptocurrencies and exchange transactions is prohibited because of a lack of regulations which results in increased illegal transactions (Siswantoro et al., 2020). According to Cao (2020), countries like Iran, Russia, Venezuela, etc. have, in recent years, been creating their own cryptocurrency. Furthermore, Cao (2020), adds that in Venezuela, the government developed a cryptocurrency called “Petro” back in 2018.

### **RESEARCH METHODOLOGY**

The study had a primary objective to discuss the possible treatment of cryptocurrencies in the context of accounting and taxation. To achieve this main objective, the study focused on the analysis of existing data to refine a conceptual framework. Therefore, the conceptual research approach was adopted because it focuses on the exploration of abstract concepts. This was essential for the researcher because conceptual research challenges the existing knowledge and assumptions and allows the development of

new ideas, concepts, and theories (Mora et al., 2008, Klopper and Brink, 2023). The researcher followed the qualitative approach because it allows the researcher to comprehend concepts and opinions. The qualitative approach involves the analysis of non-numerical data which allows a researcher to identify how things have changed over time and the emerging concepts and enables the researcher to make future assumptions. Qualitative data collection includes various methods such as conducting interviews, paper analysis, and observations (Klopper and Brink, 2023, Friedman, 2011, Caudle, 2004). This secondary data was collected using key terms such as cryptocurrencies, tax, accounting, and blockchain amongst others from the Google Scholar database.

The study used paper analysis to achieve the primary objective. The paper analysis includes a systematic review of the papers (Bowen, 2009) regarding tax regulation and the accounting rules on cryptocurrencies. The accounting treatment of cryptocurrencies was determined by reviewing past literature and applying the IASB's conceptual framework approach. Furthermore, the study specifically applied the accounting concepts of IFRS and considered the guidance issued by the IASB to reach the appropriate conclusion on the accounting treatment of cryptocurrencies. Similarly, the tax legislation was considered when analyzing the possible tax regulation of cryptocurrency transactions. The recommendations by the Davis Tax Committee were also considered and compared to the existing recommendations from past literature.

The study adopted Google Scholar as its research paper database to ensure that the risk of missing relevant literature was minimized. Google Scholar is a common research database used in related fields and one of the most recognized research paper databases. Thus, most of the journals used in this study are indexed in the Google Scholar database. The study excludes publications such as editorials, letters, unrelated literature, unavailable full text, abstract-only papers, and technical reports since this is a systematic review study and primarily focuses on original studies. The reported outcomes used in this study include outcomes that are not self-reported but rather objectively measured. The study includes English language literature. The review of the study is limited to the countries that share similar regulations with South Africa. The study reviewed papers that were not older than five years. Therefore, to ensure the robustness of the literature, up-to-date and comprehensive papers were used and aligned with the scope of the review. The findings from papers older than the mentioned range were referred to and used in the introduction of this study. To ensure validity, a quality assessment of the papers was conducted. During the process of study, the risk of bias Publications, Selection bias, and others, were evaluated to ensure an accurate and valid overall review process.

## ANALYSIS, RESULTS, AND DISCUSSION OF FINDINGS

Comparing the classification of cryptocurrency using the conceptual framework and IASB's recommended treatment, the following was found. When applying the conceptual framework, it was found that cryptocurrencies meet the definition and the recognition criteria of an asset as outlined in the conceptual framework. The conceptual framework is aligned with the IASB's proposed accounting treatment for cryptocurrencies. When evaluating IASB's proposed accounting treatment of cryptocurrencies, it was found that cryptocurrency may be classified as either an inventory or an intangible asset. The study revealed that cryptocurrencies lack the possibility of providing future economic benefits because of their high volatility. This, however, does not exclude cryptocurrencies from being classified as an intangible asset. Similarly, with regards to IAS 2, even though the measurement criteria are not met, entities that regularly mine and resell cryptocurrencies may appropriately classify cryptocurrencies as inventory.

When evaluating the measurement criteria of cryptocurrencies, it was found that the measurement method applicable for cryptocurrencies is the cost model and the cost is the amount paid by the holder of cryptocurrencies. However, if the consideration was in the form of non-monetary exchange, the fair value model must be used as the measurement method. However, some researchers opposed this and stated that neither the cost model nor the fair value method caters to assets that are subject to high volatility like cryptocurrencies. Thus, IASB should revisit and revise the accounting standards and introduce a model that will specifically cater to cryptocurrencies.

In the context of taxation within South Africa, an explanatory memorandum of the taxation laws amendment bill, which was issued on 20 January 2021, cryptocurrencies are treated as an asset and all the receipts and accrual may be subject to inclusion in income tax. Any gains and losses will be subject to capital gains tax implications. This is aligned with other tax regulations proposed and implemented by other jurisdictions such as the United Kingdom and Australia. The taxpayers may claim a deduction for expenses incurred when initiating a transaction. From the context of value-added tax (VAT) within South Africa, the treatment of cryptocurrencies is very clear. The issue was whether cryptocurrency could be classified as a financial service or not. It was found that in the South African tax legislation under the VAT act, the definition of financial services now includes cryptocurrencies. This was not the case before the emergence of cryptocurrencies. Financial services are exempt from VAT.

## CONCLUSION

The absence of specific IFRS questions whether the guidance issued by IASB is sufficient in addressing the uncertainty faced by accountants and auditors in practice and theory. The measurement criteria do not necessarily deal appropriately with cryptocurrencies. It was identified that measurement models do not cater to an asset that is subject to volatility. Therefore, IAS 38 and IAS 2 measurement criteria should be amended to cater to cryptocurrencies as they are subject to high volatility or a new measurement model must be introduced. This reflects that the measurement criteria of cryptocurrencies within IAS 38 and IAS 2 still require further analysis and research. Should the uncertainties persist, the IASB's proposed accounting treatment of cryptocurrencies will continue to be questioned. As a result, the application of existing accounting standards will continue to be inappropriate, and uncertainty will persist as IASB lags in issuing the applicable specific IFRS that addresses cryptocurrencies. Thus, it is appropriate to conclude that the conceptual framework and International Framework Reporting Standards do not provide sufficient guidance on how cryptocurrencies should be accounted for from the accounting perspective.

Similarly, the lack of tax regulation of cryptocurrencies results in taxpayers engaging in illegal activities such as tax evasion. It is evident from this chapter that most countries classify cryptocurrency as property and as a result, capital gains tax implications are triggered. It was mentioned that in South Africa, cryptocurrencies are referred to as crypto-assets and may be subject to normal income tax consequences such as, if the proceeds received from the trading of cryptocurrencies meet the definition of gross income, then it will be taxed, and the related expenses may be allowed as a deduction provided that the requirements of section 11(a) read together with section 23 are met. Moreover, it was found that cryptocurrencies may be treated as trading stock if the taxpayer is involved in the buying and selling of cryptocurrencies.

Cryptocurrencies present complexities and challenges for both taxpayers and tax authorities from the practical perspective. Addressing these difficulties, taxpayers and tax authorities may work hand in hand and collaborate to combat possible non-tax compliance. It

is also recommended that tax authorities develop tax policies and enhance technological measures to track the history of cryptocurrency transactions to ensure tax reporting obligations are met.

### Recommendations for Future Research

Further inquiries within the spectrum of this study may include investigating the measurement inadequacies within IAS 38 and IAS 2 based on substance over form on cryptocurrencies. The secondary recommendation for future research may focus on how auditors may use auditing standards to obtain sufficient appropriate audit evidence on cryptocurrency transactions to ascertain faithful representation of financial statements.

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