

Bitcoin regulation in New Zealand: A dense fog

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The article below is a summary of a speech given by [Simon Jensen](#) at the Bitcoin South Conference in Queenstown, New Zealand on 29 November 2014. The article is not legal advice and anyone considering operating a business that involves Bitcoins should seek specific legal advice before doing so.

The legal and regulatory landscape that applies to Bitcoin in New Zealand could be described as a dense fog. However, this does not appear to be limited to New Zealand as regulators internationally seem to be struggling with how to regulate Crypto-Currencies.

What is Bitcoin in a legal sense?

In order to determine how New Zealand regulation applies to Bitcoin, we need to first determine what Bitcoin is in a legal sense - which is easier said than done. Chris Skinner, who is regarded as a world leader in digital banking, describes Bitcoin and the blockchain as "a protocol, a commodity, a technology, a smart contract system, a general ledger, a secure exchange.... a many splendid thing".

So, what are the options?

- Currency, like cash
- Commodity, like gold or diamonds
- Security, like a bank account
- Payment system, like SWIFT
- All of the above.

In our view, Bitcoin and the blockchain have characteristics of all of the options above.

What do the regulators think?

- The Inland Revenue Department has not yet said much in relation to Bitcoin but, for some purposes, is treating it like a currency. For other purposes, it is likely to be a commodity
- The Reserve Bank has stated that Bitcoin is not a currency
- The Financial Markets Authority has not said anything on Bitcoin yet
- We understand the Department of Internal Affairs and the Reserve Bank have said they believe bitcoin is caught by anti-money laundering legislation.

How will Bitcoin be treated for tax?

It is not currently clear how Bitcoin fits into existing tax legislation and, as mentioned above, the Inland Revenue Department may treat it as a currency for some purposes and a commodity for others. While it is clear that dealing in Bitcoin is taxable (like foreign exchange dealing) and being paid for goods and services in Bitcoin does not avoid an obligation to pay GST, there are many things that are less clear, such as:

- Whether Bitcoin mining is taxable
- Whether mined coins could be subject to GST
- Whether Bitcoins purchased from an ATM could be subject to GST
- Whether payment by Bitcoins is likely to be treated as barter and subject to GST.

As the GST Act never contemplated Bitcoin, it does not fall within the provisions for financial services (which for GST purposes, are zero-rated). Therefore, the supply of Bitcoin is likely to be a service for GST purposes and subject to GST at the standard rate (currently 15%).

In addition, the Inland Revenue Department would have a strong argument that any Bitcoins acquired by a business in exchange for goods or services were intended for disposal and on that basis, to the extent that there was any gain in value of the Bitcoins between receipt and sale, that gain would be subject to income tax.

Is Bitcoin covered by anti-money laundering legislation?

The type of business you are operating will impact on whether you are required to comply with obligations under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the Act). However, even if you do not strictly have to comply with the Act, there may be some benefits from doing so anyway.

The subjects of AML law in New Zealand are predominantly those that fall within the definition of "financial institutions". This definition is far wider than most would expect - it can extend to sole traders and small businesses. It includes a person who in the ordinary course of business carries on one or more prescribed financial activities.

These range from issuing and managing the means of payment, accepting deposits from the public, to lending, transferring money, managing portfolios and a host of other traditionally framed activities. Depending on the nature of the business you operate, there are several that you could fall under.

For some Bitcoin businesses, there are interpretations of the Act (and the financial activities prescribed in it) that would mean those Bitcoin businesses are not caught. However, given several comments from relevant regulators like the Department of Internal Affairs and the Reserve Bank, we think there is a real risk that the Act will be interpreted broadly in order to catch Bitcoin businesses. Challenging their interpretation could result in a litigation process that is costly, time-consuming and most importantly, ultimately pointless - as the regulators have the ability to designate an entity as a reporting entity.

Additionally, the black cloud that continues to hang over Bitcoin in the minds of the general public, in terms of the criminal links, means complying with the Act would be a step to show that you are conducting a legitimate business.

This risk of designation, as well as the benefits of being seen to be regulated, means we recommend that businesses comply with the Act - this can be relatively inexpensive depending on the nature and size of your business. All businesses complying with the Act will need to undertake a risk assessment of money laundering and financing of terrorism that could be expected in the course of its business. They will also need to adopt a compliance plan to detect, deter, manage and mitigate money laundering and financing of terrorism. A compliance officer must be appointed to administer and maintain this plan. This can be done relatively inexpensively, with brief documentation and there are no restrictions about who can be a compliance officer. A business needs to report suspicious transactions and undertake an audit of its risk assessment at least once every two years.

Compliance becomes slightly more difficult and expensive if the business needs to engage in customer due diligence, this is referred to as CDD. A business will have to undertake CDD if it has a 'business relationship' with a customer or where the customer is conducting an 'occasional transaction'.

A business relationship requires some duration and will not typically be engaged in if your business involves one-off transactions or interactions with no obligation for the customer to return on a regular basis. For example - bitcoin ATMs. However, if your business involves a customer creating an account, as might happen with a Bitcoin exchange, then you may be required to undertake CDD.

Regardless of whether your business involves a business relationship, if you have an occasional transaction then you must perform CDD. An occasional transaction is one that exceeds \$9,999.99, whether in one single transaction or a series of linked transactions.

Therefore if your business does not cap the amounts that may be transacted below \$10,000, or if your business necessitates ongoing interactions, your business will need to undertake CDD.

CDD requires a business to identify its customers and verify who their customers are. This typically requires obtaining and verifying the individual's full name and address. There are more onerous CDD obligations if a customer is a particular kind of legal entity, is from a foreign country with insufficient anti-money laundering measures, or if the customer seeks to conduct a particularly unusual or large transaction or pattern of transactions.

Even if you do comply then there are the banks. The banks are concerned about their own anti-money laundering obligations and most appear to think that it is too hard and too risky to bank businesses providing Bitcoin related service (such as ATM providers and exchanges). However, this is not restricted to bitcoin as the banks have been closing accounts of bank money transfer service operators as well. The Reserve Bank appears to be taking a wait and see approach to this issue, rather than taking any active steps to resolve it.

Are you a financial service provider?

Finally, there is the Financial Service Providers (Registration and Dispute Resolution) Act 2008. If you are caught by the anti-money laundering legislation you will almost certainly fall within this Act and will be required to register. This is because the prescribed financial activities that bring you within the definition of financial institution for anti-money laundering purposes are similar to the list under the Financial Service Providers (Registration and Dispute Resolution) Act. In particular, it includes "managing a means of payment". However, the compliance obligations are relatively minimal.

Is Bitcoin a security?

Securities legislation often captures entities trying to create alternative currencies. It has been the starting point for advice for dominant players in the payments industry as well as smaller entrepreneurs. It is certainly where regulators might focus.

However, in relation to Bitcoin, right now there is no issuer and no one to regulate under securities legislation and, as it is not a financial product, the broking regulations also probably do not apply.

This changes, however, if you start looking at Bitcoin derivatives as derivatives are caught under legislation and you would be required to have a product disclosure statement if you offer them.

Consequences of being a "payment system"

A payment system is defined in the Reserve Bank of New Zealand Act 1989 as "a system or arrangement for clearing and settling payment obligations or processing payment instructions". We believe that Bitcoin could be a payment system under this definition.

However, what does being a payment system mean in practice?

- First and foremost, the Reserve Bank's powers in relation to payment systems are limited. It currently can only request information or data relating to a payment system. However, in regards to Bitcoin and the blockchain itself, there is no entity which the Reserve Bank could in fact make such a request to - there is no entity it could regulate as the operator of this payment system. On that basis, Bitcoin and the blockchain being a payment system doesn't affect any user of Bitcoin in regulatory terms
- There is a chance that the Reserve Bank could attempt to say that a type of business involved with Bitcoin is a payment system - for example, Bitcoin exchanges. However, given the current powers the Reserve Bank possesses in respect of payment systems, this should not pose too many problems for the businesses regulated. It is unlikely a request for information would be too onerous (and if your business is small, it is unlikely that the Reserve Bank would in fact exercise its powers in relation to you)
- The Reserve Bank will be gaining expanded powers in relation to payment systems - however, this will likely be limited to those that are systemically important or of system-wide importance. If Bitcoin and the blockchain itself were considered to fall within these categories, there would again be the problem of who the Reserve Bank would call on as the operator of the system.

In the short term, it is unlikely that Bitcoin and the blockchain could currently be regarded as systemically important or of system-wide importance in the context of New Zealand. The value being transacted is minor compared to the up to \$35b per day passing through New Zealand's other payment systems.

What will the future bring?

Glyn Davies in *The History of Money* said "around the next corner there may be lying in wait apparently quite novel problems which in all probability bear a basic similarity to those that have already been tackled, with varying degrees of success or failure in other times and other places".

However, we do not think Glyn Davies quite expected the level of novelty raised by Bitcoin which is fundamentally unlike anything before because:

- There is no issuer
- It is controlled by a distributed network anyone can join
- It has no national boundaries
- It can be exchanged anywhere around the world in 60 minutes or less
- It is not one thing, but "a many splendid thing".

If Bitcoin become more mainstream it is clear that the traditional ways of regulating are going to have to be adapted. We are going to have to find new ways, possibly not thought of before, to regulate it.

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