Law360 Canada | 111 Gordon Baker Road, Suite 900 | Toronto, ON M2H 3R1 | www.law360.ca

Tax

Proposed amendments to GST/HST rules for cryptocurrency mining

By **David Rotfleisch**


David Rotfleisch

(February 15, 2023, 11:03 AM EST) -- The Canada Revenue Agency/Department of Finance has been very slow in legislating or providing guidelines related to cryptocurrency. However, in February 2022, the Department of Finance released draft GST/HST legislation, which has not yet taken effect, related to cryptocurrency mining.

The proposed rules will treat cryptocurrency mining as an exempt supply. The cryptocurrency miner will neither collect nor remit GST/HST on mining income, and cannot claim input tax credits for mining-related expenses.

Subsections 165(1) and (2) of Canada's *Excise Tax Act* levy GST/HST on "every recipient of a taxable supply made in Canada." A "taxable supply" is basically a sale.

While the purchaser or consumer bears the obligation to pay GST/HST, the obligation to actually collect and remit the GST/HST falls on the vendor. So, vendors must register for a GST/HST number with CRA, charge GST/HST on their services or sales and remit that GST/HST to the CRA.

However, the *Excise Tax Act* exempts various businesses from the obligation to collect GST/HST.

For example, a financial services business is exempt. The *Excise Tax Act*'s definition of a "financial service" captures various transactions involving money or a "financial instrument."

A financial instrument generally refers to securities, insurance policies, precious metals and similar instruments. In June 2021, the *Excise Tax Act*'s definition of "financial instrument" was amended to include a "virtual payment instrument" that refers to "property that is a digital representation of value, that functions as a medium of exchange and that only exists at a digital address of a publicly distributed ledger."

So, fungible cryptocurrency, Bitcoin being the paradigm, falls squarely within the definition of a "virtual payment instrument." Cryptocurrency trading or the use of cryptocurrency as a method of payment are therefore GST/HST exempt because they each qualify as a financial service under the *Excise Tax Act*.

But a virtual payment instrument explicitly excludes the following:

- "property that confers a right, whether immediate or future and whether absolute or contingent, to be exchanged or redeemed for money or specific property or services or to be converted into money or specific property or services"; and
- "property that is primarily for use within, or as part of, a gaming platform, an affinity or rewards program or a similar platform or program."

The definition of a virtual payment instrument may therefore exclude specialized tokens that cryptocurrency platforms issue to investors under DeFi (decentralized finance) arrangements.

For example, in cryptocurrency liquidity mining, an investor gives capital to a cryptocurrency platform in need of liquidity and, in exchange, the platform may issue to the investor a specialized token bearing the right to redeem for a certain number of cryptocurrency units. The definition of a virtual payment instrument excludes specialized liquidity tokens with these attributes.

In addition, non-fungible tokens (or NFTs) don't clearly fall under the definition of a virtual payment instrument. NFT artwork, for instance, often consists of a digital representation of a piece of art or music, not a "digital representation of value." As such, it arguably doesn't "function as a medium of exchange." So, although a cryptocurrency-trading business qualifies as a GST/HST-exempt supply of financial services, commercial NFT sales remain a taxable supply under Canada's *Excise Tax Act*.

The Department of Finance proposed the addition of s.188.2 to the *Excise Tax Act* to specifically address cryptocurrency mining. If the legislation is passed, these tax rules will retroactively come into force as of Feb. 5, 2022.

Section 188.2 deems the provision of "mining activity" to not be a supply for GST/HST purposes. "Mining activity" covers three activities:

1. Cryptocurrency mining: The process by which new cryptocurrency transactions are verified and recorded as a new block on the cryptocurrency network's blockchain.
2. Cryptocurrency nodes: The process of maintaining a cryptocurrency network's blockchain and allowing access to the blockchain ledger.
3. Pool mining: The pooling of computer resources by cryptocurrency miners so that they may increase their chances of being the first to validate a transaction. (Cryptocurrency mining occurs on a competitive basis. A mining reward is credited to the miner who validates the transaction first.)

Canadians engaging in cryptocurrency mining, cryptocurrency nodding or cryptocurrency pool mining will not collect or remit GST/HST on the income they earn from their mining activities.

Further, any expenses in relation to the cryptocurrency mining activity are deemed not to have been used by the taxpayer in the course of a commercial activity. This denies deductions for claiming input tax credits (ITCs) for cryptocurrency-mining operations such as the related electricity costs.

This matches the GST/HST treatment of exempt supplies, which include, for example, financial services, health-care services, medical services and dental services. An exempt supplier doesn't charge GST/HST but cannot claim ITCs to recover the GST/HST that the supplier paid on its business expenses.

In contrast, a zero-rated supply is still a taxable supply, but the GST/HST rate is zero per cent. So, while a zero-rated supplier need not charge GST/HST, the zero-rated supplier can still claim ITCs to recover the GST/HST paid.

This is part one of a two-part series.

David J. Rotfleisch *is the founding tax lawyer of* Rotfleisch & Samulovitch P.C.*, a Toronto-based boutique tax law and corporate law firm. He appears regularly in print, radio and TV. With over 35 years of experience as both a tax lawyer and chartered professional accountant, he has helped startup businesses, resident and non-resident business owners and corporations and cryptocurrency traders with their tax planning, with will and estate planning, voluntary disclosures and tax dispute resolution including tax audit representation and tax litigation.*

Photo credit / ojogabonitoo ISTOCKPHOTO.COM

Interested in writing for us? To learn more about how you can add your voice to Law360 Canada, contact Analysis Editor Yvette Trancoso at Yvette.Trancoso-barrett@lexisnexis.ca *or call 905-415-5811.*