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The Need for Regulations Governing the Taxation of Cryptocurrency in Nigeria

Introduction

Over the years, mediums of exchange have evolved from barter to the use of gold and other precious metals, fiat currency and high-tech e-money characterized by the use of credit cards and e-wallets. Then in 2009 the concept of money and payments changed with the emergence of blockchain technology and the birth of cryptocurrencies. The emergence of cryptocurrency has pushed the world of money and finance into its next phase of evolution.

Cryptocurrency has leveraged blockchain (which records transactions that are updated in real time on an online ledger and maintained by a network of computers) to create a whole new set of jobs and businesses.[1] It has also established a new generation of wealthy individuals. On the 6th of February 2018, Forbes released the list of 'The Richest People in Cryptocurrency', showing the estimated net worth of the top 19 wealthiest people from trading crypto-assets and stakes in crypto-related businesses.[2] These 19 individuals have an estimated total net worth of about $19,450,000,000 (nineteen billion, four hundred and fifty million dollars).

Nigeria is not left out of the rush for cryptocurrencies. Since the beginning of the cryptocurrency boom, quite a number of cryptocurrency exchanges have sprung up in the country, giving individuals seeking to trade in cryptocurrencies an avenue to participate in the global trading of crypto-assets. This in turn creates a revenue stream for these individuals on which they are obligated to remit income tax to the appropriate authorities. However, the existence of cryptocurrency outside of the conventional financial system, as well as the anonymous nature of cryptocurrency transactions, make it easy for investors to operate under the tax radar, as in many cases the investments are not accounted for.

This article examines the evolution of cryptocurrency and the need for regulations in order to ensure proper taxation of income derived from cryptocurrency.

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[1] Jonathan Vaux in Garrick Hileman and Michel Rauchs, 'Global Cryptocurrency Benchmarking Study', Cambridge Centre for Alternative Finance, University of Cambridge Judge Business School (2017), 4.

[2] P. Ambler, A Au-Yeung, G. Chung and ors., 'The Richest People in Cryptocurrency', Forbes (February 6, 2018) https://www.forbes.com/richest-in-cryptocurrency/#36545741d496 accessed February 13, 2018.

The Emergence of Cryptocurrency

The year 2009 was a turning point in the history of mediums of exchange, with the creation of Bitcoin by a scientist operating under the Japanese pseudonym 'Satoshi Nakamura'. The successful launch of Bitcoin in 2009 has also seen the introduction of various other cryptocurrencies.[3] These include Ethereum, Ripple, Litecoin, Dash, Monero etc.

Cryptocurrencies allow for a distributed, safe and decentralized payment system that does not require the services of banks and intermediaries or any central infrastructure to work. This is achieved through the use of cryptography and a collective booking system known as Blockchain.[4] These cryptocurrencies can function as a medium of exchange used as payment for goods and services, or held for investment as a store of value. However, cryptocurrencies are yet to be issued with legal tender status in any country.

As at 2017, a study conducted from data gathered from over 150 cryptocurrency companies and individuals, covering over 38 countries from five world regions revealed an estimated 2.9 million to 5.9 million unique active users of cryptocurrency wallets, and between 5.8 million and 11.5 million estimated currently 'active' wallets.[5] The increasing popularity of cryptocurrency has attracted the interest of a number of investors who are considering how to invest in this new class of asset.[6] Thus cryptocurrencies are fast becoming an alternative for investors seeking to diversify their investment portfolios. In 2017, cryptocurrency had a market capitalization of over $200 billion.[7]

The rise in the acceptance and popularity of cryptocurrency has prompted governments all over the world to pay attention to the regulation and taxation of cryptocurrency.

Taxation of Cryptocurrency: The United States Example

In the United States, the Internal Revenue Service (IRS) released Notice 2014-21, describing how existing general tax principles apply to transactions involving cryptocurrencies. In its notice, the IRS was of the view that 'the sale or exchange of convertible virtual currency, or the use of convertible virtual currency to pay for goods or services in a real-word economy transaction, has tax consequences that may result in a tax liability.[8]

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[3] C. Jonathan and K Thorsten, 'The Economics of Cryptocurrencies – Bitcoin and Beyond' (April, 2017),2.

[4] N. Christian and M Markus, 'CIO Insights Reflections: Cryptocurrencies and Blockchains – their importance in the future' (December, 2017) Deutsche Bank Wealth Management, 4.

[5] Garrick Hileman and Michel Rauchs, Op. Cit., 10.

[6] D. Alexander, L. Peter and V Zintis, 'The Future of Cryptocurrency: An Investor's Comparison of Bitcoin and Ethereum' (2016) Ryerson University, 5.

[7] N Christian and M Markus Op. cit.

[8] Section 3 of the IRS Notice 2014-21.

For tax purposes, the United States Internal Revenue Service treats cryptocurrencies as property and the general tax principles applicable to property transactions are also applicable to transactions involving cryptocurrencies.[9] A taxpayer who receives cryptocurrency as payment for goods or services is obligated to include the fair market value of the cryptocurrency in computing his/her gross income. The value of the cryptocurrency must be measured in U.S. dollars, as of the date the cryptocurrency was received.[10]

Furthermore, the determination of the gross income of the taxpayer for the purpose of taxation in the United States also includes cryptocurrencies received from the mining activities (e.g. Bitcoin mining) by individuals; income derived by individuals engaged in the mining of cryptocurrencies as a trade or business; Cryptocurrency received for services performed as an independent contractor (for the purpose of self-employment tax); cryptocurrency paid by an employer as remuneration for services (for the purpose of employment tax); etc.[11]

Failure by a taxpayer to treat cryptocurrency transactions as required by IRS Notice 2014-21may subject such a taxpayer to penalties for failure to comply with tax laws. Furthermore, a taxpayer who fails to timely or properly report virtual currency transactions when required to do so may be subject to information reporting penalties under United States tax laws.[12]

In order to further ensure that taxpayers dealing in cryptocurrencies are brought under the tax net, the US Department of Justice (DOJ) filed a petition with the US District Court for the Northern District of California on November 17, 2016, wherein the DOJ asked the court for a John Doe summons to be issued to the Bitcoin exchange Coinbase Inc, the largest Bitcoin exchanger in the United States. The purpose of the Summons was to compel Coinbase Inc. to provide the DOJ with information on all Bitcoin transactions processed between 2013 and 2015. The information will then be shared by the DOJ with the IRS which will then be matched against filed tax returns.[13]

A Case for a Regulation for the Taxation of Cryptocurrency in Nigeria

Nigeria has witnessed a rise in the number of cryptocurrency exchanges operating in the country. However, years after the launch of the first cryptocurrency, the relevant tax authorities in Nigeria are yet to come up with specific regulations on the

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[9] Ibid., Section 4.
[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] Adam Bergman, 'Separating Myth and Reality of How Cryptocurrencies are Taxed and Regulated' (Jan 29, 2018) Forbes https://www.forbes.com/sites/greatspeculations/2018/01/29/separating-myth-and-reality-of-how-cryptocurrencies-are-taxed-and-regulated/#3374b79420cc accessed February 16, 2018.

taxation of cryptocurrency. While it can be argued that gains made from cryptocurrency are taxable in the hands of investors, the nature of cryptocurrency makes it difficult for gains on investments, to be tracked by the relevant authorities.
While it is agreed that blockchain technology is relatively new, therefore staff of the tax agencies may not understand how it works and as such may be unable to come up with guidelines on how such transactions should be taxed, it might be prudent for Nigeria to look to the United States model by compelling existing exchanges to disclose all cryptocurrency transactions for the purpose of taxation.
There is also the need to adequately train the staff of the various agencies on the workings of blockchain technology and cryptocurrencies as well as provide adequate infrastructure and equipment to enable these agencies operate on the same level as their international counterparts.

Plugging the loss of revenue that should accrue to the government from cryptocurrency transactions in Nigeria is possible, but the right regulations must be put in place to make this happen.

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