

Digital currency, the beginner's guide

Digital or cryptocurrencies, such as Bitcoin, have taken off in recent years, spurred on by a sharp rise in the use of the internet for currency transfer. They do not exist in a physical form. They are housed purely online. But how do they work?

If you've ever wanted to know more about the disruptive new wave of currency, as well as the what you need to think about it before diving into it, we've got it covered.

Bitcoin - what is it?

Being the most prominent form of cryptocurrency, Bitcoin will be our key focus.

Bitcoin was launched in the late 2000s by individuals operating under the alias "Satoshi Nakamoto".

In essence, Bitcoin is a peer-to-peer digital currency that can be used for a variety of online transactions. No "middle-men" such as financial institutions are involved in the currency transfer and it is decentralised.

Bitcoins can be created or "mined" by users with powerful computers solving a freely available, but complex, mathematical formula. The Bitcoins are then shared, however this does not mean that an infinite amount can be generated, with the protocol limited to generating no more than 21 million Bitcoins.

Just like dollars and cents, Bitcoins can also be divided into smaller parts - the smallest amount being a Satoshi, which is a one-hundred millionth of a Bitcoin.

How can records be kept with a decentralised currency? They're stored in an online ledger called the "blockchain".

The "blockchain" has a record of all Bitcoin - or any cryptocurrency - transactions that have ever occurred, which is freely accessible to anyone online.

For obvious reasons, this ledger only includes numbers and no personal details ever need to be listed in a Bitcoin transaction - essentially also offering some advantages of security depending on the transactions.

What are the advantages and disadvantages

As a relatively new trend, the world is still getting to grips with Bitcoin and other forms of cryptocurrency. There are a number of things you need to consider before exploring its use.

"One significant consideration is that its value is volatile. Over the past few years Bitcoin has traded for as low as US\$200-300 a Bitcoin and as high as over \$US1000 per Bitcoin," Crowe Horwath adviser Wai Choong Chan said.

"In addition, there are concerns over how securely Bitcoins are stored in Bitcoin exchanges as evidenced by the hacking of several Bitcoin exchanges and the loss of Bitcoins over the years."

"On the other hand, transacting with Bitcoin is generally cheaper than traditional non-cash means such as credit/debit cards or wire transfers."

Being a peer-to-peer service, transactions can also be simplified across borders, with a quick processing turnaround and no high transaction fees to burden users.

Are there any tax considerations

There are a number of tax considerations for businesses and individuals trading Bitcoin.

“As a business if you’re getting paid in Bitcoin, it becomes a consideration for tax,” said Chan.

“It is considered a barter arrangement and you will have to pay tax and GST on the Australian dollar equivalent of the Bitcoin received.”

According to the Australian Taxation Office “the value in Australian dollars will be the fair market value which can be obtained from a reputable bitcoin exchange.”

The ATO outline a number of records you should be keeping for each transaction:

1. the date of the transactions,
2. the amount in Australian dollars (which can be taken from a reputable online exchange),
3. what the transaction was for, and,
4. who the other party was (even if it’s just their Bitcoin address).
5. Chan said “however if it is sold its products overseas, those sales enjoy a GST exemption (for exports) and your business won’t need to pay any GST on the Bitcoin received.”

What’s next?

If you’re interested in diving into the world of Bitcoin, then the next step will naturally be to buy a few. These can be purchased from Bitcoin exchanges or via online marketplaces.

You will also want to consider purchasing something known as a Bitcoin “wallet”, which is essentially a software tool which works to protect your supply.

However before you move forward, also ensure that you thoroughly research the topic and contact your Crowe Horwath adviser for expert advice.