

**Bitcoin Mining under the South African Income Tax Act:  
A Case for a Common Treatment**

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A dissertation of limited scope in partial fulfilment of the requirements of a  
Master of Laws (LLM) in Commercial Law

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2024

[Word Count, including footnotes, *circa* 26,100]

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## **ACKNOWLEDGEMENTS**

First and foremost, I would like to extend my thanks to Prof. Titus for agreeing to supervise my research – once again. Her generosity of time, encouragement, and feedback is greatly valued, and appreciated.

In addition, I would like to thank Prof. Titus, and Prof. Hattingh of the University of Cape Town in their capacity as two of my past lecturers in the field of Tax Law; having completed this dissertation, and with the benefit of hindsight, the impact they have had on broadening my thinking on tax as a societal phenomenon emerges as a most invaluable contribution.

## ABSTRACT

Effective from the 1<sup>st</sup> October 2001, the basis for taxation in South Africa was fundamentally amended by virtue of the introduction of the Eighth Schedule as the embodiment of a tax regime based on the Haig-Simons comprehensive model of income. It is known as 'Capital Gains Tax', or CGT, the tax base of which is all non-trade net accretions to wealth, subject to certain exclusions. In contrast to the gross income definition and associated jurisprudence, the definition of a tax event for the purposes of the CGT regime includes the notion of the creation of an asset. The guidance of the South African tax authority in conjunction with academic commentary propose the construction that 'creation' must be understood with reference to a taxpayer's counterparty. This research supports the opposing view; it is necessary to give effect to the underlying statutory purpose that the term is not so narrowly interpreted as to exclude the creation of real rights.

From the perspective of South African tax policy, a crypto asset has been defined as a 'financial instrument' in order to ensure it is not treated as a currency, and falls outside the definition of 'personal-use asset' for the purposes of the CGT regime. The progenitor of modern crypto assets, Bitcoin, is dissimilar to other listed financial instruments per the definition insofar as it is more properly construed on the facts as a real right, rather than a complex of personal rights, involving an issuer and a holder. Moreover in the context of Bitcoin, the indispensable process known as 'mining' gives rise to the creation of a real right within the ambit of the intended operation of the CGT regime, as well as transactional receipts/accruals from counterparties.

Guidance issued by the South African tax authority for how Bitcoin mining is to be treated implies that it always gives rise to a tax event under the normal tax regime realization immediately upon accrual. This research examines this contention, and demonstrates that there is nothing inherent in Bitcoin mining which satisfies the jurisprudential test for 'not of a capital nature'; as such it may be dealt with under either regimes without any basis in law for deferment. Nevertheless, a legal analysis of a technological nuance born out of the practicality that mining is a computational race demonstrates the constitution

of a partnership arrangement, or an exchange contract for services, particularly in the case of hobbyist miners, or those likely lacking a trade intention. The inescapable effect is that taxation under the normal tax regime is compelled; the respective tax provisions negate any consideration of taxpayer intention. Counterintuitively, a commercial miner, who in fact has a trade intention, enjoys the possibility of taxation under either regime in principle. In a sense this leads to a violation of the neutrality principle in that there is a trade-off between preferential tax consequences and economic efficiency in conducting fundamentally the same activity.

The research recommends that the tax legislation should be amended so as to provide for a common, neutral treatment of Bitcoin mining, by which tax is collected immediately under the CGT regime in all cases, while preserving the rights of the state to tax under the normal tax regime in appropriate circumstances to ensure indifference between the current treatment suggested by the tax authority and the proposed treatment, in nominal terms. The interests of the state and taxpayer are thus balanced in accelerating cash flow for the state in exchange for the provision of tax relief for taxpayers who inadvertently fail to appreciate the legal consequences of different mining methods, and/or genuinely have no intention to trade. Universally, it leads to greater legal certainty through a simplification of the tax treatment by disregarding all the nuances which lead to differing results.

## **KEY WORDS**

Bitcoin; BTC; capital gains tax; CGT; creation; crypto; cryptocurrency; disposal; Eighth Schedule; financial instrument; gross income; Haig-Simons; interpretation; mining; neutrality; normal tax; partnership; personal right; proof of work; real right; trading stock.

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## GLOSSARY OF TERMS

- Block:** a block is a collection of data which in effect aggregates changes to BTC holdings corresponding with/to a particular wallet address on the Bitcoin Network. Blocks are continually connected forming a blockchain, which cumulatively represents the state of the network.
- Blockchain:** a concatenation of blocks in a chain, the cumulative history of which represents the current state of wallet addresses on the Bitcoin Network.
- Block Fee:** the aggregate of the BTC which Bitcoin Network users pay to have their transaction validated in any given block. It is earned by the miner who is first to broadcast a valid proof, and consequently is transactional in nature.
- Block Reward:** the BTC included as the first entry in any block, and which represent new BTC created by the first miner to find a valid proof in favour of themselves. In contrast to the Block Fee, it is not transactional in nature.
- Block Hash:** this is a string of hexadecimal characters which is generated by parsing the data contexts of a block through a hash function; each block has a unique hash identifier.
- BTC:** the asset symbol for Bitcoin.
- Difficulty:** the Bitcoin Network is designed to maintain on average a consistent rate of block generation. Consequently, when additional computational power is made available on the network, the average block time decreases. In order to offset the effect of this increase in computational resources, difficulty is increased by requiring proofs to contain more zero bits. Conversely, when computational

power is removed from the network, the difficulty is decreased.

**FPPS:** Full-Pay-per-Share (“**FPPS**”) is a luck-agnostic model. Participants and the promoter of a pool receive distributions based on a simulated calculation, ie the total Bitcoin per block divided by the statistical average number of shares expected to be required to find a proof. The pool then distributes based on this hypothetical value. Distributions, therefore, are not predicated on the pool actually finding a proof, but proceeds on the basis that in the long run the pool would neither be lucky nor unlucky. Any liquidity risk, however, in the short term is by implication carried by the promoter.

**Hash:** a 64-digit hexadecimal number.

**Horizontal Equity:** this concept connotes the philosophy that persons in materially similar economic circumstances should bear an equal tax burden.<sup>1</sup>

**Luck:** given a particular level of difficulty for a required proof, luck expresses the variance of a pool from what is determined as the expected number of computations required to find a proof. Presuming this expected value is 1,000 computations, where a pool finds a proof after 100 computations, it is considered lucky, or unlucky if it exceeds the expected number of computations.

**Node:** a node is an intersection point between the Bitcoin Network and mining devices used to support the network via direct interaction with a copy of the entire Bitcoin blockchain. For the sake of simplicity, it may be regarded

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<sup>1</sup> Christians, Allison, ‘Introduction to Tax Policy Theory’ 2018 SSRN at p 11. See also Pistone, Pasquale et al. *Fundamentals of Taxation: An Introduction to Tax Policy, Tax Law and Tax Administration* (2013) at ch 2.

as a direct interaction between a miner and the Bitcoin Network.

**Mining:** mining is the process of using computational hardware to find a proof for a block by a process of testing hexadecimal hashes until a valid proof is found.

**Mining Pool:** mining is a computational race, and in order to maintain competitiveness with node miners, smaller participants pool their resources. A mining pool typically takes the form of a promoter, who provides the node and infrastructure, and miners who provide the computational capacity; this forms a mining pool. As a practical matter, Bitcoin mining devices are configured with the URL of the Pool.<sup>2</sup> While only one participant, if any, may find a proof, each participant expends effort in a collaborative search for a proof.

**Pool Fee:** this is the BTC payable to the promoter of a pool.

**PPLNS:** Pay-per-Last-N-Shares ("**PPLNS**") is a model by which distributions of BTC from the pool are determined. Under a PPLNS model, the pool rewards participants in proportion to the number of shares they submitted relative to the total number of shares submitted to the pool in aggregate during a round. This is, however predicated on the pool finding a proof; where no valid proof is found, the participants and the promoter receive nothing. The distributions received are, therefore, affected by Luck.

**Proof:** a proof is a hexadecimal number that when parsed together with the block hash results in a new hash with  $n$

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<sup>2</sup> URL is an acronym for 'universal resource locator' and acts as an address for a computer server on the internet.

zero bits;  $n$  is determined from time to time by the network difficulty.

**Round:** a round is the elapsed time between the creation of new blocks. On average, a round lasts 20 minutes.

**SCA:** the Supreme Court of Appeal.

**Share:** a share is a partial-proof. It acts as a mechanism by which a pool can assess and quantify the extent to which a participant has expended effort in searching for a Proof.

**TLAB:** Taxation Laws Amendment Bill.

**Vertical Equity:** this concept stipulates that persons of greater economic power should bear relatively higher tax burdens.<sup>3</sup>

**Wallet address:** a wallet address is a unique, public hexadecimal string which has associated with it a private key. The possessor of the private key has effective control of the wallet address, and in turn the BTC associated with that wallet address. It is analogous to a bank account, and for ease of reference is referred to as a wallet.

**ZAR:** the South African Rand.

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<sup>3</sup> This may be expressed alternatively that fairness in taxation equates to each person must be deprived equally of utility; vertical equity is an adjustment for diminishing marginal utility of money.

## 1 CHAPTER I: RESEARCH OVERVIEW

### 1.1 *Historical Development of Bitcoin*

The publication of the whitepaper in 2008 by the pseudonymous Satoshi Nakamoto,<sup>4</sup> known as the 'Bitcoin Whitepaper', may arguably be positioned as the beginning of the era of decentralised finance. Designed to function as a payment network, it is the first of its kind to operate on a peer-to-peer basis rather than via a central authority; the state of the network at any point in time, ie the wallet balances, is agreed by means of consensus. Consensus is achieved where an economic agent expends effort (work) to find a valid proof, which is then broadcast to the various nodes on the network to integrate as the next block in the blockchain; this proof-of-work process is referred to as 'mining'.

At its core, the Bitcoin protocol aimed to solve the double-spend problem, being the mischief that a party to a transaction, as payee, does not know whether money to be paid to them has already been spent by the payer. In traditional finance, this problem is addressed by the introduction of a trusted central authority such as a bank. The Bitcoin protocol, however, solves the double-spend problem by replacing the need for trust with cryptographic proof in a public consensus model maintained by miners of the Bitcoin Network; it is no longer the bank validating transactions. Houy provides an effective summary,<sup>5</sup> as

When an individual sends some bitcoins to another individual, this information is broadcast to the peer-to-peer Bitcoin network. ...this transaction needs to be included, together with other transactions forming a block, in the blockchain in order to be confirmed and secured. The blockchain is a public ledger that contains the full history of all the transactions in bitcoin ever processed. It is the role of miners to do this work of confirming and securing transactions. Practically, this mining process consists in solving a mathematical problem and spreading the result to the Bitcoin network for it to reach consensus.

This mathematical problem is as follows. Data contained in each block is used to generate an input hash. A miner undertakes a sequence of guesses at determining a response hash such that when concatenated with the input hash, and parsed through a cryptographic hash function –

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<sup>4</sup> Bitcoin: A Peer-to-Peer Electronic Cash System available at <https://bitcoin.org/bitcoin.pdf>

<sup>5</sup> Nicolas Houy 'The Bitcoin Mining Game' (2015) SSRN at p 2.

SHA256 in the case of the Bitcoin Network – the output results in a valid proof.<sup>6</sup> The number of zero bits required are periodically modified to increase or decrease the number of guesses required on average to find a proof, ie  $2^n$  where  $n$  is the number of stipulated zero bits. Consequently, the more computational power is made available on the network, the greater the difficulty has to become to maintain a consistent rate of block generation.

Conducting activities as a ‘miner’ on the network is driven by economic incentives. Specifically, when a miner gathers together transactions into a block for validation, the selection of which transaction takes priority is a matter of which attracts the highest transaction fee. On the successful mining of a block, the block fee is earned by the miner, and thus is a simple profit maximisation problem. Secondly, there is the block reward. In colloquial terms, this is expressed as the reward earned by a miner for creating a new block, in addition to the block fee. However, this explanation is technically incorrect. When a miner creates a block to be validated, the miner inserts a line of code whereby new BTC is created in their favour. Once a miner has found a proof, they broadcast the block along with the proof to the network nodes, which they accept it as the next block in the blockchain. It is incorrect to understand the block reward as a release of BTC to a miner from some escrow; the new BTC are created by the miner, the coming into existence of which is acknowledged by others. As Houy describes it,<sup>7</sup> “...reward comes from both *ex-nihilo* creation of some new bitcoins and some fees...”

Generally speaking, in contexts other than trade the creation of goods by a taxpayer is ignored for tax purposes. Yet, South African tax policy has seemingly taken a position to bring BTC creation within the tax base. However, it is alleged that the tax authority has provided imprecise, albeit somewhat favourable, guidance on how the law ought to be applied to

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<sup>6</sup> SHA256 stands for Secure Hash Algorithm 256-bit; it was developed by the United States Government’s National Security Agency (NSA).

<sup>7</sup> Houy op cit at note 5 at p 2.

mining. Consequently, it is of importance that an investigation into the tax treatment be undertaken in order to confirm or refute this guidance.

The undertaking in this research is to determine the following: to what extent is the tax authority's suggested treatment supportable in law, and how may harmonisation be achieved by providing for a neutral, common treatment?

## 1.2 *Rationale for the Research*

While it was the vision of the Bitcoin Whitepaper that validators would be numerous, the economic incentives of mining Bitcoin, given its consistent outperformance of traditional asset classes, has turned the activity into a multi-million dollar industry, both for miners and the manufacturers ASIC devices required for mining.<sup>8</sup>

It is the core mission of a tax authority to ensure that taxes are fully assessed and collected. However, tax legislation is a dynamic exercise, and when confronted with disruptive technology in the commercial space, coupled with novel concepts, a *casus omissus* may be observed. From a tax policy and design perspective, subsistence income and goods are excluded from the tax base for reasons of vertical equity;<sup>9</sup> this is the general position in South African tax law, however it excludes crypto assets.

The South African Revenue Service (“**SARS**”) on the 8<sup>th</sup> April 2018 published a media release (“**the Guidance**”) in which it documented the tax authority's stance on the tax treatment of cryptocurrencies like BTC.<sup>10</sup> In particular, SARS noted the following with respect to mining,

...the “miner” is rewarded with ownership of new coins which become part of the networked ledger. This gives rise to an immediate accrual or receipt on successful mining of the cryptocurrency. This means that until the newly acquired cryptocurrency is sold or exchanged for cash, it is held as trading stock which can subsequently be realized [emphasis added].

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<sup>8</sup> ASIC is an acronym for 'Application Specific Integrated Circuit'; it is a processing unit which is designed to perform one type of computation with great efficiency at the loss of being fit for more general purpose use.

<sup>9</sup> Pistone et al op cit at note 1.

<sup>10</sup> South African Revenue Services 'SARS's stance on tax treatment of cryptocurrencies' Available at <https://www.sars.gov.za> (Accessed on 29<sup>th</sup> November 2021).

The use of the phrase ‘this means’ has the effect of creating the impression of an equivalency. While it recognises that mining gives rise to an immediate accrual, the tax consequences are purported to be deferred until such time as the BTC is liquidated. If one were to read in such that the phrase proceeds as ‘this also means’, one is able to evaluate the statement somewhat differently. Under this variation the remark regarding the immediate receipt or accrual is a neutral statement, moreover once accrued, or received, it becomes trading stock until sold.

The guidance has two notable implications: BTC mining is presumed always to be revenue in nature, and to have deferred tax consequences. Furthermore, the guidance creates the impression that the tax treatment of mining does not distinguish between block rewards and the block fees. It is fundamental to a state governed by the rule of law that legal subjects have reasonable notice of their obligations under the law. It is submitted that the guidance provided by the tax authority is at least ambiguous, and in part inaccurate; this research aims to address this deficiency.

Finally, it is necessary to consider the effect on the integrity of the tax system as a whole. The concept of tax neutrality is noted as an ideal standard on which to base an efficient tax system. According to Pistone et al, neutrality is the requirement that taxation should not create distortion in the allocation of economic resources to their most productive use.<sup>11</sup> This principle should be borne in mind for the discussion following.

### **1.3 Research Objectives**

#### **1.3.1 General research objective**

The principal objective of this research is to consider the question: how should Bitcoin mining be taxed given the scheme of Income Tax Act, Act 58 of 1962 (“**the ITA**”), and the policy considerations and objectives attendant upon the integration of cryptocurrency by National Treasury into the legislative framework?

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<sup>11</sup> Pistone et al op cit at note 1.

### **1.3.2 Supplemental research objective**

In addition to the primary research question, specific consideration is given to the following two-part question: in what ways does SARS' guidance deviate from the proper treatment under the ITA? What amendments to the ITA, if any, could be made to harmonise the legislation with what SARS submits as acceptable treatment in practice?

## **1.4 Research Methodology**

In order to achieve the stated objectives, the research shall proceed on the following basis.

Chapter II develops the framework of statutory interpretation in South Africa with a view to determining the broad associated principles, and whether or not these principles apply equally to the interpretation of fiscal legislation. Building on those findings, the ITA is examined both from the perspective of its general scheme, and intended operation, as well as the manner in which the relatively novel phenomena of cryptocurrencies and crypto mining have been positioned within this scheme. Ultimately it is argued that the ITA in effect bifurcates the treatment of non-trade and trade income into two separate regimes, ie the CGT regime, and the normal tax regime; cryptocurrencies may fall into any one of these two regimes.

Chapter III examines the tax implications of BTC mining undertaken as a node operator. Under the CGT regime, the central issue is what constitutes 'creation' in the context of a disposal, whereas under normal tax regime the legal construction of 'not of a capital nature', and what constitutes trading stock is crucial.

It is argued that BTC mining should always give rise to a CGT event. Moreover, where circumstances exist whereby it is dealt with under the normal tax regime, the tax event would be deferred to the extent of the block reward only. SARS' guidance is criticised insofar as it implies that the normal tax regime is the only possibility.

Chapter IV examines the tax implications of BTC mining through mining pools. Mining pools are considered in the light of whether they result in a fiscally-opaque entity, or constitute some other business form. Under the two possible mining models, pool mining gives rise to either a partnership arrangement, or a barter contract in the form of services for BTC. It is ultimately found that the normal tax regime would be applicable, moreover on account of deeming provisions. Further, SARS' implication of any tax deferral is refuted.

Chapter V summarises and concludes the research pursuant to making certain proposals for reform of the ITA.

## 2 CHAPTER II: CRYPTOCURRENCY, AND THE SCHEME OF THE INCOME TAX ACT

### 2.1 Overview

Cryptocurrency, as a technology, is a relatively recent innovation, and arguably is only now approaching the point of meaningful institutional adoption.<sup>12</sup> To this end, it has been the object of much debate among policymakers as to how it ought to be regulated by market as well as prudential regulators; the criteria for its classification as a security, or a commodity has been a particularly vexed question, internationally.<sup>13</sup>

From a fiscal perspective, one has not only to consider how the process of cryptocurrency mining intermeshes with taxation, but how it is to be integrated as a concept. The objective of this chapter is to develop an overview of the operational scheme of the ITA, and how cryptocurrencies have been subsumed therein by policymakers.

### 2.2 *Statutory Interpretation, and the ITA*

At its inception in 1961, South Africa was established on the basis of state constitutionalism, which prior to 1994 was formulated on the Westminster System;<sup>14</sup> while it possessed the discrete organs of an executive, a judicial, and a legislative branch, significantly the exercise of the state's coercive power was not subject to judicial review. Consequently, as a collective body of lawmakers it enjoyed superior might, giving rise to what may be referred to as the period of Parliamentary Sovereignty.<sup>15</sup>

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<sup>12</sup> In the middle of January 2024, the United States Securities and Exchange Commission announced the approval of several Bitcoin Spot Exchange-Traded Funds, marking a major intersect between traditional brokerages and digital assets.

<sup>13</sup> See *US SEC v Ripple Labs Inc* Case 1:20-cv-10832-AT-SN.

Available at: <https://www.nysd.uscourts.gov>

<sup>14</sup> Seedorf, Sebastein, and Sanele Sibanda 'Separation of powers' *Constitutional Law of South Africa 2* (2008).

<sup>15</sup> The depth of Parliamentary Sovereignty is well illustrated by s 34 of the 1983 amended Constitution of South Africa, Act 110 of 1983, which provided that, '*no court of law shall be competent to inquire into or to pronounce upon the validity of an Act of Parliament*'.

Statutory Interpretation in South Africa as an independent scholarly field began to emerge in the late 1940s,<sup>16</sup> pioneered by the publication of 'Uitleg van Wette' by LC Steyn. Nevertheless, legal theorists have over time proposed several bases upon which to model this very practical exercise. Given that in the first instance the Judiciary would be faced with a language-based written instrument, an obvious paradigm is Literalism. Untempered, this legal philosophy espouses the notion that statutory meaning flows only from the written word.<sup>17</sup> As such, where a provision is expressed in clear language, the plain and ordinary meaning, uninfluenced by any specialist or technical inclination, must be followed notwithstanding the results may be grossly unfair, inequitable or contrary to common sense. The proliferation of such a draconian practice is more easily understood when keeping in mind the consequences of Parliamentary Sovereignty, and the relegated role of the judiciary. Nevertheless, applying Literalism to statutory interpretation begins to break down when faced with the evolutionary nature of language.

Intentionalism subsequently is proposed as an alternative theory. In fundamental contrast to the rigidity of Literalism, it directs the line of inquiry into the broader question of what outcome the legislator intended to achieve. Somewhat ironically, the words of a statute are the principal piece of evidence in determining this intention,<sup>18</sup> which reintroduces the insufficiencies of applying a literalist approach.

The common law 'Golden Rule' cemented itself as the dominant theory for statutory construction,<sup>19</sup> and adopts a Literalism-cum-Intentionalism approach. It is succinctly expressed by Lord Wensleydale in the matter of *Grey v Pearson*,<sup>20</sup> who noted,

The grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument [emphasis added].

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<sup>16</sup> LM du Plessis 'Statute Law and Interpretation' *The Law of South Africa* vol 25(1) (2011) at para 311.

<sup>17</sup> Du Plessis op cit at 16 at para 314.

<sup>18</sup> Du Plessis op cit at 16 at para 315.

<sup>19</sup> L du Plessis 'Theoretical (dis-) position and strategic leitmotifs in Constitutional Interpretation in South Africa' (2015) 18(5) *PELJ* at p 1335.

<sup>20</sup> (1857) 10 E.R. 1216 at p 1234 at para 116.

In such an instance, the Golden Rule permits that a statute may be interpreted so as to give modified meaning to it, but only so far as is necessary to address the absurdity of the outcome.

The Constitution of the Republic of South Africa, 1996 radically changed the face of South African constitutionalism; s 1(c) founds the post 1994 SA on the principles of the rule of law, and constitutional supremacy. In particular, s 2 of the Constitution, the Supremacy Clause, provides,

This Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled.

In this era of Constitutional Supremacy, it is clear that any provision of statutory law, which is offensive to the principles enshrined in the Constitution, is invalid; clearly the Westminster system and Parliamentary Sovereignty has been abolished.<sup>21</sup> Moreover, s 39(2) is of particular relevance to the current discussion; it provides that,

When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights [emphasis added].

The precise impact of s 39(2) must be contemplated within the framework of constitutional interpretation, which South African jurisprudence regards as a framework discrete from ordinary statutory interpretation.<sup>22</sup> Nevertheless du Plessis contends, despite any nuances between the two, it is bound to have some meaningful impact on statutory construction; this is an eminently reasonable, and acceptable assertion.

In the matter of *Matiso and Others v The Commanding Officer, Port Elizabeth Prison and Others*,<sup>23</sup> Froneman J remarked, ‘...the purpose and method of statutory interpretation in our law should be different from what it was before...’ [emphasis added].<sup>24</sup>

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<sup>21</sup> Botha, C. *Statutory Interpretation: An Introduction for Students* (2012) at ch 9.1.2.

<sup>22</sup> Du Plessis op cit at note 16 at para 327.

<sup>23</sup> 1994 (3) BCLR 80 (SE) at p 87

<sup>24</sup> Strictly speaking, statutory interpretation as a practical matter should not be conflated with judicial review. The former is concerned with attributing meaning to a statute, whereas judicial review is concerned with establishing whether an asserted meaning of a statute is lawful when measured against some standard, ie the Constitution. Under Parliamentary Sovereignty the role of the Judiciary was confined to the former, moreover under Constitutional Supremacy now encompasses both.

The reasoning underpinning this dictum is sound; Parliament is no longer supreme as is made clear by s 2 of the Constitution, and as such it should not be a principal concern to a court. On the basis that the Golden Rule of interpreting statutes was predicated on the pre-eminence of Parliament, as the premise is invalidated so too should be the result.

The learned judge continued that it is now the purpose of statutory interpretation to test whether a particular interpretation of a legislative provision conforms to the values and principles enshrined in the Constitution; that the role of the Judiciary is to develop (or interpret) the content of these Constitutional values and principles, which are otherwise couched in very broad terms. Botha argues given ordinary statutory interpretation inevitably imports interpretation of the Constitution, the reconciliation of the purposive method required for constitutional interpretation with an approach modelled on Literalism-cum-Intentionalism would be problematic.<sup>25</sup> Further, it is held that de Ville's contention that methods for constitutional interpretation should inform those methods to be applied for ordinary statutory interpretation ought to be accepted; consequently, s 39(2) has the effect that statutory interpretation should also be undertaken with deference to a purposive method. Under the new constitutional dispensation, the object of statutory interpretation is established as a test for the constitutionality of a legal construction, and the new methodology is the purposive approach.

The classical exposition of Purposivism in the common law tradition is by reference to the so-called 'Mischief Rule',<sup>26</sup> for which the *locus classicus* is to be found in the seminal 16<sup>th</sup> century Exchequer court case against Heydon, known as *Heydon's case*.<sup>27</sup> Lord Coke, who presided over the matter, proposed a set of four questions, which ultimately amount to examining a 'mischief' not remedied by common law, but

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<sup>25</sup> Botha op cit at note 21 at ch 9.1.1.

<sup>26</sup> Contextualism is implied by Purposivism in that the Mischief Rule imports into the inquiry the historical context of a statute; however, the purpose of a statutory provision may also be apparent from its context within the statute, ie interpretation *ex visceribus actūs*.

<sup>27</sup> [1584] EWHC Exch J3.

remedied by a statutory provision, with a view to establishing the 'true reason' of the remedy; he finally concluded,

The office of all judges is always to make such construction as shall suppress the mischief and advance the remedy... according to the true intent of the makers of the Act *pro bono publico*.<sup>28</sup>

In South African jurisprudence, Purposivism, as a method for interpreting statutes, famously appears in the minority decision of one of our most eminent judges, Schreiner JA. In the matter of *Jaga v Dönges, NO and Another*,<sup>29</sup> he remarked that provisions of a statute may be interpreted contextually, where context is not limited to the language of the statute itself; that context extends further and encompasses,

...the matter of the statute, its apparent scope and purpose, and, within limits, its background [emphasis added].

Notwithstanding that such an approach is arguably now mandated by the Constitution, the Judiciary may be marked as having been resistant to taking it on board. Majuta et al comment that the composition of the Judiciary at the time the Constitution was drafted was heavily indoctrinated in Literalism, the Golden Rule and the tradition of Parliamentary Sovereignty.<sup>30</sup> An example is the 1995 case *Coopers & Lybrand v Bryant*.<sup>31</sup> Moreover, Wallis laments that since *Jaga* there has been a 'tug of war' between advocates of Literalism, and Contextualism.<sup>32</sup>

The purposive method was finally settled as the proper approach in 2012 in *Natal Joint Municipal Pension Fund v Endumeni Municipality*.<sup>33</sup> Briefly, the facts were that an employee had made strategic use of the rules governing retirement funds so as to inflate their benefits artificially.

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<sup>28</sup> It is interesting to note as a legal curiosity that the Purposivism method pre-dates Literalism in English jurisprudence. At the time of *Heydon's* case, Parliament sat so irregularly that it inevitable fell to the court to rectify and augment isolated pockets of statute law. Literalism was a device catering to the Westminster system and Parliamentary Sovereignty prevalent only from the 19<sup>th</sup> century onward. See du Plessis op cit at note 16 at para 316.

<sup>29</sup> 1950 (4) SA 653 (A) at p 421.

<sup>30</sup> Majuta et al 'The Judicial role in the legislative lawmaking process in Africa: the South African case' (2015) 42(1) *The African Review: A Journal of African Politics, Development and International Affairs* at pp 7-10.

<sup>31</sup> 1995 3 SA 761 (A).

<sup>32</sup> Wallis Interpretation before and after *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 4 SA 593 (SCA) (2019) 22(1) *PELJ* at p 6.

<sup>33</sup> *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] 2 ALL SA 262 SCA.

As these were 'defined benefit' funds,<sup>34</sup> this resulted in their insolvency. A case was, therefore, made against Endumeni Municipality to make good the shortfall in terms of the associated regulations.<sup>35</sup>

Wallis JA in *Endumeni* criticised the conceptualisation of a proper approach to interpretation by the court *a quo* as null insofar as it proffered no guidance as to what constitutes the 'ordinary meaning of words' or why they would reveal the true intention of the draftsman.<sup>36</sup> Instead, the view expressed by Schreiner in *Jaga* was adopted as the Proper Approach to statutory interpretation under Constitutional Supremacy.<sup>37</sup> A lingering question which remained was whether the Proper Approach applied to the interpretation of fiscal legislation.

Du Plessis recapitulates that,<sup>38</sup>

...where an Act is capable of two interpretations, that one should be preferred which does not take away existing rights, unless it is plain that such was the intention of the Legislature.

In the context of taxation laws, this was embodied in the *Contra Fiscum* rule, which was recognised by the courts in *Executors Testamentary, Estate Reynolds and Others v CIR* per the dictum of Stratford ACJ,<sup>39</sup> '*...in a matter of doubt we are bound to invoke the rule of interpretation contra fiscum*' [emphasis added]. This rule has been challenged on the basis that its origins are traced to notions of equity and fairness, and yet taxation is devoid of such considerations; it is onerous by nature. This viewpoint is apparent when examining *CIR v Simpson*,<sup>40</sup> citing the dictum in *Cape*

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<sup>34</sup> In a 'defined contribution' fund, the value of contributions made (capital and growth) are used to purchase a living annuity with a projected future value of nil given the estimated duration of retirement; nevertheless, once the asset base is consumed, the retiree's income ceases. In contrast, a 'defined benefit' fund creates an annuity right on retirement in exchange for an actuarially determined contribution during the period of employment; in an instance where the value of the contributions on retirement is insufficient to fund the annuity, factoring in market conditions and life expectancy, the fund has an effective net liability.

<sup>35</sup> An amendment to the definition of 'pensionable emoluments' had been inserted per Regulation 1(xxi)(h), which read:

...should at any time the pensionable emoluments of a member...increase in excess of that assumed by the actuary...for valuation purposes...the committee...may direct that the local authority employing such member pay an adjusted contribution...

<sup>36</sup> *Endumeni* supra at note 33 at para 17.

<sup>37</sup> *Endumeni* supra at note 33 at para 19.

<sup>38</sup> Du Plessis op cit at note 16 at para 334.

<sup>39</sup> 8 SATC 203 at p 213

<sup>40</sup> [1949] 4 All SA 460 (A).

*Brandy Syndicate v. Inland Revenue Commissioners*,<sup>41</sup>

There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing to be implied. One can only look fairly at the language used.

Furthermore, it is also useful to reflect on *CIR v George Forest Timber Company*,<sup>42</sup> having cited *Partington v AG* with approval,<sup>43</sup>

...if there be an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.

The debate finally came to a head in the matter *Glen Anil Development Corporation Ltd v SIR*.<sup>44</sup> Having considered both the *Simpson* and *George Forest Timbers* cases, and the *Cape Brandy* and *Partington* cases underpinning them, respectively, Botha JA settled the matter in his dictum,<sup>45</sup>

...there seems little reason why the interpretation of fiscal legislation should be subjected to special treatment which is not applicable in the interpretation of other legislation.

It is noted that the timing of this ruling was during the subsistence of Parliamentary Supremacy. However, the underlying question was less to do with statutory interpretation as it was to do with whether fiscal legislation was *sui generis*. Fortunately, in *CSARS v Bosch and Another*,<sup>46</sup> Wallis JA, who penned the *Endumeni* judgment, confirmed unequivocally by implication the Proper Approach does apply to fiscal legislation.

### **2.3 The Operational Scheme of the ITA**

The ITA is an amalgamation of various pieces of fiscal legislation, enacted since 1914.<sup>47</sup> Additionally, it is perhaps the only statute which is amended at least on an annual basis, and by the very nature of its matter is a comparatively intricate and technical piece of law. Nevertheless, all its complexity abounds from one simple purpose - funding the fiscal policy of a state government by carving out a portion of the income of a taxpayer.

The common theme found among various economic researchers

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<sup>41</sup> (1921) (1), K.B. 64 at p 71.

<sup>42</sup> 1 SATC 20 at p 29.

<sup>43</sup> (1869) 21 LT 370 at p 375.

<sup>44</sup> 1975 (4) SA 715 (A).

<sup>45</sup> *Ibid* at p 334.

<sup>46</sup> [2015] JOL 32547 (SCA) at pp 7-8 at para 9.

<sup>47</sup> See Preamble of the ITA.

referenced by Holmes appears to be that true economic income is subjective;<sup>48</sup> Simons departed from this, and determined that income must be quantitative, objective and measureable for it to be a useful for tax purposes. His formulation was expressed as, '*the algebraic sum of the market value of rights exercised in consumption and the change in the value of the store of property rights...*' Contemporaneously, Haig's formulation was expressed as,<sup>49</sup> '*income is the money value of the net accretion to one's economic power...*' The Haig-Simons model is the integration of these two formulations.

The basis of what constitutes income for tax purposes is one of the cornerstones of South Africa tax law – the gross income definition. The ITA defines gross income generally in s 1 as,

- (i) the total amount, in cash or otherwise, received by or accrued to or in favour of such resident...excluding receipts or accruals of a capital nature...

For present purposes, all that needs to be said about the phrase '*received by or accrued to*' is it speaks to the time at which a person becomes liable for tax. With respect to the former, a person must have received it for their own benefit and on their own behalf (the Benefit Principle),<sup>50</sup> and must have done so by virtue of the intent of the remitter that they should so receive it,<sup>51</sup> evaluated objectively.<sup>52</sup> Regarding the latter, the central issue is when a person has become entitled to an amount,<sup>53</sup> unconditionally,<sup>54</sup> notwithstanding that it may not yet be due and payable. Of greater relevance to the matter at hand is how the concept of an amount of gross income has played out in South African jurisprudence.

In the matter of *Lategan v Commissioner for Inland Revenue*,<sup>55</sup> the court had opportunity to consider the nexus between a person's income

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<sup>48</sup> Kevin Holmes *The Concept of Income: A Multi-Disciplined Approach* (2001) at p 33.

<sup>49</sup> James Alm 'Is the Haig-Simons standard dead? The uneasy case for comprehensive income tax' (2018) 71(2) *National Tax Journal* at p 381.

<sup>50</sup> See *Geldenhuys v Commissioner for Inland Revenue* 1947 (3) SA 256 (C)

<sup>51</sup> See *Commissioner of Taxes v G* [1981] (43 SATC 159)

<sup>52</sup> See *Ochberg v Commissioner for Inland Revenue* 1931 CPD 256 (6 SATC 1)

<sup>53</sup> See *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* (1990 (2) SA 353 (A)) 52 SATC 9. The Appellate Division upheld the construction as contemplated in *Lategan v Commissioner for Inland Revenue* (1926 CPD 203) 2 SATC 16, Cf *Delfos v Commissioner for Inland Revenue* (1933 AD 242) 6 SATC 92.

<sup>54</sup> See *Mooi v Secretary for Inland Revenue* (1972 (1) SA 675 (A)) 34 SATC

<sup>55</sup> *Lategan supra* at note 53

and the meaning of '*total amount*' in the tax context. In his analysis, Watermeyer J began by noting that the definition of gross income (as it then was) taken literally seemed only to include amounts of money. He compared this to the concept of income in the ordinary (economic) sense by which income is whatever is earned by a person by the use of either their financial or human capital; moreover, the fruits thereof may be derived in the form of cash, rights or other property. The final conclusion is summarised in the oft quoted passage,

In my opinion, the word 'amount' must be given a wider meaning and must include not only money, but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value.

The ratio in *Lategan* turned on which theory for statutory interpretation was considered appropriate; while the judgment referred to parliamentary intention, it is arguable that the outcome is more readily reconcilable with a narrow construction ultimately furthering the originating purpose of the legislation, ie to carve out a portion of an individual's annual economic empowerment. This interpretation was upheld by the Appellate Division shortly thereafter in *Delfos*,<sup>56</sup> and more recently in *Peoples Stores*.<sup>57</sup>

It is noteworthy how this construction of income deviates from the Haig-Simons concept. In the *Lategan* case, although it was in respect to the issue of the tax value of unpaid debts, *St. Lucia Usines v St. Lucia (Colonial Treasurer)* was cited as an appropriate authority to be considered by a South African court.<sup>58</sup> In this case, Lord Wrenbury remarked, '*there must be a coming in to satisfy the word Income*' [emphasis added].<sup>59</sup> This may be considered in light of the minority judgment of Schreiner, JA in *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* (the conclusions of which eventually were incorporated into legislation), where he remarked,<sup>60</sup>

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<sup>56</sup> *Delfos supra* at note 53.

<sup>57</sup> *Peoples Stores supra* at note 53.

<sup>58</sup> 1924 AC 508.

<sup>59</sup> *St Lucia supra* at note 58 at p 3. See also *Tennant v Smith* (1892) A.C. at p 150 per Lord MacNaughton, '*...a person is chargeable for income tax...not on what saves his pocket, but on what goes into his pocket...*' [Emphasis added].

<sup>60</sup> *Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd* (1946 AD 441) 14 SATC 1

With a few possible exceptions (one thinks... the primary producer in so far as he produces for his own consumption what is treated as income) the taxpayer obtains his income from other persons [emphasis added].

It may be inferred from these dicta that for tax purposes income only arises where there is some a nexus to a transaction; one cannot transact with oneself, ergo what economic advantages one may bring about by oneself fall outside the tax base. It, nevertheless, must be acknowledged the learned judge did admit to the possibility of certain niche exceptions.

The quality of an amount of income being 'not of a capital nature' is one which has been a rich source of debate in South African jurisprudence. From an economic perspective, Adam Smith famously defined capital (in Economics) as,<sup>61</sup> *'...that part of a man's stock which he expects to afford him revenue.'* While that is meant by 'a man's stock' is not apparent, the general implication is that capital is what gives rise to income. In modern economic parlance, capital is understood as being composite of human and financial capital, or what Watermeyer in *Lategan* referred to as, *'...his work or his wits, or the employment of his capital'*, respectively. Moreover, in transitioning from Economics to Law, the general distinction between capital and revenue is often given with reference to *Commissioner of Inland Revenue v Visser*,<sup>62</sup> in which it was stated, *"Income' is what 'capital' produces, or is something in the nature of interest or fruit as opposed to principal or tree.'*

The extent of case law on the topic of capital nature is not by any means a coincidence; historically, whether an amount was subject to taxation was a binary classification problem. Consequently, where a taxpayer was able to demonstrate an amount was capital in nature, it did not give rise to any taxation. This naturally created a massive incentive for tax arbitrage, and avoidance behaviour. Furthermore, since in reality a person may earn an income by growing their capital, as much as receiving a wage, such a tax regime seems counter-intuitive given the underlying purpose on which the ITA is predicated.

SA adopted what is referred to as 'Capital Gains Tax' in 2001 ("**CGT**"),

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<sup>61</sup> Smith, Adam *The Nature and Causes of the Wealth of Nations* 1976

<sup>62</sup> *Commissioner of Inland Revenue v Visser* (1937 TPD) 8 SATC 271 at p 81.

although the name is to some degree a misnomer. The tax policy considerations for this move were noted in a briefing submitted to the Portfolio and Select Committees on Finance as in the first instance being in keeping with international best practices and trends in aligning income taxation with the comprehensive income concept proposed under the Haig-Simons model.<sup>63</sup>

Treasury argued that horizontal equity would be achieved through the revenue-capital agnostic CGT regime; persons of equal comprehensive incomes should bear similar burdens. Furthermore, the disproportionality gap in vertical equity is addressed by creating tax incidence for wealthier taxpayers, who invariably earn their income through capital accretions. Adopting a comprehensive income model was in this way justified. Lastly, it was believed that the CGT regime would lead to greater economic efficiency through enhanced tax neutrality insofar as removing investment bias away from growth assets to income-producing assets, and allow for a relaxation of tax rates by base-broadening through reduced avoidance behaviour and greater revenue collection from higher income tiers.

The CGT regime was introduced into the ITA as sch. 8. An exposition of the mechanics may be understood by an examination of para 35(1); it provides that,

...the proceeds from the disposal of an asset by a person are equal to the amount received by or accrued to, or which is treated as having been received by, or accrued to or in favour of, that person in respect of that disposal...

Furthermore, para 35(3), to which para 35(1) is made subject, reduces the 'proceeds from disposal' by any amount which must be included in gross income,<sup>64</sup> or taxable income before capital gains.

The definition of 'asset' per para 1 of sch. 8 is expressed in the general, but specifically includes, in effect, any form of property or right which is capable of being owned by a person; it is noteworthy that currency is specifically excluded. What constitutes a 'disposal' is also here defined,

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<sup>63</sup> Capital Gains Tax in South Africa (24<sup>th</sup> January 2001) at para 3.1, hereinafter '**the Briefing**'. Available at: <https://www.ftomasek.com/NationalTreasury.pdf> (Accessed 31st December 2023). See also Comprehensive Guide to Capital Gains Tax Issue 9 at para 1 ("**the CGT Guide**").

<sup>64</sup> Paragraph 35(3) is also retrospective in that a reduction to proceeds must be made where an amount has in the past been include in gross income, or taxable income.

moreover it redirects to incorporate the contents of para 11, which defines it more extensively. Read together, a disposal is, '*...any event... which results in the creation, variation, transfer or extinction of an asset...*' [emphasis added]. As a result, even the creation of a personal right seemingly triggers potential operation of the CGT regime.

A person's capital gain per para 3 is the proceeds from disposal of an asset (the gross capital income) less its base cost (tax cost), as defined in para 20; unsurprisingly, this is analogous to the computation of taxable income, moreover without the element of 'not of a capital nature' on the gross income side or the 'trade', 'production of income' and 'not of a capital' elements of s 11(a) representing the tax cost side. Furthermore, a taxable capital gain under para 10(1) is effectively only taxed at 40% of the applicable marginal rate of the taxpayer by inclusion in taxable income.<sup>65</sup>

Viewed holistically, the CGT regime has not completely bridged the divide between tax free capital growth and a regime based fully on the comprehensive income model; however, in effect it has created a minimum tax payable on any amount to which a taxpayer becomes entitled,<sup>66</sup> unless such amounts are brought within the normal tax regime as gross income, attracting a higher tax rate.

While the CGT regime operates mechanically via s 26A, which provides that taxable capital gains are included in a person's taxable income, it is submitted this it must be understood that the CGT and normal tax regimes are still discrete. It is operated in this fashion to ensure vertical equity is maintained for the CGT regime without the need to assess a taxpayer separately; the normal tax regime already operates as a progressive tax. This methodology is efficacious for the tax authority's administrative capacity.

## 2.4 Cryptocurrency

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<sup>65</sup> This inclusion rate is specific to the type of taxpayer, and consequently may vary; 40% is applicable to natural persons.

<sup>66</sup> This is naturally subject to specific exceptions.

Generally, assets can be broadly classified as being either a currency, a commodity, a security, or some other right. When one contemplates currency in the context of commerce, one would more likely think of the ZAR. It is generally accepted in economic terms that a currency has the characteristics of being a medium of exchange, a unit of account, and a store of value;<sup>67</sup> therefore, it may be anything which fulfils these functions. BTC arguably possesses all these qualities – economic agents settle trade using BTC, and furthermore, it has a mathematically guaranteed scarcity, for which it has been given the popular label ‘digital gold’.

In South Africa, the ZAR is the state-issued fiat currency,<sup>68</sup> and possesses the significant additional feature of being the sole monetary unit and legal tender within our borders in terms of s 15 and 17 of the South African Reserve Bank Act, 1989, respectively.<sup>69</sup> In June 2021, the legislative assembly of El Salvador passed into law a statute, known as the ‘Bitcoin Law’, elevating the BTC to equal status with the country’s fiat currency;<sup>70</sup> to date it is the only state to have done so.

A commodity is a general term used to describe some economic good, or service.<sup>71</sup> Typical characteristics of a commodity are they are either fully or substantially fungible, and are intrinsically valuable on account of their utility – agricultural products, mineral resources, energy, *et cetera*. What constitutes a security, however, is a more complex issue. For the purposes of the Companies Act, 2008,<sup>72</sup> a ‘security’ is defined in s 1 as, ‘*any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company.*’ The term

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<sup>67</sup> Max Kubát ‘Virtual currency Bitcoin in the scope of money definition and store of value’ (2015) 30 *Procedia Economics and Finance* at p 409.

<sup>68</sup> A ‘fiat currency’ is a currency issued by a state which is not supported by a basket of commodities to maintain its purchasing power; value is maintained directly by government intervention, hence the Latin word ‘fiat’ meaning ‘let it be done’.

<sup>69</sup> South African Reserve Bank Act, Act 90 of 1989.

<sup>70</sup> Ley Bitcoin, Degree 57 of 2021 per art. 1, available at: <https://www.transparencia.gob.sv/instituciones/rreee/documents/508900/download>.

<sup>71</sup> Alfred Marshall *Principles of Economics* (1920).

<sup>72</sup> Companies Act, Act 71 of 2008 (“**the Companies Act**”).

'debenture' is a legacy phrase from the prior iteration of the Companies Act, 1973,<sup>73</sup> whereas the Companies Act refers to 'debt instruments'.<sup>74</sup>

Prior to amendment in 2011, the Companies Act definition mirrored s 1 of the Securities Services Act, 2004;<sup>75</sup> this statute was repealed to make way for the Financial Markets Act, 2012,<sup>76</sup> moreover the definition remained unchanged. It incorporates shares and debentures in the Companies Act sense, but is far more expansive. Nevertheless, it is not predicated on any fundamental idea beyond it demarcating on what the legislation operates given its purpose, ie the regulation of trading of securities.

A 'share' both in the Companies Act and ITA is defined as, '*any unit into which the proprietary interest in that company is divided.*' At common law, a share is construed as a complex of personal rights:<sup>77</sup> a right to capital, a right to vote, and a right to receive a dividend. Moreover, these definitions do not proceed from any implicit set of characteristics.

It is not the object of the above discussion to define a security, *per se*, other than to generalise it as being a 'financial instrument' of some sort. In turn, a financial instrument may be distinguished from a commodity in that it ultimately is founded in some form of contractual arrangement between a holder and an issuer, by which personal rights and obligations are created, *inter se*; a commodity enjoys independent existence, and represents a real right.

As described above, BTC may fit the criteria for currency, but it is questionable whether it constitutes a financial instrument, as a security – it has no issuer, nor does it represent any personal rights owed by a counterparty. It is asserted as being a commodity insofar as its fundamental nature is concerned.

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<sup>73</sup> Companies Act, Act 61 of 1973 ("the Old Companies Act").

<sup>74</sup> The proposed Companies Act Amendment Bill, 2021 proposes to amend this to align the terminology.

<sup>75</sup> Securities Services Act, Act 36 of 2004.

<sup>76</sup> Financial Markets Act, Act 19 of 2012

<sup>77</sup> H Stoop 'Companies Part I' *The Law of South Africa* vol 6(1) (2022) at para 73.

Cryptocurrency was first introduced into the ITA per s 1(1)(c) of the Taxation Laws Amendment Act, 2018 by way of insertion of para (f) into definition of 'financial instrument' per s 1,<sup>78</sup> reading as 'cryptocurrency'. The explanatory memorandum issued by National Treasury with respect to this amendment clarified that the motivation was to close a gap in the tax base; it stipulated that,<sup>79</sup>

...seeks to clarify that cryptocurrency is a financial instrument and would therefore not be a personal use asset for capital gains tax purposes [emphasis added].

Under para 53 of Sch. 8 'personal-use assets' do not form part of the tax base. While it is acceptable that the purpose of the amendment was to bring cryptocurrency within the ambit of the ITA, the manner in which National Treasury expressed this leads to ambiguity. Specifically, it is noted that cryptocurrency 'is' a financial instrument, as opposed to cryptocurrency is to be treated as if it were. Reasoning that since financial instruments in general are complexes of personal rights, the implication that cryptocurrency is equivalent, and not a commodity-type real right, is not immediately supported by the underlying facts. It may be regarded in a sense as a legal fiction.

In 2020 the South African legislature passed the Taxation Laws Amendment Act, 2020;<sup>80</sup> in terms of s 2(1)(c), the term 'cryptocurrency' as contained para (f) of the 'financial instrument' definition was replaced by the term 'crypto asset'. Once more, National Treasury published an explanatory memorandum; it noted that the change was to align the ITA with a uniform definition of 'crypto asset' within a broader regulatory framework.<sup>81</sup> The amendment did not alter the status of crypto assets not qualifying as 'personal-use assets', moreover the question whether crypto assets are real rights, or a complex of personal rights, now must be addressed within the broader regulatory objectives of state authorities.

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<sup>78</sup> Taxation Laws Amendment Act, Act 23 of 2018.

<sup>79</sup> National Treasury 'Explanatory Memorandum on the Taxation Laws Amendment Bill' (2018) (17<sup>th</sup> January 2019) at p 40.

<sup>80</sup> Taxation Laws Amendment Act, Act 23 of 2020 ("**the 2020 TLAB**").

<sup>81</sup> National Treasury 'Explanatory Memorandum on the Taxation Laws Amendment Bill' (2020) (20<sup>th</sup> January 2021) at p 50.

Real rights may be analysed in terms of two theories – the personalist theory, and the classical theory.<sup>82</sup> The former focuses on the characteristic that a real right is enforceable against the world at large, rather than a specific person; the latter is premised on the point that personal rights operate in the context of two legal subjects, whereas a real right is concerned with a legal subject's relationship with a thing. A list of criteria by which a real right may be identified is enumerated in South African law,<sup>83</sup> however it is conceded that as a practical matter not all accepted real rights comply with every element of these criteria. It is submitted that as the right to BTC is enforceable against all persons, and that there generally is no second legal subject inherent in the holding thereof and who owes the right to the holder, the indication is for BTC to present with a stronger potential for being regarded as a real right, rather than a personal right.

Circa the time of the 2020 amendment, a division of the Inter-governmental Fintech Working Group published a position paper on cryptocurrency and blockchain;<sup>84</sup> this was updated in 2021, and is examined for further context of the regulatory position (“**the Working Paper**”).

The Working Paper provides,

A crypto asset is a digital representation of value that is... traded, transferred and stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility... [emphasis added].

It continues to expound that South African regulators are taking a ‘functional approach’,<sup>85</sup> whereby no single definition is being set. Consequently, one must examine the context in which a crypto asset is

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<sup>82</sup> CG van der Merve ‘Things’ *The Law of South Africa* (2014) 27(2) at para 60.

<sup>83</sup> *Ibid* at para 61.

<sup>84</sup> Crypto Assets Regulatory Working Group, Position Paper on Crypto Assets (2021). Available at: [https://www.ifwg.co.za/IFWG%20Documents/IFWG\\_CAR\\_WG-Position\\_Paper\\_on\\_Crypto\\_Assets.pdf#search=consultation%20paper%20on%20crypto%20assets](https://www.ifwg.co.za/IFWG%20Documents/IFWG_CAR_WG-Position_Paper_on_Crypto_Assets.pdf#search=consultation%20paper%20on%20crypto%20assets) (Accessed 1<sup>st</sup> January 2024).

<sup>85</sup> Crypto Assets Regulatory Working Group, Position Paper on Crypto Assets (2021) Available at: [https://www.ifwg.co.za/IFWG%20Documents/IFWG\\_CAR\\_WG-Position\\_Paper\\_on\\_Crypto\\_Assets.pdf#search=consultation%20paper%20on%20crypto%20assets](https://www.ifwg.co.za/IFWG%20Documents/IFWG_CAR_WG-Position_Paper_on_Crypto_Assets.pdf#search=consultation%20paper%20on%20crypto%20assets) (Accessed 1<sup>st</sup> January 2024). *op cit* at note at paras 2.1.2-2.1.3.

used to determine whether it is being used as currency, as a security or generally as a tradeable commodity.

The Working Paper reports that many central banks have been reluctant to perpetuate the idea that crypto assets may be used as a substitute for fiat currency as it is not legal tender.<sup>86</sup> Given that its positioning within the general scheme of the ITA as a financial instrument was sustained in the most recent amendment, current law does not treat BTC as foreign currency. This contention is strengthened when viewed from National Treasury's point of view in that the effect of s 24I(3), read with s 24I(2), would import BTC's market volatility into annual revenue collection; effective budgeting requires predictability.

Notwithstanding the possibility of a crypto asset being used as a security, it is submitted that under South African law this is unlikely to be the case for BTC; it has independent existence, is not issued by a counterparty, and does not carry with it any personal rights. Furthermore, the concept of an investment contract as a security is not a feature of our capital raising machinery.<sup>87</sup> It is asserted that for tax purposes BTC is treated as a commodity, or simply regular property.<sup>88</sup>

## **2.5 Cryptocurrency and Taxable Events**

Taxation is not an arbitrary occurrence, but aligns with the happening of specific tax events. As was earlier discussed, the Guidance released by SARS is perhaps ambiguous with respect to this critical element.

In the context of mining under a normal tax regime, there is support for the view BTC gives rise to an immediate inclusion in gross income when mining takes place;<sup>89</sup> This is founded on the basis of para (c) of the gross

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<sup>86</sup> Ibid at para 2.1.1.

<sup>87</sup> It is noted that under United States Federal Securities laws, a security is defined to include the notion of an investment contract, whereby the scheme in which a commodity (like Bitcoin) is sold, may amount to a security. Classification of an investment contract as a security was circumscribed by the United States Supreme Court in *SEC v W.J. Howey Co.* 328 USD 293 (1946). No equivalent exists under South African securities law.

<sup>88</sup> "Regular property" in this context is indicative that BTC is not a currency, or a security; it is a general form of asset without any inherent inclination towards a particular classification.

<sup>89</sup> Remerta Basson 'An analysis of issues relating to the taxation of cryptocurrencies as financial instruments' (2020) 13(1) *Journal of Economic and Financial Sciences* at p 487.

income definition in that mining is, '*essentially a transaction validation service*'.

This particular commentator concludes that mining merely has the potential to give rise to an immediate tax event.<sup>90</sup> It is submitted that insofar as the Block Fee is concerned the application of fundamental tax principles would see no difficulty in substantiating a more definitive response in favour of the proposition.

The 2020 OECD report on virtual assets discusses mining in the context of key tax events in which it reaffirms the distinction between the Block Reward and the Block Fee;<sup>91</sup> further, that the former may conceptually give rise to a tax event.<sup>92</sup> Moreover, in surveying various tax jurisdictions, it is reported in particular that the South African tax authority views the mining of BTC as the first taxable event.

Given that the OECD in its discussion appreciates the distinction between new BTC and transaction fees, the context it creates in presenting its research findings lend credence to the view that the Guidance should be disambiguated in the direction of holding to an immediate tax event.

This may be held as a qualification to the Guidance for contrast against the outcome of the analysis performed; it is not accepted as irrefutable at this stage.

## **2.6 Conclusion**

It has been demonstrated above that current South African law requires a purposive approach to interpreting legislation. Furthermore, the most fundamental purpose is to collect as tax a portion of a person's income. The introduction of the CGT regime in 2001 effected a step by National Treasury towards a more comprehensive income taxation model, however did not proceed as far as to align it perfectly with gross income taxation methodology. A broad overview of sch. 8 suggests that the ITA is now

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<sup>90</sup> Ibid at p 9.

<sup>91</sup> OECD (2020), *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues*, OECD Publishing, Paris at p 12.

<sup>92</sup> Ibid at p 22.

bifurcated into two tax regimes, a basic, or minimum incidence, tax which is not fettered by the 'not of a capital nature' element, and a normal tax regime, which is restrictively applied only to amounts which are the result of a transaction involving another party.

*Prima facie*, 'disposal' for CGT is defined to include the creation of assets with the consequence that BTC mining, being a process by which assets are created, would seem at least to fall within the CGT regime, if not attract taxation at higher rates under the normal tax regime. The nuances hereof are considered in the following chapter.

### **3 CHAPTER III: BITCOIN MINING –CGT OR NORMAL TAX REGIME?**

#### **3.1 Overview**

As discussed in chapter II, the ITA encompasses what has been termed in this research as the CGT regime and the pre-existent normal tax regime. The preeminent characteristic which sets these two regimes apart is the element of 'not of a capital nature'. With respect thereto, the CGT regime is not overtly made subject to any condition precedent, but the scheme of the ITA necessarily implies it concerns itself with amounts of a capital nature. In contrast, the normal tax regime concerns itself with amounts 'not of a capital nature', ie revenue in nature.

The guidance proposed by SARS implies that the proceeds of BTC mining would only ever fall within the normal tax regime. This chapter will question this suggestion by analysing the CGT regime from the perspective of its core concepts and drawing conclusions as to how it may apply to the block reward and the block fee. Subsequently, the normal tax regime will be examined with particular focus on the contention that mined BTC is held as trading stock, and the normal tax event deferred.

The scope of this chapter is to examine BTC mining as an isolated activity by a taxpayer, not acting in concert, i.e. node mining.

#### **3.2 The CGT Regime**

The most fundamental definition contained in sch. 8 is what constitutes a 'disposal'. The legislature by design has cast this definition in very wide terms for fear of a *cassus omissus*.<sup>93</sup> In furtherance of this purpose, the creation of an 'asset' constitutes a disposal under sch. 8. Consequently, the mining of BTC may be brought within the ambit of the CGT regime, and may not be excepted from taxation merely on account of it being a creationary process insofar as the block reward is concerned.

Cassidy observed that sch. 8 is highly comparable to the first iteration of the Australian capital gains legislation of 1986 with respect to how the terms 'asset' and 'disposal' were phrased.<sup>94</sup> Further, it had been criticised by the Australian Judiciary as presenting significant difficulty in interpretation.<sup>95</sup> The legislation, as a result, was subsequently amended to replace the usage of 'disposal' with the term 'CGT event', presumably to alleviate the ambiguity.<sup>96</sup>

Schedule 8 of the ITA never suffered from such ambiguity in its original construction; it refers to an event together with a stipulated result, and is congruous to the amended Australian provision. While this may have achieved clarity as to the definition, it has been remarked, nevertheless, that the creation of an asset as constituting a result leading to a disposal is counter-intuitive;<sup>97</sup> a disposal connotes stepping away from an asset, whereas creation implies the opposite. It is submitted this confusion is linguistic in nature, predicated on the term 'disposal' necessarily importing into the definition a colloquial meaning of the word; as such, Literalism here ought to be avoided.

Where one applies a more purposive approach, the interpretative difficulties are alleviated. Taking a holistic view of sch. 8, 'disposal' is a defined term meant to connote that which may trigger consequences

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<sup>93</sup> The CGT guide op cit at note 63 at p 84.

<sup>94</sup> Julie Cassidy 'Capital Gains Tax in South Africa: lessons from Australia?' (2004) 16(2) *SALJ* at p 164.

<sup>95</sup> Per s 160M(6) of the Australian statute Income Tax Amendment (Capital Gains) Act, Act 52 of 1986, '*a disposal of an asset that did not exist...but is created by the disposal, constitutes a disposal of the asset for the purposes of this Part...*' This is functionally congruous to the para 11(1).

<sup>96</sup> Cassidy op cit at note 94 at p 2.

<sup>97</sup> The CGT Guide op cit at note 63 at p 87.

under the CGT regime. In light of the discussion with respect to the overall scheme of CGT regime appearing to act as a minimum tax payable, under the Haig-Simons comprehensive model of income a creation of an asset is asserted as being one of the more obvious ways in which a taxpayer may have a net accretion to wealth; creation necessarily implies having that which did not before exist. In the context of the gross income definition, it is readily acceptable that there is a normal tax event where there is the creation of an unconditional right to 'an amount...not of a capital nature'. By parity of logic, it should be equally acceptable in the context of the CGT regime to the extent it represents a stipulated event. Consequently, if the ITA were to borrow the new Australian terminology such that para 11(1) read as 'a CGT event is any act which results in the creation of an asset,' certainly there would not be this immediate sense of counter-intuition.

The CGT Guide, nevertheless, deals with the provision as it is, wherein it is noted that there is no difficulty in the integration of asset creation as a valid CGT trigger;<sup>98</sup> it is cited as well established and accepted in Australian tax law. SARS clarified the matter by stating that,<sup>99</sup>

The confusion seems to stem from the impression that it is the party in whose hands the asset is created who has a disposal...The concept in fact refers to the creation of an asset by one person for the benefit of another. In creating the asset for the other person, the existing rights of the creator are diminished...that represents the disposal.

In *Gien v Gien* the court defined ownership as the most comprehensive right a legal subject may have in a thing, subject to certain limitations of law.<sup>100</sup> More recently, Erasmus J in *Vairetti v Zardo NO & Others* referred to ownership as an 'elastic' bundle of rights,<sup>101</sup> which may be separated into the bare dominium and the enjoyment of fruits. Proceeding from the well-established *nemo plus iuris* principle, it follows, therefore, that under SARS' conception when one speaks of the creation of an asset one does

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<sup>98</sup> The CGT Guide op cit at note 63 at p 87.

<sup>99</sup> The CGT Guide op cit at note 63 at pp 87-88.

<sup>100</sup> (1979 (2) SA 1113 (T)).

<sup>101</sup> (12423/2007) [2010] ZAWCHC 146 at paras 17-18.

not refer to the underlying asset, but in fact the creation of a personal right of action to demand transfer of the asset.

Cassidy explores the definition of 'asset' under Australian law to conclude it includes only '*proprietary assets*',<sup>102</sup> ie rights in property which are able to be transferred. This is how Australian courts had circumscribed the term with the effect that it excluded certain personal rights. A distinction is made between the Australian common law based system of property and the Roman-Dutch law system operant in South Africa, namely that South African property law is concerned with whether an asset can be given a pecuniary value.<sup>103</sup> Moreover, the concept of value is linked to the ability to sell, or otherwise realise the value of that asset. Cassidy ultimately contends that the South African concept of property excludes certain non-transferrable rights, ie *res extra commercium*. Moreover, she accepts Williams' view that for the purposes of the CGT regime an asset as property may come in the form of a personal right, fit to be transferred for pecuniary value.<sup>104</sup>

Developing further on the creation of personal rights as disposals, it is a necessary concomitant that there would be two events falling within the definition of 'disposal' – the initial creation of the personal right, and the eventual real transfer. It is consequently of natural importance to determine when a disposal takes place; this is dealt with in para 13 of sch. 8. On close examination, it is apparent that the provision operates to disambiguate timing within the context of assets already in existence. The creation of a completely new asset, other than a personal right, is not contemplated. This would seem to imply two possible propositions: a) the CGT regime was never contrived to include *true* creation, or b) there was in fact nothing to disambiguate on account of the timing of the disposal being naturally and as a matter of course contemporaneous with the moment of creation.

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<sup>102</sup> Cassidy op cite at note 94 at pp 167-169.

<sup>103</sup> The Australian system of property is concerned principally on whether an asset may be transferred or not.

<sup>104</sup> Cassidy op cite at note 94 at p 174.

In evaluating the first possibility, one may fall back to the observation of Schreiner JA that gross income is derived from another person,<sup>105</sup> and consequently tax events have the implicit prerequisite of requiring a transaction. Extending this supposition to the CGT regime, so would a disposal require the creation of an asset to be in the context of a transaction, the substance of which necessarily requires some existent legal object.

It is submitted that such an argument may be refuted on two grounds. First, Schreiner did circumscribe his observation by acknowledging the possibility of exceptions. However, what is asserted as being of more persuasive value lies in once more taking a broad purposive view of the ITA. At the time the *Lever Brothers* judgment was handed down, the CGT regime was not in force, and the definition of gross income clearly excluded from its ambit amounts 'not of a capital nature'. The underlying purpose of the legislation was consequently only to tax a person on amounts generated by their intentional undertaking of a trade, which is non-exhaustively defined in s 1 of the ITA as,

'Trade' includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property... [Emphasis added].

Clearly stated in broad terms, what these expressions of the definition of 'trade' seem to have in common is that they necessarily imply interaction with another economic agent; just as one cannot contract with oneself, one clearly cannot have a trade receipt in isolation. Schreiner did contemplate as an exception to his contention the instance of a primary producer who produces for their own consumption; this may be further generalised to any instance of original ownership by means of 'acquisition of fruits'. However, it was added as a follow up to that remark, '*...what is treated as [gross] income*' [annotation added]. It is asserted, therefore, the learned judge recognised the exception did not apply absolutely in that what may be produced for self-consumption, and not being taxable, may become taxable when it forms part of a trade activity. Consequently, this arrives one back at the prerequisite of a counterparty.

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<sup>105</sup> *Lever Brothers* supra at note 60

The CGT regime has been described as giving rise to a minimum tax payable on capital amounts (or non-trade amounts), as opposed to the normal tax regime, which may further be described as concerned only with what emerges from trade activities. This is supported on the basis the CGT regime is unfettered by a requirement that any amount within its ambit must be 'not of a capital nature'. It may, therefore, be concluded that while normal tax requires a transaction, there is no apparent reason why the CGT regime should follow suit as it does not necessarily require a trade, ergo a counterparty. Thus, it may include the creation of a completely new asset as giving rise to a disposal event, notwithstanding that many instances would involve a counterparty.

Another avenue of inquiry along which to examine the extent of the CGT regime is to presume it does apply to the creation of real rights. According to Swart,<sup>106</sup> the extent of the definition of 'disposal, '*...can cover the creation or transfer of real rights as well as [the creation and transfer] of personal rights*' [annotation added]. As opined above, it seems fraught with difficulty to contend that a legal subject may transfer more real rights than they possess, or else they would first need to create such a real right. For the purposes of illustration of the consequences of sustaining this state of affairs, let us return to the example of a person who grows food for their own consumption. On their gathering of the harvest a real right is created by virtue of the coming into existence of the fruits as a separate *res*. On the basis that the creation of the asset constitutes a CGT regime event, this would give rise to tax payable to the state in monetary terms, which the taxpayer does not possess. This may well be described as an inequitable outcome, and to interpret sch. 8 in such a way would violate the common law presumption that statute law is not unjust,<sup>107</sup> inequitable or unreasonable, and must avoid as far as possible precipitating individual hardship.

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<sup>106</sup> Gerard Swart 'Interpreting some core concepts governing the taxation of capital gains' (2005) 17(1) *SA Mercantile Law Journal* at p 6.

<sup>107</sup> Du Plessis op cit at note 16 at para 334.

Before 2012 such an outcome may have been defended on the basis there is no equity as to a tax, however *Endumeni* and *Bosch* made it clear fiscal legislation is held equally to the purposive standard. SARS has remarked that the overriding purpose of the CGT regime is to achieve horizontal equity by not differentiating between a taxpayer who attains income in the form of gross income and one who attains it in the form of capital growth. Applying this principle, one could equally propose, therefore, that a taxpayer who attains monetary income in order to purchase goods should not be treated differently to one who provides such goods for themselves; both have an equal level of consumption under the Haig-Simons model. On balance, however, it could not have been the purpose of the CGT regime to give rise to situations which violate that hallmark of sound tax policy, the ability to pay.<sup>108</sup> This principle satisfies both vertical and horizontal equity,<sup>109</sup> the improvement of which was noted as one of the purposes for the introduction of the CGT regime. As such, it ought to be considered as having import into the legal construction of sch. 8. On the other hand, one should not interpret a statutory provision divorced from its context, and as such regard must be had to the reality that sch. 8 contains certain exclusions from the CGT regime.

In this regard, para 53(1) of sch. 8 provides that natural persons and special trusts are to disregard gains or losses on a disposal of a 'personal-use asset'. The exclusion from the ambit of para 53(1) of companies, and ordinary trusts, seems to rest on that they may be considered structures inclined to commercial undertakings, and/or wealth management strategies; natural persons are private citizens, and special trusts are distinguished for their humanitarian purpose. Paragraph 53(2) defines a 'personal-use asset' as, '*...an asset...that is used mainly for purposes other than the carrying on of trade.*' The CGT regime was an attempt to bring taxation of income closer to the comprehensive Haig-Simons model, which spoke of net accretions to wealth. In the spirit of

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<sup>108</sup> Christians op cit at note 1 at p 15.

<sup>109</sup> The CGT Guide op cit at note 63 at pp 1-2.

this purpose, wealth is positioned as not being as rudimentary as a person's net worth. What constitutes wealth for the purposes of sch. 8 is illustrated by the list of assets excluded from the 'personal-use asset' definition.

It is asserted that para 53, read in context, makes clear that the drafters of the legislation, on which the CGT regime rests, had due regard to the potential consequences of defining a CGT event as being constituted by the creation of an asset in the context of private persons. The insertion of para 53 is a carve out, and qualifies what constitutes wealth for the purposes of a comprehensive tax on income laid out in the CGT regime. It dispels the criticism that the interpretation of 'disposal' above leads to unduly harsh outcomes for ordinary people, possessed of those assets one typically would expect of the average South African citizen. All matters considered, it is asserted that there exists no reason not to accept Swart's view on the legal construction of 'creation'; any exceptions on tax policy grounds are dealt with by para 53.

### **3.3 *BTC Mining under the CGT Regime***

In applying the above principles to BTC mining, one must first recall the bifurcated nature of the process. In the first instance, the block reward, as discussed above, is created *ex nihilo* (from nothingness). Consequently, it constitutes an original creation of an asset giving rise to a disposal, as defined. Further, BTC, a crypto asset, has specifically been made part of the definition of 'financial instrument', which per para 53(3)(e) is excluded from the ambit of 'personal-use asset'. What makes it somewhat of a special case in the context of sch. 8 is that it is the only listed financial instrument which is contended to be a real right, and able to be created in isolation; the complex of personal rights embodying other financial instruments necessarily require a counterparty.

With respect to the timing of the disposal, it is asserted it must naturally coincide with the broadcast of the validated block and proof. The proceeds would be equivalent to the market value of the block

reward (“**R<sub>p</sub>**”); para 35(1) provides, ‘...*equal to the amount ...in favour of that person in respect of that disposal.*’

Secondly, insofar as the block fee is concerned, it is at inception a right to demand payment. This has been accepted as constituting an asset for the purposes of the CGT regime under the persuasive authority of Warner, J in *Zim Properties Ltd v Proctor*.<sup>110</sup> In application, however, this is slightly more complex to contemplate than the block reward with respect to the creation and extinction of rights, as discussed below.

When a transactor submits their transaction for validation, there is an implied public offer that the indicated fee for validating that transaction shall be payable to the miner who finds the proof, and broadcasts the new block to the network thus validating the transaction; these represent suspensive conditions. In mining the block, a miner by construction accepts the offer and communicates the acceptance by broadcasting the block to the network, having fulfilled all the required conditions. At this point, a personal right (“**X**”) is created by the transactor in favour of the miner. Almost simultaneously, the transactor fulfils their obligation by transferring by way of cession the block fee to the miner whereupon in terms para 11(1) of sch. 8 the miner’s right in X is extinguished giving rise to a disposal. The proceeds are equivalent the market value of the block fee at the time of accrual (“**F<sub>p</sub>**”), the timing of which would be governed by para 13(1)(a)(i), ie when the suspensive conditions are fulfilled, not when actual transfer takes place.

This resolves such that the timing for both the block reward and the block fee disposal occur simultaneously for the purposes of the CGT regime, notwithstanding the differing legal pathways.

Base cost is determined in terms of para 20(1)(a) as, ‘*the expenditure actually incurred in respect of the cost of acquisition or creation of that asset*’ [emphasis added]. Consequently, they may be denoted as **R<sub>c</sub>** and **F<sub>c</sub>**, and would be the weighted average cost per unit BTC received for

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<sup>110</sup> (1984) 58 TC 371 at 392F–G.

mining the block. The net accretion to wealth from both would be the sum of:  $R_p$  less  $R_c$ , and  $F_p$  less  $F_c$ .

BTC mining by a node operator would always give rise to a CGT event, unless it comes within the ambit of para 35(3). In such a case, it would be escalated out of the CGT regime into the normal tax regime. While the block reward does not satisfy the conceptualisation of income as arising from another person,<sup>111</sup> this is purely a matter of timing.

It is necessarily implied by the definition of gross income that the timing of a tax event under the normal tax regime is the earlier of receipt, or accrual; it is the duty of the taxpayer to report their income in line with this principle. It was determined in *Secretary for Inland Revenue v Silverglen Investments (Pty) Ltd* that the tax authority does not have a choice in the matter.<sup>112</sup> Where a taxpayer has disclosed an accrual of gross income the tax authority is required to assess them as at that date. Only where a taxpayer has failed to disclose an accrual does the tax authority have discretion - see *Kotze v Kommissaris vir Binnelandse Inkomste*.<sup>113</sup>

The crux of the matter in determining which regime to apply lies in the meaning of 'not of a capital nature', as developed by the South African Judiciary, and the legal construction of trading stock. As noted in chapter I above, it is unclear whether the ambit of the SARS guidance is intended to refer to all the BTC received from mining, or only the new coins, ie block reward. As such, it would be inappropriate to evaluate the guidance in the context of the block fee without founding the discussion on a rebuttable presumption as to the ambit of the guidance.

In the first instance, it is the opinion of this author that both the block fee and the block reward always give rise to a tax event for the purposes of the CGT regime with the consequence that the tax authority must collect tax in the respective year of assessment; there is no question of

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<sup>111</sup> *St Lucia Usines* supra at note 58, and *Lever Brothers* supra at note 60.

<sup>112</sup> (1969 AD) 30 SATC 199

<sup>113</sup> (1992 (1) SA 825 (T)) 54 SATC 149

deferral, which supports the qualification to the Guidance noted previously with respect to timing.

The reckoning of base cost for the purposes of calculating the tax base on a subsequent event (sale or exchange) may require some disambiguation given the only apparent expenditure has already been taken into account for tax purposes. Such an event would progress in line with the established mechanics of sch. 8. The personal right to the proceeds in favour of the taxpayer is created in exchange for the transfer of BTC to the purchaser; the tax value, ie the value at which it was originally received, constitutes expenditure actually incurred in the creation of the asset.<sup>114</sup> When performance is discharged by the purchaser, the right is extinguished for proceeds equivalent to the value of consideration; the tax base is thus the difference, as in any other case.

For the sake further clarity, the fundamental purpose of the ITA is reiterated as not being a tax on economic capital (despite the terminology of sch. 8 referring to 'capital'), but a tax based on the Haig-Simons comprehensive income model, as qualified by established tax policy. It is precisely for this reason that the tax base is defined as proceeds less the base cost; the cost represents a restoration of economic capital to the taxpayer, and therefore is not part of their economic comprehensive income. It is only what is returned in excess thereof, which qualifies. On the happening of any tax event (CGT or normal tax regime), once the income component has been subjected to tax, it becomes capital in the truest sense, consequently falling outside the ambit of the ITA. A global conceptual check through all the various creations and extinctions of personal and real rights is the differentiation between what is truly capital and truly income; thus, one arrives at the correct tax base.

It is, however, possible that para 35(3) may operate with respect to both the block fee and the block reward; this is predicated on it being demonstrably 'not of a capital nature'. The block fee, unlike the block

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<sup>114</sup> The phrase 'expenditure' was circumscribed by the court widely enough to include expenditure by way of assets having a monetary value for which a liability has been incurred. See *Commissioner for South African Revenue Service v Labat Africa Ltd* [2012] 1 ALL SA 613 (SCA) at para 12.

reward, comes about by way of a transaction, ie the implied 'coming in' requirement of gross income is satisfied. Therefore, similarly to an event under the CGT regime, there is no question of deferral of the tax collection until a later date; it merely occurs under the normal tax regime instead. Conversely, as the block reward does not involve a transaction, the qualified Guidance that there is an immediate tax event is subject to some doubt; it is this author's opinion that that the tax event is deferred until ultimate sale. Furthermore, it is not yet accepted that the block reward as a matter of course is dealt with under the normal tax regime; this implies it can only represent an amount 'not of a capital nature'. This is considered further below.

Following on from the above, it was demonstrated that for the outcome which the tax authority envisions to come about with respect to the block reward, it must fall within the ambit of para 35(3) of sch. 8. This is suggested by the tax authority to be on account of it always constituting trading stock. This is considered further below.

### **3.4 The Normal Tax Regime**

In order for an amount to be made subject to the normal tax regime, it must fall within the ambit of para 35(3) of sch. 8. This is brought about by it constituting an amount 'not of a capital nature' (as its brought within the ambit of the gross income definition), or arising in relation to a trading stock asset.

According to the guidance of the tax authority, para 35(3) would as a matter of course remove it from the CGT regime on the basis the proceeds are trading stock. This proceeds from the supposition it is inherently a trade activity, giving rise to gross income. Before examining the definition more closely, it should be established how trading stock intermeshes with the broader scheme of the ITA.

An excellent illustrative example from our jurisprudence is *Commissioner for Inland Revenue v Jacobsohn*.<sup>115</sup> The taxpayer here

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<sup>115</sup> 1923 CPD 221

was a merchant in wool, who had reinvested profits from trade during the year in stocks; the sale price of the commodity by the end of the year had dramatically decreased, precipitating his disclosure of income for the period on the basis of the quoted price. This resulted in a loss; nevertheless the tax authority issued an assessment marking the wool at cost. The Special Income Tax Court found in favour of the taxpayer, noting that the reduction in price was a 'loss actually incurred'. The appeal court agreed with the result, but rejected the reasoning of the court *a quo* as being incorrect in law.

Corbett JA ruled that the taxpayer's gross income must be determined with reference to the market value of the wool, and in his reasoning laid down the following insights,<sup>116</sup>

[The Act] must be construed to impose a charge upon income (which in effect is equivalent here to profit or gain) and not upon any receipts or accruals, which merely give back to the merchant... [Annotation added].

Further, he accepted the position of the Special Court,<sup>117</sup> that '*the underlying principle upon which income is assessed is value*' [emphasis added].

It has been said that the segmentation of trade, which otherwise represents a continuous and uninterrupted activity, into annual periods of assessment is an artificial construct.<sup>118</sup> This is an acceptable assertion. The court in *Jacobsohn* described the assessment of a trader within this artificially created construct as reconciling on the one hand the true value of the capital deployed to acquire stocks,<sup>119</sup> ie the cost price, and on the other the value of receipts and accruals, ie the sum of the sale price of stock actually sold and the likely sale price of stock to be sold in the future, represented by the ruling market price. In such a way, one may determine to what extent the activities of a trader have resulted in an increase in wealth. The court further commented such is an equitable treatment for both taxpayer and tax authority, as it preserves the right of

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<sup>116</sup> *Jacobsohn* supra at note 115 at p 228.

<sup>117</sup> *Jacobsohn* supra at note 115 at p 229.

<sup>118</sup> DM Stewart 'The prohibition of tax avoidance: an evaluation of s 103 of the South African Income Tax Act 58 of 1962' (1970) 3(168) *CILSA* at p 189.

<sup>119</sup> *Jacobsohn* supra at note 115 at p 229.

the latter to tax the trader where the actual sale price of wool turns out to be higher than the estimated value on assessment.

The *Jacobsohn* case illustrates the tax base for the purpose of the ITA is that global amount by which a taxpayer has increased their wealth, whether or not that wealth is represented in money or in goods. The mechanical operation of the ITA, however, necessarily allows a taxpayer to deduct from their gross income amounts paid for the acquisition of trading stock in terms of s 11(a). As explained above, the purchase of stocks in trade is not a loss to the taxpayer, and, were it not taken into account in assessing their net accretion to wealth, it would distort the purpose of the statute. It was nevertheless recognised in *Richards Bay Iron and Titanium (Pty) Ltd and Another v Commissioner for Inland Revenue* that this would amount to a mechanism for continual tax deferral.<sup>120</sup>

Section 22 of the ITA, originally introduced per s 6(f) of the Income Tax Act, 1956,<sup>121</sup> was characterised in *Commissioner for South African Revenue Service v. Volkswagen South Africa (Pty) Ltd* as an anti-avoidance provision designed to curb this mischief;<sup>122</sup> s 22(1) included in the determination of taxable income the value of trading stock held at the time of assessment. Shortly after the *Volkswagen* case, per s 24(1) of the Taxation Laws Amendment Act, 2019,<sup>123</sup> it was made clear that s 22 is meant to encapsulate those principles outlined in *Jacobsohn*; the value of trading stock constitutes gross income to the extent it is a store of the net increase in value of a trader. The *Volkswagen* case was significant in itself as it set out the principles on which a taxpayer may claim a valuation of trading stock below the cost price, however this is not relevant to BTC mining on account that s 22(1)(a) specifically excludes financial instruments from being valued below cost.

Having established how trading stock is positioned in the overall scheme of the ITA, one may turn to examine what constitutes trading

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<sup>120</sup> 58 SATC 55.

<sup>121</sup> Income Tax Act, Act 55 of 1956.

<sup>122</sup> [2018] ZASCA 116 at para 7.

<sup>123</sup> Taxation Laws Amendment Act, Act 34 of 2019.

stock for tax purposes. This term is defined term per s 1; in terms of para (a)(i) 'trading stock' is constituted as,

Anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange... [Emphasis added].

One must first undertake the exercise of interpreting this provision. In the first instance, it refers to 'anything'. In terms of South African law the conventional definition of a 'thing' is given as,

A corporeal object external to man [sic] which is an independent legal entity susceptible to private ownership and valuable and useful to legal subjects [emphasis added].<sup>124</sup>

While it is acceptable that a 'financial instrument' fulfils most of these criteria, it fails on corporeality.<sup>125</sup> Notwithstanding that BTC has been differentiated as arguably constituting real right rather than a complex of personal rights, it similarly fails on this criterion.

The 'trading stock' definition has a so-called catch all; in terms of para (a)(ii) 'trading stock' is,

Anything the proceeds from the disposal of which forms or will form part of the taxpayer's gross income... [Emphasis added].

Here again is referenced 'anything'. Further, the phrasing implies that the classification of proceeds as gross income must be a certainty, whereas what is uncertain is when it would be received or accrued. This provision may be said to act in concert with para 35(3) of sch. 8 in that it moves the proceeds from a disposal from the CGT regime to the normal tax regime, but merely suspends the tax consequences until gross income arises.

In *Commissioner for South African Revenue Service v I-net Bridge (Pty) Ltd* it was held that data,<sup>126</sup> notwithstanding its lack of corporeality, was nevertheless trading stock on the basis it was acquired with a view to it being sold. The judgment of the court in *I-Bridge* demonstrates a principles-driven approach, which should not be overridden by a narrow and technical interpretation; giving effect to the purpose of the provision

<sup>124</sup> Van der Merve op cite at 82 at para 18.

<sup>125</sup> A share certificate for example may be in materialised, but it must be distinguished as merely the *prima facie* evidence of the right, and not the right itself.

<sup>126</sup> 73 SATC 141.

requires 'anything' be regarded as a qualification of the scope, and not a limitation to a particular type of property.

Paragraph (a) of the 'trading stock' definition was given specific consideration in the *Richards Bay Iron* case.<sup>127</sup> In this regard the court made the important remark that the emphasis of subpara (i) lay in the phrase 'for the purpose of'; subpara (ii) was interpreted as merely calling for an objective (factual) inquiry. In interpreting the phrase 'for the purposes of trade', the court in *Commissioner of Taxes v BSA Co Investments Ltd* circumscribed its meaning as requiring inquiry only into what use a taxpayer intends – what motivates them to contract is irrelevant.<sup>128</sup> It is submitted 'the purposes of trade' is notionally equivalent to the acquisition of something for the purposes of selling as trading stock.

The scope of subpara (ii) was discussed in *De Beers Holdings v Commission for Inland Revenue*.<sup>129</sup> In this case the taxpayer contended certain shares fell within the ambit of subpara (ii) on the basis that were they to be sold they would constitute gross income, notwithstanding it was accepted their intention was not to sell. In his judgment, Corbett JA remarked that subpara (ii) simply denotes futurity, and should not be interpreted such that it extends to a hypothetical state of affairs which would not become a reality.<sup>130</sup> It may be inferred, therefore, that a taxpayer must have a genuine intention to deal with their assets in a subsequent tax year and so as to give rise to gross income by virtue of it being 'not of a capital nature'.

The principles attendant on the assessing of the intention of a taxpayer are well established in our jurisprudence, of which the two most illustrious cases are *Commissioner of Inland Revenue v Stott*,<sup>131</sup> and *Natal Estates v Secretary for Inland Revenue*.<sup>132</sup> In *Stott*, the taxpayer was alleged to

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<sup>127</sup> *Richards Bay Iron* supra at note 120 at p 72.

<sup>128</sup> *Commissioner of Taxes v BSA Co Investments Ltd* 28 SATC 1 at p 5.

<sup>129</sup> *De Beers Holdings v Commission for Inland Revenue* 47 SATC 229.

<sup>130</sup> *De Beers Holdings* supra at note 129 at p 256.

<sup>131</sup> (1928 AD 252) 3 SATC 253. See also *Commissioner of Inland Revenue v Paul* (1956 (3) SA 335 (A)) 21 SATC 1, and *John Bell and Co (Pty) Ltd v Secretary for Inland Revenue* (1976 AD) 38 SATC 87.

<sup>132</sup> (1975 (4) 177 (A)) 37 SATC 193

have sold sub-divided parcels of land with the intention of dealing with them as trading stock. In handing down judgment, the court established several key principles. Intention must be assessed along a continuum from the point of acquisition to the point of disposal; that the *ipse dixit* of a taxpayer ought to be accepted unless there are objective facts to impugn its credibility; that a taxpayer is entitled to deal with their asset to their best advantage. In *Natal Estates* the court demarcated the extent to which a taxpayer may realise their asset in accordance with the 'best advantage' principle. Where the manner and extent of realisation activities mimic what may be expected of a commercial undertaking, the taxpayer was said to have 'crossed the Rubicon'.

Notwithstanding that *Stott* and *Natal Estates* established useful principles, current prevailing law on the issue of revenue or capital intention is found in the seminal case of *Commissioner for Inland Revenue v Pick 'n Pay Employees Share Purchase Trust*;<sup>133</sup> a brief summary of the facts is as follows.

At the time, the Old Companies Act was still in force;<sup>134</sup> under s 38, a company was prohibited from providing any financial assistance to a person for the purposes of the acquisition of securities of the company, or its holding company. There was, however, an exception to this prohibition per s 38(2)(b), which allowed financial assistance in instances where the securities were held by trustees pursuant to a scheme for the benefit of employees. Such a scheme was devised in accordance with this exception. Finance would be advanced to the trustees, where an employee indicated their wish to participate in the scheme, and shares at the ruling price (the shares were listed) would be acquired. The finance capital was repayable within ten years but not earlier than five. Thereafter a demand for transfer of the securities may be made, moreover in the interim, the trustees held the shares in a fiduciary capacity.

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<sup>133</sup> (1992 (4) SA 39 (A)) 54 SATC 271.

<sup>134</sup> See note 73.

The incentive scheme was subject to the condition that a participant employee would forfeit their right to demand transfer on repayment of the finance capital in instances where they were dismissed for impropriety, or resigned prior to the end of the lock-in period of five years. Consequently, from time to time the trustees had a surplus quantity of shares on hand, which were available for allocation to new scheme participants at a prevailing market price relatively higher to the base cost of forfeited shares. As a result, the trustees reported a profit on share sales, which the tax authority assessed as gross income on the basis they were undertaking a profit-making scheme; having found in favour of the Commissioner, the matter was ultimately resolved by the SCA.

The SCA found in favour of the appellant, however it was not unanimous. In his minority judgment, Nicholas AJA expressed a view that there is no universal test for 'of a capital nature', and each case is to be assessed independently on its merits. Nicholas echoed the sentiments of Innes, CJ in *Overseas Trust Corporation Limited v Commissioner for Inland Revenue*, who remarked that,<sup>135</sup>

When an asset is realised as a mere change of investment there is no difference in character between the amount of enhancement and the balance of the proceeds.

The learned judge in the *Overseas Trust* case had gone on to cite the judgment handed down in *Californian Copper Syndicate v Inland Revenue*,<sup>136</sup> where Lord Justice Clerk opined,

...where what is done is not merely realisation or change of investment but an act done in what is truly the carrying on or the carrying out of a business [emphasis added].

And further,

...a gain made by an operation of business in carrying out a scheme for profit making, then it is revenue derived from capital productively employed, and must be income.<sup>137</sup>

Nicholas, AJA held that the court *a quo* had erred in setting the matter to turn on whether the trust was operating a scheme of profit making; the decisive issue was whether the sale of shares was a realisation of an

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<sup>135</sup> (1926 AD 444) 2 SATC 71

<sup>136</sup> (1904) (41 Sc. L.R. 691)

<sup>137</sup> *Californian Copper* supra at note 136.

investment, or the carrying on of a business. Further, while the trustees did not carry on a business in the conventional sense, it nevertheless was trading (buying and selling) the shares, from which profits had arisen. He, therefore, agreed with the Commissioner.

It is noteworthy that the minority and majority judgement reached consensus on many legal issues, notwithstanding they reached differing conclusions. One of the most fundamental of these was whether the test for carrying on a business or trade was a subjective or an objective test. In the judgment handed down in *Income Tax Case No. 1413*,<sup>138</sup> which had also dealt with a trust at the heart of an employee share incentive scheme, it was found that the test to be applied was objective. In distinction, thereto, the majority in the *Pick 'n Pay Employees* case disagreed, and determined that it is insufficient that a taxpayer merely operate a scheme of profit making; the taxpayer must do so with the intent to trade. In so doing, the court affirmed once more that the issue is what a taxpayer subjectively intended, not what was contemplated, but their objectives, aim and true purpose.

The majority held that a profit motive is not decisive, albeit a relevant consideration; one must look at the dominant purpose, and whether the gains were merely incidental, as opposed to deliberately sought; where the mode and manner of activities has a commercial-like quality,<sup>139</sup> a business purpose may be inferred. The established test has subsequently been cast in the convention: was there a subjective intention to operate a business in carrying out a scheme of profit-making.<sup>140</sup>

### **3.5 BTC Mining under the Normal Tax Regime**

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<sup>138</sup> (1985) 48 SATC 167

<sup>139</sup> See *Natal Estates* supra at note 132.

<sup>140</sup> Cf *Commissioner for South African Revenue Services v Wyner* 66 SATC 1. The court here departed from the subjective approach, and applied an objective standard. It is submitted nevertheless that the *Pick 'n Pay Employees* case should be upheld as the correct authority, as it was subsequently reapplied in *Commissioner for South African Revenue Services v Capstone 556 (Pty) Ltd* (2016) (4) SA 341 (SCA).

Given the economic incentives underpinning BTC mining, there is no denying that it may be undertaken as a business. There exist massive BTC mining installations in the United States and China;<sup>141</sup> in a public-private partnership,<sup>142</sup> the government of El Salvador intends harnessing geo-thermal energy from an active volcano in its territory to power an expansive BTC mining plant. These are clear examples of mining as a business on a large scale, moreover it does not imply that it may not be undertaken as a business on a smaller scale. It would, however, require a more detailed inquiry into facts and circumstances; it would not be obvious by inspection.

The issue at hand is to determine whether BTC mining is inherently a business. As such, it is necessary to note that alternative use cases for BTC mining do exist, other than as a commercial undertaking. These include: currency debasement hedging, heating solutions, power grid balancing,<sup>143</sup> *inter alia*.

BTC has been compared to the commodity, gold, on account of its mathematically-guaranteed scarcity. A comparative analysis has been undertaken to establish the tax nature of amounts received under cash-settled derivative contracts used for hedging purposes in the share market;<sup>144</sup> it was suggested as being analogous to the approach of the court in taxing the proceeds from sale of Krugerrands as a hedge asset.<sup>145</sup> It was argued that in such circumstances a court would look at the surrounding objective facts and circumstances to establish as the critical issue whether the value of the derivative contract had sufficient

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<sup>141</sup> Foundry (USA), Bitfury (USA) or Bitdeer (China) are some examples. <https://www.nasdaq.com/articles/volcano-energy-builds-road-to-geothermal-bitcoin-mining-in-el-salvador>.

<sup>143</sup> Electrical power generation is highly inelastic on the supply side, whereas the demand side is characterised by peaks and troughs. This would create a necessary tendency to favour a shortage of supply, rather than a surplus, for fear of overloading a distribution network. BTC mining is able artificially to increase demand *ad hoc* during times of otherwise low consumption, and *vice versa*. This would not likely be relevant for private persons other than minimising energy wastage from renewable sources, yet it highlights BTC mining not as a commercial undertaking but as a tool in engineering.

<sup>144</sup> Stephen Doidge *The Tax Treatment of Receipts and Accruals arising from Equity Option Contracts* (Mcom thesis, Rhodes University, 2003) at p 45.

<sup>145</sup> *Commissioner for Inland Revenue v Nel* 59 SATC 349, *Income Tax Case No. 1355* 44 SATC 132, *Income Tax Case No.1379* 45 SATC 263, and *Income Tax Case No. 1543* 54 SATC 446.

negative correlation with the underlying asset – the Effective-Hedge requirement.

Choi and Shin recently published the results of a data-driven study of BTC and financial markets,<sup>146</sup> wherein they concluded it could be used as an effective hedge during times of inflationary pressure. These findings, however, must be taken in the context that the data equally suggested that BTC is not an effective hedge against stock market declines, which may form a basis to cast doubt on the Effective-Hedge argument as relevant. However, it is submitted that the foundational reasoning upon which it is based is transferrable to BTC as an inflation-hedge; the intention of the taxpayer is to preserve their economic position, or at least to mitigate the risk of its dilution. Such is distinguishable from one who operates a business of risk-taking in the pursuit of profit.

The plausibility of such an intention may be justified also on philosophical grounds. Falling back to the *Jacobsohn* principles, taxation is predicated on aggregate value accretion. At its core, paper money was introduced to address the transportability issue of gold, which is regarded as a true store of wealth given its intrinsic value. In this respect, paper money is issued in our case by the South African Reserve Bank in the form of a bank note; here ‘note’ must be interpreted in the legal sense as representing a promise between the holder and the issuer that the real value, not just the nominal value, represented by the note is redeemable.

Historically, this was the purpose of the Bretton Woods Monetary Order established in July 1944, which ultimately guaranteed convertibility of currency into US Dollars within a 1% bid-offer spread; the US Dollar, as a reserve currency, was in turn convertible into gold bullion at USD35.00 per troy ounce, ie the Gold Standard. This was ultimately abandoned which has had the effect that governments and central banks have been able to debase the value of their currency,<sup>147</sup> which ultimately

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<sup>146</sup> Choi, Sangyup & Junhyeok Shin ‘Bitcoin: An inflation hedge but not a safe haven’ (2022) 46 *Finance Research Letters*

<sup>147</sup> Curiously, the term ‘debase’ originates from the practice of replacing the quantity of gold, or silver, in coinage with base metals.

leads to inflationary pressure – SA is no exception, reporting the highest historical level of M3 money supply in June 2023.<sup>148</sup> The acquisition of BTC through mining, or otherwise, to offset the devaluation of currency as a store of value, forming the basis of taxation, should not be discounted as a genuine intention of the taxpayer to exclude a trade purpose.

Besides value preservation, more imaginative use cases exist. BTC mining is fundamentally a computational undertaking, which has as an inevitable by-product significant conversion of electrical energy into heat energy. In a more practical application,<sup>149</sup> research has been conducted which discusses how such energy may be used for the heating of residential homes as opposed to more conventional methods.

The choice made to power a mining device as a source of heat is conceded as having the effect of yielding a gross return, or at least a recoupment of the cost of the electrical energy. This, however, does not amount to a trade as there is no intent to operate the scheme as a business. The conversion of electrical energy to heat energy is squarely within the ambit of the *Stott* case; the taxpayer is merely exercising their right to realise their electrical energy asset to best advantage.

There may be other instances where BTC mining has a role to play, however the above demonstrates plausible real world uses for BTC mining pertinent to individuals, other than as a business endeavour.

Consequently, an absolute generalisation of BTC received from mining constituting trading stock is questionable.

### **3.6 Conclusion**

Over the course of this chapter, the distinguishing element of the CGT regime and the normal tax regime was of principle concern. With respect to the former, the central issue was whether a disposal is constituted by the creation of an asset in favour of the taxpayer by the taxpayer,

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<sup>148</sup> Source: <https://tradingeconomics.com/south-africa/money-supply-m3>

<sup>149</sup> Tri Nguyen Anh Hoang *Reusing Waste Heat from Cryptocurrency Mining to Heat Multi-Family House* (BEng thesis, Metropolia University of Applied Sciences, 2018).

themselves, and not a counterparty. Swart was steadfast in their opinion there should be no bar to construct the meaning of this definition otherwise. It is concluded that this position is correct as the scheme of the CGT regime is to tax on comprehensive income, and under a dispensation where all exclusions for the sake of equitable treatment in terms of the ability-to-pay principle have been taken into account through personal use assets. As financial instruments are not subject to such exclusions, the clear policy choice to position crypto assets as such must necessarily reinforce this assertion that the creation of BTC through mining must give rise to a tax event under the CGT regime.

In consequence thereof, the SARS guidance, as qualified with respect to the timing of the tax event, is acceptable for the purposes of sch. 8.

In the context of the normal tax regime, the gross income definition was crucial, and in particular the element of 'not of a capital nature'. It was demonstrated that the test to be applied in determining whether an amount is such rests upon whether it arises pursuant to the activities of a taxpayer, the intention of whom is to trade; mere profits, or gains, are insufficient. Paragraph 35(3) of sch. 8 would only be applicable where such an intention is apparent, whereby the BTC mined would be dealt with under the normal tax regime. The SARS guidance, however, is able to be criticised in that it is declaratory of the normal tax regime always being applicable; this was refuted by the identification of alternative purposes for the mining of BTC other than operating a scheme of profit making. The suggestion of the tax authority cannot be made as to an absolute certainty in this regard.

It was further illustrated that an amount in the context of gross income must necessarily involve a 'coming in', ie it must be of a transactional nature. Consequently, the block reward was distinguished from the block fee in that only the latter satisfies this criterion with result that only it would give rise to tax event under the normal tax regime at the time of receipt, as contemplated in the qualified Guidance.

The tax treatment of the block reward, therefore, was considered in light of the provisions of the ITA concerning trading stock. It was

established that the scheme of the ITA was to levy a tax on value accumulated during a tax year, which may reside both in money and stocks. Additionally, the jurisprudence and legislative scheme reinforced the notion that it is the increase in net accretions to wealth during a period of assessment which constitutes the tax base. As a practical matter the block reward represents a notional net accretion of wealth, which would only materialise upon realisation for its extrinsic value in the market. In the interim, the cost of creating the asset equates to its tax value, which ultimately resolves to a zero sum game.<sup>150</sup>

Consequently, on the basis of the SARS guidance, as qualified by the brief commentary above, gives an arguably incorrect overview of the treatment of the block reward in the context of the normal tax regime in that the tax event is immediate. This does not take into account that the principles established around the gross income definition requires there to be a 'coming in' from a counterparty. While this is a departure from the held view in the literature, it is submitted, nevertheless, as being consonant with established jurisprudence.

Chapter IV below considers the tax consequences of mining via pools, rather than interaction with the Bitcoin Network directly via nodes.

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<sup>150</sup> The inclusion of the tax value in gross income per s 22 would be offset by the deduction against gross income allowable under s 11(a); as the quanta are the same, there is a nil affect on taxable income.

## 4 CHAPTER IV: BITCOIN MINING BUSINESS STRUCTURES

### 4.1 Overview

In chapter III above, the tax implications of BTC mining were considered in the context of a node interacting directly with the Bitcoin Network. This in practice, however, is only suited to large enterprises with substantial computational capacity; the more common method for private or small-scale operations is to mine via a mining pool.

As described above, mining is a computational race where the winner takes all. As such, a miner who has 60% of the total computational power on the network would on average find more proofs than a miner who only has 40%. To illustrate the practicalities, at the time of writing the most powerful single mining device currently available on the market is merely  $3.767 * 10^{-5} \%$  of the total computational power currently operating on the Bitcoin Network.<sup>151</sup> Intuitively, it is sensible for small private operators to pool their resources to close the gap between their capacity and larger node operators; these co-operatives constitute a mining pool.

Notwithstanding the above, operating a node directly on the Bitcoin Network requires a certain degree of technical knowledge and skill; arguably an equally relevant attraction for private persons to participate in mining pools is the ease with which a mining device may be configured, ie merely inputting a URL as easily as one would enter a website URL into a browser. In the modern age, this would not constitute specialist knowledge.

Mining pools generally operate on some variation of either one of two paradigms – PPLNS, or FPPS. The purpose of each model is fundamentally a basis for which to allocate BTC mined to the participants in a pool, and have in common that they make use of total submitted shares in a round. Dissimilarly, however, is their attribution of risk. In the case of the former, miners are only rewarded with BTC to the extent the mining pool finds a proof, whereas under the FPPS model miners receive

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<sup>151</sup>  $3.767 * 10^{-5} \% = 0.000003767\%$ .

a fixed reward per share submitted regardless of whether the pool actually finds a proof or not. Necessarily, therefore, under FPPS model someone needs to make good any short-term shortfall.

The objective of this chapter is to establish in the first instance whether the participation in such a mining pool gives rise to a specific legal structure which the ITA may regard as fiscally opaque, or alternatively fiscally transparent. It is envisaged that the three possibilities which may arise under our law are: a) formation of a separate legal person, and joining is akin to membership, b) the constitution of a partnership, or c) a mere manifestation of a commercial contractual arrangement.

## **4.2 Legal Form of Mining Pools**

### **4.2.1 Fiscally-Opaque Forms**

The concept of separate legal personality as a juristic person is well established in South African law, however the only automatic allocation of personality is that assigned to natural persons at birth.<sup>152</sup> In contrast, juristic personality is deliberately bestowed, and sets the entity apart from those persons associated with it.

The most common modern example is the corporation, which is defined per s 1 of the Companies Act as a juristic person registered in terms thereof, *inter alia*. The creation of companies is not by virtue of the will of existing persons alone, but ultimately requires the cooperation of an officialdom to recognise that a new juristic person has been created.<sup>153</sup> A comparative analysis of several other prominent jurisdictions also present with this requisite formality; it is, therefore, reasonable to regard it as a principle of general application. One may conclude, therefore, joining a mining pool does not give rise to a juristic person under the Companies Act as there is no observable fulfilment of this formality.

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<sup>152</sup> DSP Cronje 'Persons' *The Law of South Africa* vol 20(1) (2009) at para 440.

<sup>153</sup> See Annexure A for a review of how corporate personality comes into existence in various jurisdictions. The common element is that a state authority must first recognise that a juristic person has been created.

However, a juristic person may also be recognised under Roman-Dutch law, ie *universitas personarum*. In *Webb & Co Ltd v Northern Rifles, Hobson & Sons v Northern Rifles*,<sup>154</sup> the court distinguished this from an unincorporated association, such as a partnership (*societas*), remarking,<sup>155</sup>

...is a legal fiction, an aggregation of individuals forming a *persona* or entity, having the capacity of acquiring rights and incurring obligations to a great extent as a human being.

Roman-Dutch law further makes the distinction that whereas *Societas* is created by contract, the *universitas* is not.<sup>156</sup> However, over time South African jurisprudence has conflated the legal tenets of English clubs, formed by charter (or some similar constitutive document), such that the view has emerged the *universitas* is now similarly a contractual creation. The blending of these legal traditions has been criticised as giving rise to problems.<sup>157</sup> Nonetheless, the prevailing common law is that juristic personality is,<sup>158</sup> '*founded on the basis of mutual agreement*,' notwithstanding that this is in direct opposition to its Roman-Dutch law origin.

In modern South African contract law, consensus is the wellspring of all contractual obligations.<sup>159</sup> Moreover, agreement may be made in the form of conduct, ie tacit agreement.<sup>160</sup> Nevertheless, any party must still have *animus contrahendi*, tacit or overt; it is doubtful this is the case here. Further, Heaton succinctly notes the requirements which emerge for recognition of personality as a *universitas*,<sup>161</sup> namely – there must be a continuous existence, irrespective of any fluctuation in membership, the ability to acquire rights, duties and capacities

<sup>154</sup> 1908 TS 462 at pp 464-465. See also *Morrison v Standard Building Society* 1932 AD 229 at p 238.

<sup>155</sup> Cf *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 at p 550 per Innes, CJ, '*a separate entity distinct...is no [sic] merely artificial and technical thing.*'

<sup>156</sup> GJ Pienaar 'Associations' *The Law of South Africa* vol 2 (2015) at para 154.

<sup>157</sup> Gerrit Johannes Pienaar *Die gemeenregtelike regspersoon in die Suid-Afrikaanse privaatreë* (LLD thesis, Potchefstroom University for Christian Higher Education) at pp 168–176 & 207–218.

<sup>158</sup> Pienaar op cit at note 156 at para 155.

<sup>159</sup> Dale Hutchison, Chris-James Pretorius & Jacques Du Plessis et al *The Law of Contract in South Africa* 4 ed (2022) at p 13.

<sup>160</sup> ADJ van Rensburg 'Contract' *The Law of South Africa* vol 9 (2014) at para 296.

<sup>161</sup> Jacqueline Heaton *The South African Law of Persons* 3 ed (2008) at p 7.

independently, and be for a purpose other than gain. Pienaar qualifies this last requirement in noting that the acquisition of gain merely ought not to be the primary purpose, rather than that it is an absolute obstacle.<sup>162</sup> Neither describe whether gain is monetary in nature,<sup>163</sup> or would include qualitative benefits. Clearly, the mining pool is an undertaking for gain as its principal purpose; it is unnecessary to consider the other elements. As such, the conclusion may be reached that it does not constitute a juristic person from which distributions may be akin to dividends; any tax consequences would flow through to underlying associated parties.

#### **4.2.2 Fiscally-Transparent Forms**

Fiscally transparent business forms under South African law are the sole trader, or the partnership.<sup>164</sup> The courts per *Joubert v Tarry and Co* have accepted Pothier's formulation of the essentialia for the creation of a partnership,<sup>165</sup> and is consequently defined in our jurisprudence as,<sup>166</sup>

A legal relationship arising from a contract between two or more persons, each contributing to a business or an undertaking carried on for joint benefit, with the object of making a profit [emphasis added].

The first of the essentialia is there must be a contribution by a partner. This may be in the form of assets, labour or expertise.<sup>167</sup> It should be common cause that a participant is expending effort in some form toward finding a proof for the pool which would necessarily require the use of assets and electricity. The transaction may be constructed as the provision of services in exchange for a partnership interest; viewed objectively,<sup>168</sup> the attainment of such an interest as consideration for services may give rise to a normal tax event per para (c) of the gross income definition. Nevertheless, it is asserted that as a practical matter

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<sup>162</sup> Pienaar op cit at note 156 at para 154.

<sup>163</sup> Monetary in the sense of money, or 'money's worth'.

<sup>164</sup> A trust is presumed not to be applicable here.

<sup>165</sup> 1915 TPD 277.

<sup>166</sup> JJ Henning 'Partnerships' *The Law of South Africa* (2022) 31(3) at para 430.

<sup>167</sup> Henning op cit at note 166 at para 438.

<sup>168</sup> *Commissioner South African Revenue Service v Brummeria Renaissance (Pty) Ltd* (2007 SCA 99 (RSA)) 69 SATC 205. Cf *Stander v Commissioner for Inland Revenue* 59 SATC 212.

the valuation of this amount would be zero.<sup>169</sup> It is consequential to note that para (c) irrebuttably presumes the amount to be ‘not of a capital nature’; the expenditure incurred would only be relevant in the context of sch. 8. Further consideration of this falls outside the scope of this research.

The promoter in turn makes their contribution in the form of labour, assets and expertise, ie infrastructure, oversight and maintenance.

Bitcoin mining is at least an undertaking. Furthermore, it should be agreed that it is not philanthropic, but for a gain of some sort. These essentialia are arguably fulfilled as well.

The element of ‘mutual benefit’ requires a more expansive exposition. This refers to the requirement that each partner must gain some value or advantage. However, more than that it has been developed by the courts as a means of differentiating between what is a true partnership, or some other contractual arrangement. Two cases illustrate this distinction as follows.

The matter of *Mackay v Naylor* involved a dispute over a purported lease of a racehorse.<sup>170</sup> The terms of the agreement stipulated that the so-called lessee was responsible for all training and racing expenses, and that the so-called lessor was entitled to half of any winnings. The court was called upon to adjudicate an unlawful repudiation. While the ratio for the decision rested on a presumption of a lease, the court, nevertheless, emphasised as *obiter* that a partnership necessarily implies the carrying on of a venture in common. This must necessarily manifest itself as a participation in profits (gains less expenditures), not merely gross gains.<sup>171</sup>

In *du Preez v Steenkamp and Another*,<sup>172</sup> this view was reinforced. The court remarked *obiter* once again that partnership must involve the

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<sup>169</sup> It is asserted that moment at which partnership interest is determined precedes the accrual of any value to the partners in common, notwithstanding the broadcast of the proof happens very shortly thereafter.

<sup>170</sup> 1917 TPD 533.

<sup>171</sup> *Mackay* supra at note 170 at p 537.

<sup>172</sup> 1926 TPD 362.

common sharing of profits and losses.<sup>173</sup> Losses are merely the manifestation of the assumption of risk. Therefore, it ought to be held that mutual benefit can only be satisfied where the parties are commonly affected by the risks of the undertaking.

It is asserted as sufficient to infer when the arrangement between the participants and the promoter is more likely one of partnership than not by application of the afore-mentioned principles. While there is no expenditure in common within a mining pool (each party makes as their contribution an integrated complex of net value), the PPLNS model and FPPS model differ in the attribution of risk. In the case of PPLNS, the risk is shared; where no proof is found, neither party receives any value. Under the FPPS model, both participants and promoter receive commensurate value for the round, however the risks and rewards of any temporary deficits or surpluses rest with the promoter. Stated alternatively, the implications of 'luck' in the mining process affect the promotor only.

On a balance of probabilities, it is argued that a pool under PPLNS paradigm would give rise to a partnership. Under the FPPS model the arrangement is one of exchange;<sup>174</sup> a sale contract may be excluded as the *pretium* is not payable in money, given it has been clearly established that under South African law BTC is property, not legal tender.

#### **4.2.3 Objective Bases for Contractual Obligations**

The subsistence of a partnership or an exchange arrangement is still predicated on the general requirements of contract, of which one is the parties must have the genuine intention that specific legal consequences result. Thus, no definitive general determination can be made. Nevertheless, the following is suggested as useful principles.

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<sup>173</sup> The ratio was that profits and losses do not equate to gross produce (in the sense of crops). It was insufficient to dismiss the arrangement as one of lease merely on the basis that the consideration was only certainly ascertainable in the future.

<sup>174</sup> The contract may be framed as a lease given certain specific intentions, however it is submitted the simplest, and therefore more likely construction, is an agreement of exchange.

In his dissenting judgment in *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*, De Wet CJ made the following remark,<sup>175</sup>

...if the Court on a consideration of all the circumstances comes to the conclusion that the transaction was in fact not what it purported to be, it follows that[,] however honestly the parties thought that their intention was in accord with the simulated transaction, that was not their real intention [annotation added].

Chief Justice de Wet here suggests that where parties to a transaction have the genuine belief the nature of their transaction is of one kind, but the objective facts attendant upon it, or its execution, are irreconcilable with such a belief, the legal consequences should be objectively defined. In accordance with this sentiment, when viewed objectively, the actions of the promoter and the participants in a PPLNS scenario lead one to the reasonable conclusion they have bound their fortunes together in common; under the FPPS, they have not. This is proposed as a basis upon which to assert a definitive classification based on objective facts and circumstances.

Alternatively, the matter may be considered from the perspective of the how the court enforces a contract where one party claims there was dissensus arising from legal mistake; the outcome of such an inquiry is relevant for the tax purposes as the tax consequences must follow the legal consequences of the contract.

While consensus under Roman-Dutch law is determined subjectively, the English standard, known as the doctrine of quasi-mutual assent, was confirmed as being part of South African law in *Sonap Petroleum (SA) (Pty) Ltd (formerly known as Sonarep (SA) (Pty) Ltd) v Pappadogianis*.<sup>176</sup> The court laid down the test for its application as follows: did the mistaken party lead their counterparty to believe in fact their declared intention represented their actual intention, and further would a reasonable person have been so misled?

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<sup>175</sup> 1941 AD 369 at p 383.

<sup>176</sup> 1992 (3) SA 234 (A) at pp 119-120. See also the *locus classicus* in English Law, *Smith v Hughes* (1871) LR 6 QB 597: 'If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.'

In applying this test in principle, it is submitted as sensible to cast the promoter of a mining pool as a party making a public offer; a participant in joining a mining pool is an acceptor of the offer. Consequently, were a participant to assert they were mistaken as to the true legal consequences of their actions, the contract would still be enforced in accordance with its purported tenure if the promotor was, or as a reasonable person would have been, mistaken. It is submitted that any person able to connect to a mining pool, unassisted, is at least literate and able to appreciate the rudimentary difference between their economic interests being contingent or absolute. A reasonable person would not likely perceive a genuine possibility that their counterparty may have failed to appreciate such a difference.

It is, therefore, argued that the election by a participant in a mining pool of either models is decisive of what legal consequences follow on account of subjective intentions being overridden by the outwardly objective nature of the arrangement.

It is now necessary to consider the tax implications of either of these two alternatives because, as will be demonstrated, it has the inevitable effect of rendering a miner's intention for tax purposes nugatory.

#### **4.3 Taxation under a PPLNS Partnership**

The taxation of persons carrying on business in partnership was not legislated in the ITA until relatively recently, and was principally motivated by National Treasury wishing to 'close loopholes'.<sup>177</sup> In light of this, a purposive interpretation of the relevant provision requires that one first examine the position prior so as to identify the mischief.

The first of these loopholes arose from *Sacks v Commissioner for Inland Revenue*,<sup>178</sup> at the centre of the dispute was the dissolution of a partnership operating a wholesale merchant business under E Sacks,

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<sup>177</sup> A. Titus, 'A review of the taxation of partnerships in South Africa over the last 100 years' in *Income Tax in South Africa – The First 100 Years* (2016) at p 132.

<sup>178</sup> *Sacks v Commissioner for Inland Revenue* 1946 AD 31.

Futeran and Company (“**the Partnership**”). The pertinent facts are summarised below.

There was no written partnership agreement, however the accounts were drawn for the period 1<sup>st</sup> July to 30<sup>th</sup> June each year. Sacks’ share of the profits was 43 and a third percent, however he wished to retire at the end of December 1940. The Partnership’s accountant calculated an average profit for the prior three years to arrive at £5,351 as representing half the current year’s profits. Subsequently, the Partnership had an especially prosperous trading season reporting net gains for the period of £58,177.

The tax authority contended that the profit had accrued uniformly to the partners over the year, and assessed Sacks accordingly for a sum of £14,297. The matter was finally decided by the Appellate Division.

In its judgment, the court rejected the Commissioner’s theory of the case that gross income and expenses accrue to the partners from day to day such that at any point their taxable income is ascertainable by applying the average. It was common cause that the Partnership property was owned in common in undivided shares; no one partner acquired a separate right to that property until profits were divided. The court determined that profits can only be ascertainably measured by reference to the increase (or decrease) of assets between two points in time, which the partners determine by agreement. The inevitable concomitant of this case was that it represented a significant tax avoidance tool, ie partners could effectively set their own period of assessment.

The second mischief identified by National Treasury was the uncertainty as to whether certain types of partners could be regarded as carrying on business of the partnership;<sup>179</sup> gross income only includes amounts ‘not of a capital nature’. This envisioned a situation where a general partner with a trading intention enlists silent, *or en commandite*

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<sup>179</sup> National Treasury ‘Explanatory Memorandum to the Income Tax Amendment Bill’ (1988) at p 22.

partners, for the purposes of capital formation, who in contracting have an investment, or capital intention.

The taxation of partnerships has been governed by s 24H since its insertion in 1988, and addresses the above concerns of National Treasury. Section 24H(2) now provides that all partners are deemed to be carrying on the trade of the partnership;<sup>180</sup> passivity, or a capital intention, is no longer a grounds to argue amounts received do not qualify as gross income. Of greater importance for the purposes of this discourse is what is provided under s 24H(5)(a), namely,

Where any income has in common been received by or accrued to the members of any partnership...a portion (determined in accordance with any agreement between such members as to the ratio in which the profits or losses of the partnership are to be shared) of such income shall, notwithstanding anything to the contrary contained in any law or the relevant agreement of partnership, be deemed to have been received by or to have accrued to each such member individually on the date upon which such income was received by or accrued to them in common [emphasis added].

In the ordinary course, where the common property of a partnership is severed in favour of the individual partner as their own separate property, this would naturally give rise to a disposal by virtue of their being a transfer of ownership rights. Section 24H(5)(a) presumes as a condition that income has accrued to the partners in common; it then appears to override the situation by instead deeming the income to have accrued to the individual partner. As such, a necessary inquiry is whether the effect of this provision is also to deem the income never to have accrued in common at all. It is asserted as not being the case. The purpose of the legislation was to address the facility for tax avoidance through deferral of liability brought about by the *Sacks* case; the erstwhile loophole did not derive from common ownership of property *per se*. It is consequently argued that the provision should be understood merely to override what a partnership agreement stipulates such that profits in common are separated in favour of individual partners immediately after it has so

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<sup>180</sup> Furthermore, in terms of the majority decision in *Commissioner for Inland Revenue v Epstein* [1954] 4 ALL SA 7 (A) the source of partnership income lies where the partner undertakes the partnership business. Whether this is the view of National Treasury is open to some debate given Schreiner's dissenting view in the *Lever Brothers* case found its way into the ITA per s 9; Schreiner in *Epstein* again expressed a differing view to his brother judges.

accrued in common. The tax consequences should be viewed in the light of their being a change in ownership.

It may be inferred from the above that under a PPLNS model, where participants are analogous to passive partners and a promotor the general trading partner, there is no possibility to classify any of the BTC received through mining otherwise than receipt or accrual 'not of a capital nature'; s 24H(2) imputes a revenue intention among all partners, and excludes the CGT regime.<sup>181</sup> Of even greater consequence is whereas before the normal tax consequences attendant on the block reward would have been deferred as not satisfying the 'coming in' requirement, under the partnership PPLNS model the creational element of the block reward takes place with respect to the common property. As a result, when the ITA separates the common property in favour of the participant partner, the legal fiction has the inescapable effect of now satisfying this 'coming in' requirement; the change of ownership amounts to a transaction.

On this basis, it is alleged that the guidance published by SARS, as qualified, is accurate under PPLNS. There is an immediate tax event in terms of the normal tax regime which is peremptory; the principles of *Kotze* would apply.

#### **4.4 Exchange Transactions and the FPPS Model**

An exchange transaction does not have attendant upon it any tax consequences which deviate from principles established in chapter III. What is of consequence, however, is that in the case of mining under the FPPS model there is no longer a need to differentiate between the block reward as an instance of true creation of an asset, and the block fee. The underlying legal nature of the arrangement between a participant and the promotor of a pool is transactional; a promotor in fact publishes the proof to the network, and earns the block fee, and creates the block reward, whereas the participant merely receives BTC as settlement of consideration *in specie* for services rendered. The fact the consideration

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<sup>181</sup> A participant may subsequently deal with the asset with a capital intention after normal tax has been raised.

is linked to the hypothetical BTC inherent in a block is irrelevant.<sup>182</sup> It may, therefore, be concluded that irrespective of whether the BTC is taxed under the normal tax regime, or the CGT regime, there would be no deferral of the respective tax event. The SARS guidance, as qualified, is acceptable.

It is further useful to consider whether the consideration under such a bartering arrangement would in all cases constitute gross income by way of the general definition. Mkonza examined the question of whether rental income from the letting of fixed property amounted to trading activity.<sup>183</sup> The conclusion was reached that the mere receipt of rental was insufficient to constitute trade, notwithstanding the definition of 'trade' includes the letting of property; the taxpayer must have the requisite intention to trade as their dominant purpose, and execute their actions in accordance with this intention.

A majority of the cases examined by Mkonza did not place before the court the question of whether rental was gross income or no. The jurisprudence does, however, highlight that what may intuitively appear as income in the economic sense does not necessarily equate to gross income giving rise to a normal tax event. What is necessary is for the 'not of a capital nature' element to be deliberately nullified.

The test established by *Pick 'n Pay Employees*, as reinforced by *Capstone*,<sup>184</sup> makes it clear the current legal position in South Africa is resultant profit alone is insufficient for an amount to be 'not of a capital nature'; the subjective and dominant intention of the taxpayer must be to conduct trade. It should, therefore, be theoretically possible to mine BTC via a FPPS pool without necessarily having a different intention than if one were to do so via a node. It is asserted that this type of scenario is precisely the rationale for the CGT regime as a minimum level tax. While

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<sup>182</sup> See *Victor & others v Chep SA (Pty) Ltd & others* (2020) 41 ILJ 2802 (LAC) at para 39. The court found that how consideration is determined does not alter the substance of a contract. While the subject matter of this case was a labour dispute, it nevertheless illustrates on point the trite principle of substance over form.

<sup>183</sup> Qhinga Aidan Mkhonza 'A common law view of "carrying on a trade"' (MCom thesis, 2017, Rhodes University) at pp 41-51.

<sup>184</sup> *Capstone* supra at note 140.

a taxpayer may not have a trading intention, they nevertheless make some form of contribution to the state treasury in accordance with the benefit principle; this is only escalated in cases where there clearly is a trade intention.

In any event, the underlying nature of the transaction is representative of services rendered; it would be subject to the special inclusion by way of para (c) of the gross income definition, and always give rise to a normal tax event. In all likelihood, a taxpayer would assert the intention to trade in order to have the benefit of deductions.<sup>185</sup>

#### **4.5 Conclusion**

In this chapter, the tax implications of mining BTC were considered in light of the common practice for participants to mine via pools. It was argued that pool mining gave rise to either a partnership scenario, where a participant miner enjoins their fortunes with a pool promoter, or engages in a simple exchange transaction in the form of services for consideration *in specie*.

The tax consequences of pool mining are they would always result in a normal tax event. It is nevertheless important to stress this is not on account of the intention of the taxpayer being to conduct business. The normal tax regime is selected on account of s 24H deeming the carrying on of trade, or para (c) of the gross income definition overriding the requirement that an amount be 'not of a capital nature'.

In this regard, the qualified SARS guidance is acceptable in that there is in fact no deferral of the tax event, however whether or not the taxpayer holds the BTC as trading stock for the purposes of any subsequent treatment is still governed by the capital-revenue intention test under *Pick 'n Pay Employees*.

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<sup>185</sup> Section 11(a) remains subject to the trade requirement, notwithstanding the 'not of a capital nature' of the gross income definition is disregarded in the case of special inclusions.

## 5 CHAPTER V: FINDINGS AND CONCLUSIONS

At the onset of this research, the principles of statutory interpretation in the era of Constitutional Supremacy were discussed. The ultimate conclusion was that the construction of any statutes must be undertaken keeping in mind the context of the provision and its underlying purpose; the contention that fiscal legislation is excluded from this imperative, as being *sui generis*, was rejected by the court in *Bosch*.

Per the respective explanatory memoranda, the introduction of cryptocurrency into the ITA demonstrated National Treasury's primary concern was to negate the argument that where it is used as currency the tax treatment should follow suit; this presented a volatility risk to revenue budgets and collection. Additionally, it was inserted into the ITA via the definition of 'financial instrument' to exclude it on the one hand from the definition of 'personal-use assets' for the purposes of the CGT regime, and prevent revaluation below base cost under the s 22 trading stock provisions on the other. While the purpose of the amendment to 'financial instrument' per para (f) is clear, it was noted that in contradistinction a crypto asset such as BTC represents a real right, rather than a complex of personal rights which typically is the nature of a financial instrument. The subsequent re-phrasing only sought to align the definition with the broader regulatory agenda.

The research proceeded to reflect on the CGT and normal tax regimes against the backdrop of the qualified Guidance issued by the tax authority in the context of node mining. It was demonstrated that the theorised tax treatment was predicated on the assumption that BTC mining is by its inherent nature a trade activity. This universal treatment was refuted on the basis of possible alternate use cases where it may not amount to an undertaking with a dominant intention to trade. Treatment under the CGT regime was confirmed as possible; the qualified guidance as to timing is acceptable, however insofar as the Block Reward is concerned it does not accord with the established jurisprudence. Further investigation revealed that the manner in which BTC mining is undertaken, ie an implied partnership or a contract for exchange, once again resulted in differing

consequences than is the case in/for node mining. Here, there is no deferral of the tax event, moreover more importantly BTC mined would need to be dealt with under the normal tax regime. It is once more highlighted that this is on account of deeming provisions, rather than an underlying intention to deal with BTC as trading stock as a matter of course.

In responding to the stated research goals in chapter I, it is concluded that the precise treatment of BTC mining for tax purposes is very dependent on highly nuanced facts and circumstances as to whether it falls under the CGT or normal tax regime; it, however, is determinable upon rigorous analysis. The secondary research goal was to evaluate the guidance published by the South African tax authority. Based on the interpretation of the guidance, it has been illustrated that the only basis for the deferment of a tax event is where a taxpayer mines through interaction directly with the Bitcoin Network via a node with normal tax consequences. As a practical matter, since the computational power race effectively sets an exceptionally high barrier to entry, this is unlikely to be the case in a great majority of cases involving private persons. In all other possible contingencies, there is no deferral of tax consequences - this part of the qualified guidance is submitted as acceptable.

Finally, the contention that mined BTC constitutes trading stock is questionable. Under the normal tax regime and the CGT regime insofar as the block fee is concerned, the BTC received is merely settlement *in specie* of an amount giving rise to a tax event. In terms of the CGT regime and the block reward, the creation of the asset gives rise to a tax event. Any subsequent conversion would not inherently possess the quality of carrying on a business in operating a scheme of profit making. It is nevertheless possible for a taxpayer to deal with it as trading stock, but that would operate on intention and not on any intrinsic feature of crypto assets.

The purpose of the dual regime scheme of the ITA is to separate trading profits from simple comprehensive income. The effect in the case of the latter is that all taxpayers make some minimal contribution to the fiscus,

unless the nature of the income is excluded for reasons of equitable tax policy. The inference from the broader discussion above, is that operation of this scheme appears inverted. While in principle a node miner may have their BTC gains subject to the CGT or normal tax regime, the barriers to entry would imply such a participant is almost certainly operating a business as envisioned in *Pick 'n Pay Employees*. On the other hand, private persons who mine via pools do not have the possibility of falling within the ambit of the CGT regime, despite a lack of trade intention. The differentiation between pool and node mining is founded in a minor difference in technological configuration, and one which an average private person would fail to appreciate. Excepting in cases of differing treatment arising from a conscious commercial choice, the underlying substance of the economic activity of mining in either case is so substantially similar that it is asserted the resulting deviation in treatments offends the principle that a tax system should be neutral, ie equal consequences should follow substantially the same activity. Stated alternatively, a small-scale miner would select node mining for the sake of having the CGT regime available to them even though it would not be the most economically efficient arrangement of resources. It is submitted that were such a violation to remain tolerable, it should be a node mining which always attracts the normal tax regime, leaving pool miners the possibility of either regimes.

On the other hand, it would appear that the National Treasury is, by virtue of its guidance, prepared to accept a tax deferral in the belief that it would always be normal tax collected. This has the potential to prejudice both the state treasury, where tax could be collected sooner. Legislation, however, may be adapted to ensure a more equitable and compromised result without necessarily impugning the neutrality principle.

The following recommendations are made to re-position the integration of crypto assets within the ITA to clarify potential ambiguity, and introduce a *modus operandi* which balances the interests of the state and the taxpayer per a proviso to para 12(2)(c) of sch. 8. The purpose of these amendments is two-fold: to trigger baseline tax collection on the minting

of crypto assets through mining via the CGT regime in all cases, and to restore the normal tax outcome on a sale or exchange where it is in the course of carrying on a trade, or within too brief a holding period to justify a deeming of capital nature similar to the relief provided for in s 9C. The benefit to the state would be partial tax collection immediately, while still preserving its tax base in future periods, where appropriate.

The proposed amendments are as follows:

Section 1 should be amended as follows:

The deletion of para (f) of the definition of ‘financial instrument’.

The insertion of the following definitions,

‘crypto asset’ means any unitised digital token represented on a blockchain or distributed ledger, irrespective of its inherent or intended function, excluding a stablecoin;

‘stablecoin’<sup>186</sup> means any crypto asset the value of which is fixed, or intended to be fixed, by some ratio to the value of any official state currency;

‘minting’ means the creation by any person of any crypto asset, including the transfer of ownership of any crypto asset in connection with and in consequence of the creation of that crypto asset, provided: where that person mints any crypto asset in concert or in cooperation with any other person, that person shall be deemed to have acted alone.

Section 22(1)(a) should be amended as follows:

The insertion after the words ‘not being any financial instrument’  
of,

...or any crypto asset

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<sup>186</sup> Current examples in the market would be USD Tether (“USDT”), USD Circle (“USDC”), EURO Circle (“EUROC”).

The Eighth Schedule should be amended as follows:

The amendment of the definition of 'asset' per para (1) such that subpara (a) shall now read as,

...property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency [or stablecoin], but including any coin made mainly from gold or platinum [or any crypto asset]

The definition of 'disposal' per para 11(1) should be amended by the insertion of subpara (h) as,

the minting of any crypto asset

The definition of 'personal-use asset' per para 53 should be amended by the insertion of subpara (3)(eA),

'crypto asset'

The insertion of a proviso to para 12(2)(c) as,

Provided where this paragraph shall apply to any person in respect of a sale or exchange of a minted crypto asset in the course of carrying on any trade of that person, or within a period of five years of minting, any capital gain or capital loss shall be disregarded, and that person shall be deemed to have qualifying expenditure for the purposes of s 11(a) equivalent to: any expenditure allowable under paragraph 20 in respect of the minting of that crypto asset, increased by the taxable capital gain or decreased by the taxable capital loss from the minting of that crypto asset, as the case may be.

The effect of these amendments would be a common tax treatment for both node and pool mining, and unifies the Block Reward and Block Fee through a singular concept, ie minting. The mischief that taxpayers, genuinely not undertaking trade yet forced into the normal tax regime on account of a obscure technological difference they do not appreciate, would be alleviated. In the first instance, any BTC mining would give rise to a tax event within the ambit of the CGT regime. The inserted proviso to para 12(2)(c) of sch. 8, nevertheless, reserves the right of the state to tax

mined BTC under the normal tax regime given certain circumstances. It disregards the tax authority's position of absolute tax deferral, and effectively replaces it with partial tax collection on minting as tax under the CGT regime, coupled with a final tax collection under the normal tax regime on eventual realisation pursuant to a business undertaking or within such a short period of minting as to imply a revenue intention; this does not create an additional tax burden in nominal terms on account of the deeming of expenditure for the purposes of s 11(a).

The proposed proviso to para 12(2)(c) could also be easily modified to create an irrebutable presumption in favour of the taxpayer whereby the tax consequences are kept within the CGT regime only; this would be tax policy consideration based on incentivising taxpayers to retain scarce and valuable assets for longer periods. An argument could be made that it may have the effect of easing the financial burden of the state providing benefits to retirees, moreover this would then need to be relief confined to natural persons. Potentially, this issue may warrant further investigation.

In the alternative, the guidance should be developed in more detail to highlight the nuances identified so as to alert taxpayers of what they ought to consider when fulfilling their tax obligations.

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